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Impacts of money laundering and terrorism financing: Final report

Alicia Schmidt

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Acronyms and abbreviations

AIC	Australian Institute of Criminology
AML/CTF	anti-money laundering and counter-terrorism financing
APGML	Asia/Pacific Group on Money Laundering
AUSTRAC	Australian Transaction Reports and Analysis Centre
FATF	Financial Action Task Force
FinTech	financial technology
GDP	gross domestic product
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
RegTech	regulatory technology
TBML	trade-based money laundering
UNODC	United Nations Office on Drugs and Crime

Abstract

This report outlines a conceptual model of the social and economic impacts of money laundering and terrorism financing. Drawing on a comprehensive literature review and stakeholder interviews, it identifies possible economic, societal and sectoral impacts. Economic impacts are those that affect the economy at a macro level and include reductions in economic growth and foreign direct investment and the distortion of exchange and interest rates. Societal impacts include changes in crime levels—predicate offences which generate illicit proceeds that are then laundered, crimes financed using laundered funds and crimes attracted to areas where money laundering occurs—and the associated costs to the community. They also include the consequences of terrorism enabled by terrorism financing, including the costs of terrorist attacks and the impact on national reputation. Sectoral impacts include damage to the reputation of the financial sector and other regulated entities, the crowding out of legitimate competitors, artificial increases in prices (eg real estate prices), and lost tax revenue. Importantly, not all impacts are harmful; potential benefits of money laundering include the recovery of proceeds of crime from the enforcement of the anti-money laundering and counter-terrorism financing (AML/CTF) regime, the profitability of certain sectors that facilitate or enable money laundering, and the growth of the AML/CTF industry. Having identified these impacts, this report assesses their significance in the Australian context and sets out a path towards quantifying the impacts identified as both relevant and measurable.

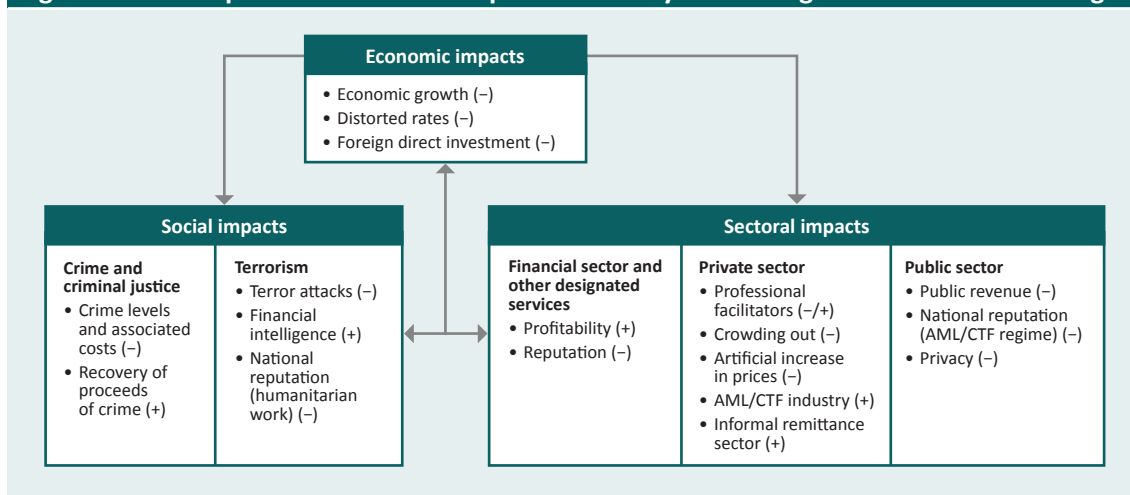
Executive summary

Money laundering is the process of concealing the true source of illicit funds generated by crime in an attempt to legitimise the funds. This is generally undertaken in three stages: placement, layering and integration. Money laundering makes crime attractive by enabling criminals to spend illicit profits in the legitimate economy. The Financial Action Task Force (FATF) was established as the inter-governmental global money laundering watchdog and sets out recommendations that act as minimum standards to be implemented domestically to form an anti-money laundering and counter-terrorism financing (AML/CTF) regulatory regime (FATF 2020c). Many jurisdictions have since implemented AML/CTF regimes and there now exists a growing body of research into money laundering and terrorism financing methodologies, trends and enablers and, to varying extents, the efficacy of the regimes to prevent and disrupt them. Less clear are the impacts of money laundering and terrorism financing and how these are influenced by the AML/CTF regime, here in Australia or overseas.

The Australian Institute of Criminology (AIC) was commissioned by the Australian Transaction Reports and Analysis Centre (AUSTRAC) to conduct research into the impacts arising from money laundering and terrorism financing and to identify measures that would enable the future quantification of these impacts. A major challenge in measuring the harms of money laundering is determining the scale of money laundering activity. Measures of the total volume of money laundered continue to prove elusive, suggesting the need for a more focused approach on specific forms of money laundering or specific sectors. The current highest risk money laundering opportunities are longstanding, enable large volumes of money to be moved and are included in the AML/CTF regime. With the increasing enforcement of the AML/CTF regime, the emerging opportunities are more sophisticated and often employ new technology. Emerging terrorism financing opportunities are also exploiting new technology and terrorist organisations are diversifying their income streams and in some cases are self-funded and therefore not reliant on financing. Different money laundering and terrorism financing typologies may be associated with different harms or benefits.

This report identifies many impacts of money laundering and terrorism financing. These impacts can be categorised in a number of ways, but the higher-level categories used are the economic, societal and sectoral impacts identified in Figure 1. The economic impacts are those that affect the economy at a macro level, and the societal impacts are further broken down into impacts on crime and impacts on terrorism. Sectoral impacts are also categorised into subcategories—those affecting the financial sector and other designated services, those affecting the private sector more broadly and those affecting the public sector. The harms and benefits individually are also considered as either economic or social. The existing evidence in relation to the harms and benefits within each of these sectors was mixed but sufficient to demonstrate the potential breadth and scale of the likely impacts of money laundering and terrorism financing.

Figure 1: A conceptual model of the impacts of money laundering and terrorism financing



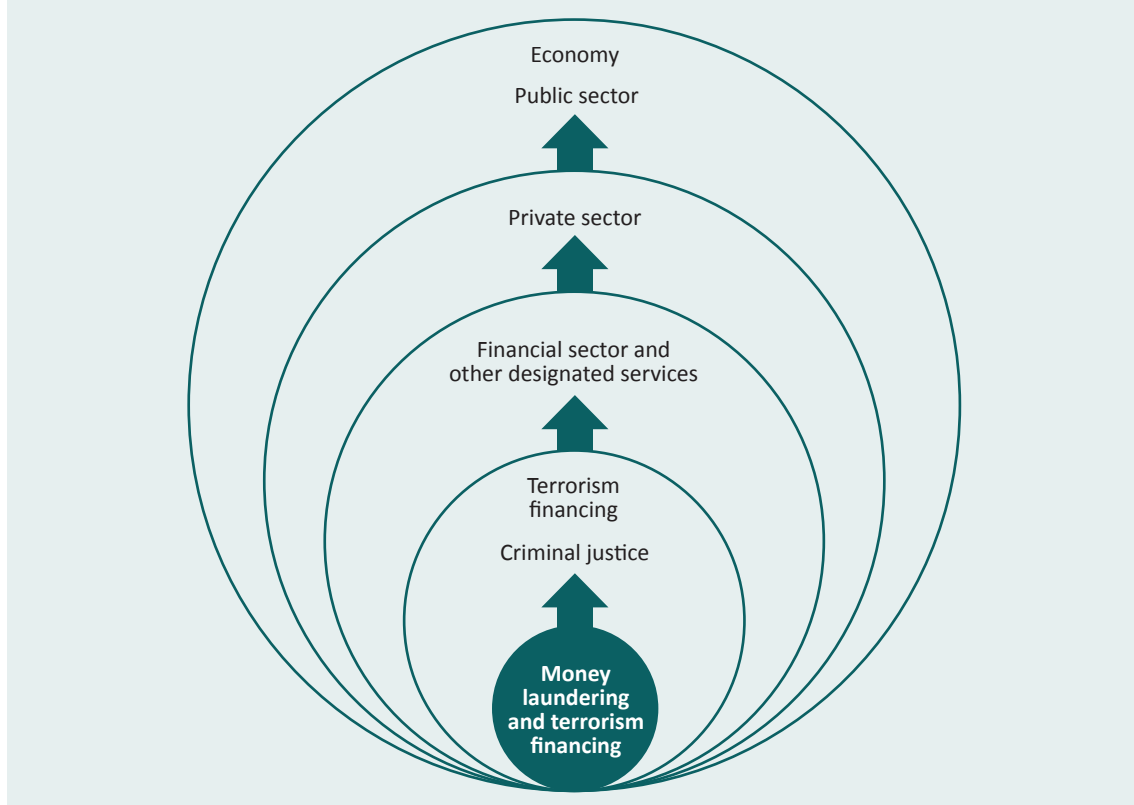
Following the literature review, extensive consultation with stakeholders was undertaken to ascertain which of the identified impacts are most relevant to or significant in Australia and to consider methods to measure the magnitude of the identified impacts. The stakeholders interviewed included those in government policy and law enforcement at the Commonwealth and state/territory level, a broad range of entities in regulated sectors, industries that may be impacted by money laundering or terrorism financing but are not directly regulated and entities involved in the AML/CTF compliance industry. In addition, national and international stakeholders were engaged from academic institutions and non-government and inter-governmental organisations. A total of 25 interviews involving 51 participants from 31 agencies were conducted.

Many consistent themes emerged from the stakeholder interviews in terms of the current and emerging money laundering and terrorism financing opportunities in Australia. Understandably, this included some differing emphasis depending on the expertise of the interviewees. Stakeholders in the private sector and particularly regulated entities often provided very specific insights into the AML/CTF regime as it applies within their sector and the opportunities that do or do not exist as a result. The national and international stakeholders provided broader insight to the opportunities and impacts considering Australia’s position in the Asia-Pacific region and the world. The themes that emerged from the stakeholder engagement relating to the impacts were narrowed to those relevant to Australia and these were used to refine the conceptual model (Table 1).

Table 1: Impacts in Australia		
Impact	Harm or benefit	Relevance and/or significance in Australia
Economic impacts		
Distorted rates	Harm	Relevant
Foreign direct investment	Harm	Relevant
Economic growth	Harm	Relevant
Societal impacts		
Crime and criminal justice		
Crime levels and associated costs (predicate offences, financed crimes and crimes attracted by money laundering)	Harm	Relevant and significant
Recovery of proceeds of crime	Benefit	Relevant
Terrorism		
Terror attacks	Harm	Relevant
Financial intelligence	Benefit	Relevant and significant
National reputation (humanitarian work)	Harm	Relevant
Sectoral impacts		
Financial sector and other designated services		
Profitability	Benefit	Relevant
Reputation	Harm	Relevant and significant
Private sector		
Professional facilitators	Short-term benefit	
Long-term harm	Relevant	
Crowding out legitimate business	Harm	Relevant
Artificial increase in prices	Harm	Relevant and significant
AML/CTF industry	Benefit	Relevant
Informal remittance sector	Benefit	Relevant
Public sector		
Public revenue	Harm	Relevant and significant
National reputation (AML/CTF regime)	Harm	Relevant
Privacy	Harm	Relevant

Importantly, the extent to which impacts in these sectors can be attributed to money laundering and terrorism financing varies (Figure 2).

Figure 2: Direct to indirect impacts of money laundering and terrorism financing



There was consensus in both the literature and stakeholder interviews that some of the most direct impacts of money laundering relate to crime and criminal justice. This is a result of the necessary coexistence of the criminal offences that generate illicit funds—predicate offences—and money laundering. Money laundering allows individuals and criminal organisations to profit from their crimes and also enables the financing of future crime. Stakeholders suggested the recovery of proceeds of crime was an important tool to target offenders because criminal groups are very concerned about losing their wealth. However, the degree to which the costs of crime are offset by governments of different levels recovering the proceeds of crime is not clear. This may vary across Commonwealth or state/territory governments but money recovered is likely to represent only a small proportion of all crime costs.

Terrorism financing also directly contributes to the funding of terrorist organisations and terror attacks. Terror attacks cause significant and immediate social and economic harm. However, some of the impacts of terrorism financing will also occur over the longer term and be felt more indirectly—for example, the longer term impacts on foreign direct investment or government expenditure in response to an attack. However, stakeholders suggested the magnitude of the short-, medium- and long-term impacts of terror attacks in Australia may be less significant relative to other countries. Rather than directly preventing the financing of terrorism, stakeholders emphasised that the benefit of the AML/CTF regime was the financial intelligence it provides. This financial intelligence is used in conjunction with other forms of intelligence as a surveillance tool, behavioural analysis tool and a way to corroborate other forms of intelligence.

Stakeholders agreed that the damage to an entity's reputation—a relatively direct economic harm—was a significant concern for designated services, particularly in the financial and gambling sector in Australia. Stakeholders in these sectors discounted the direct benefit of money laundering to profitability. However, other stakeholders argued there is a public perception designated services benefit in terms of profitability from money laundering. Stakeholders did not support the idea that money laundering led to the benefit of increased availability of credit in the financial sector or the harm of liquidity risk in the Australian context.

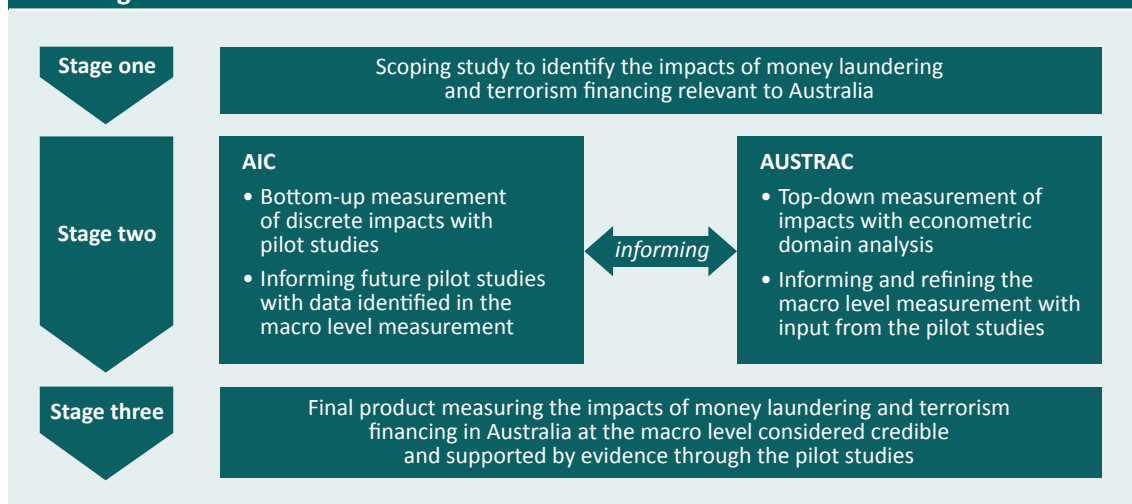
The impacts of money laundering in the private sector can be relatively direct, but most are indirect. Stakeholders agreed professional facilitators in Australia, both complicit and unaware, can benefit individually from money laundering through increased profitability. However, they also acknowledged professional facilitators can be harmed as a collective, including from being subject to increased regulation. Stakeholders did not agree that money laundering has contributed to a general artificial increase in prices or the artificial demand for industries in Australia as an economic harm. However, stakeholders did agree that it had the potential to increase in prices in the real estate market, a significant longer term harm preventing legitimate buyers from entering the market. Stakeholders also believed money laundering undermined legitimate business with the potential to result in crowding out of legitimate competitors. Stakeholders supported the AML/CTF regime and an increased focus on money laundering as a benefit to the compliance services and technology sector.

Stakeholders supported the view that the public sector is also indirectly impacted by the scale of money laundering, resulting in reduced tax revenue and reputational damage. Stakeholders considered that the impact of money laundering on corruption and the undermining of government is not significant in Australia. However, they suggested that this impact can manifest indirectly as damage to the national reputation. Some stakeholders believed money laundering has an indirect impact on the economy, causing economic harm in the long term, including by reducing foreign investment. However, other stakeholders argued that many of the economic impacts, such as distorted rates, were speculative. The economic harm and the cumulative impact on economic growth may be more strongly correlated with the crimes enabled by money laundering and the long-term impact on the economy of increased serious and organised crime.

The next stage of this research focuses on identifying discrete impacts from the conceptual model that were supported in the literature review and affirmed in the interviews with stakeholders and attempting to measure these impacts as a series of pilot studies (Figure 3). This will begin with pilot studies on the four impacts that are relevant and measurable in the Australian context. These pilot studies will aim to determine the existence and magnitude of the impact and the degree to which it can be attributed to money laundering or terrorism financing. They will employ rigorous methods, draw on comparable international studies and be guided by the advice provided during the consultation process. Simultaneously in stage two, AUSTRAC will undertake econometric domain analysis—a top-down approach to measuring the impacts of money laundering and terrorism financing that uses available data and studies. The outcomes of the AIC’s pilot studies will provide important evidence to help refine the work being undertaken by AUSTRAC. Additional pilot studies may be developed as new sources of data and methods for measuring identified impacts become known.

The final product of this research will be a measure of the impact of money laundering and terrorism financing in Australia that is considered credible and supported by evidence. The duration of stage two, and the number of pilot studies, will depend on an assessment of the likely value of these studies in informing the econometric domain analysis and contributing to an overall measure of the net harms associated with money laundering and terrorism financing, capturing as many of the impacts identified in this initial feasibility study as possible.

Figure 3: Stages in the project to measure the impact of money laundering and terrorism financing



Introduction

While there is widespread agreement that the costs of money laundering and terrorist financing are significant (Bartlett 2002; McDowell & Novis 2001; Quirk 1996; Unger et al. 2006; UN Office on Drugs and Crime (UNODC) 2011), the scale of these costs—including in the Australian context—are unknown or contested (Alldridge 2002; Levi, Reuter & Halliday 2018). The Australian Transaction Reports and Analysis Centre (AUSTRAC) commissioned the Australian Institute of Criminology to undertake a scoping and feasibility study of the impact of money laundering and terrorism financing as part of a longer-term project to provide a more robust measure of the impact on government, business and the wider community.

Purpose of this report

This report details the current and emerging opportunities for money laundering and terrorism financing, and the associated harms and benefits, based on an extensive review of the literature and interviews with stakeholders. It presents a conceptual model that can be used as the basis for further research and development.

This report considers the harms and benefits described and details where the impacts have been supported, discounted or reinterpreted by stakeholders in government, industry or academia. The analysis of relevance to Australia extends to harms and benefits that may not directly impact Australia but are still relevant insofar as they may occur in the Asia-Pacific region or may directly impact on another country and Australia's relationship with that country or international reputation more broadly.

This report does not aim to review the efficacy of the AML/CTF regime. However, the efficacy of the AML/CTF regime is relevant when consideration is given to whether the regime reduces, has no effect on, or contributes to certain impacts associated with money laundering or terrorism financing.

Methodology

This report describes the findings of the first stage of a three-stage project to measure the magnitude of the impacts of money laundering and terrorism financing in Australia. This first stage, a scoping and feasibility study, involved two distinct components. The first component of this scoping study was an exploratory review of the literature on the impacts of money laundering and terrorism financing. The second component involved extensive engagement with stakeholders to consider the relevance to Australia of the impacts identified in the literature review, and the methods by which the direct and indirect impacts could be measured.

Literature review

The review used an exploratory approach to draw on different literature addressing the opportunities and impacts of money laundering and terrorism financing. A systematic search of the literature was not undertaken as it was evident it would not identify the most relevant material. The exploratory search commenced by exploring the opportunities for money laundering and terrorism financing and their impacts. The impacts identified are categorised as follows:

- economic;
- societal;
 - crime and criminal justice;
 - terrorism;
- sectoral;
 - financial and remittance sectors and other designated services;
 - private sector; and
 - public sector.

When impacts were identified through this method, the search was expanded further to identify literature relevant to those impacts in the context of money laundering and terrorism financing.

The literature reviewed in compiling this report spanned almost 30 years. This is from shortly after international standards were first introduced to the present time, to include more recent and ongoing developments in technology and globalisation relevant to financial flows.

Therefore, while some impacts identified may have been more significant in the early stages of global regulation, others are a consequence of more contemporary and emerging opportunities and enablers.

The literature reviewed was also not specific to Australia and included sources from or focused on jurisdictions across the world. Therefore the impacts identified include those in:

- developing economies;
- jurisdictions with high financial secrecy;
- jurisdictions with high levels of perceived corruption; and
- jurisdictions that have been identified, at different stages, as having strategic AML/CTF deficiencies.

Interviews with stakeholders

Following the literature review, stakeholders with relevant expertise were identified in consultation with AUSTRAC. Due to the broad nature of the impacts of money laundering and terrorism financing, stakeholders with expertise relevant to the direct and indirect impacts across different sectors were identified. Interviews were undertaken with stakeholders who have knowledge specific to Australia, including from the perspective of:

- government policy;
- law enforcement at the Commonwealth and state/territory level;
- financial institutions and remittance services;
- gambling service providers;
- new payment platform service providers;
- AML/CTF compliance services; and
- private sector, including small business.

In addition, interviews were undertaken with Australian and international academics and stakeholders from non-government and inter-governmental organisations who have published widely on money laundering, terrorism financing and the measurement of their impacts from:

- academic institutions; and
- non-government and inter-governmental organisations.

The large majority of interviews were conducted via videoconference and most were conducted one-to-one, although there was one workshop with 13 participants and several group interviews involving multiple participants from the same organisation. A total of 25 interviews (including workshops and group interviews) involving 51 participants from 31 agencies were conducted.

All interview participants were asked a series of general questions and a series of questions specific to their sector to analyse the relevance of specific harms and benefits identified in the literature.

Terminology

This report categorises the impacts as economic, societal and sectoral; however, the impacts within these categories also use the terms ‘social impact’ and ‘economic impact’. An economic impact is purely financial and includes both microeconomic and macroeconomic effects. Microeconomics considers individual markets such as the supply and demand for services and how these affect households or organisations, typically in relation to revenue or profitability. Macroeconomics considers the nation or global economy and how large sections of the population are affected, rather than individuals or organisations. Macroeconomic impact is measured in rates such as economic growth, unemployment and inflation. An economic benefit will occur when money laundering, terrorism financing or the AML/CTF regime has a net positive effect and an economic harm will occur when there is a net negative effect.

As defined by the Centre for Social Impact (<https://www.csi.edu.au/about-social/>), a social impact occurs when there is an effect on ‘a community and the well-being of individuals and families’. A social benefit will occur when money laundering, terrorism financing or the AML/CTF regime has a net positive effect on the community and the wellbeing of individuals and families, and a social harm will occur when the net effect is negative. In many cases it is possible to measure these social impacts in monetary terms. The next component of this project attempts to measure these social impacts and, in doing so, convert them to monetary terms.

Limitations

There are limitations to the literature review and the consultation that must be acknowledged. The first limitation of the literature review is that many of the impacts identified require money laundering to take place at scale. These harms and benefits rely on money laundering having macroeconomic significance. Despite many attempts to measure money laundering, there are no estimates that have been widely accepted as accurate (Unger et al. 2006).

Further, the impacts identified are affected by many internal and external events. The degree to which they are attributable to money laundering or terrorism financing, directly or indirectly, has been considered but not established in all cases.

Measuring the net impact also presents challenges. In some cases, the net impact will depend on the characteristics of the relevant jurisdiction, such as the size, diversity and stability of the economy. At this stage of the project, the impact has been considered in the context of Australia and determined to be a harm or a benefit or to have the potential to be both at different points in time. The potential impact has been assessed for its significance and the probability of it occurring in Australia, considering the evidence available to support it.

A limitation of the consultation process is that not all organisations and individuals invited to participate in the research participated in an interview. In some cases time constraints made it difficult to organise or reschedule consultations within the time available to inform this report.

Next steps

In the next stage of this research the AIC will identify discrete impacts from the conceptual model that were supported in the literature review and affirmed in the interviews with stakeholders and attempt to measure these impacts as a series of pilot studies. This will begin with pilot studies for the four impacts that are relevant and measurable in the Australian context. These pilot studies will aim to determine the existence and magnitude of the impact and the degree to which it can be attributed to money laundering or terrorism financing. They will employ rigorous methods, draw on comparable international studies and be guided by the advice provided during the consultation process. Simultaneously in stage two, AUSTRAC will undertake econometric domain analysis—a top-down approach to measuring the impacts of money laundering and terrorism financing that uses available data and studies. The outcomes of the AIC’s pilot studies will provide important evidence to help refine the work being undertaken by AUSTRAC. As has been noted, additional pilot studies may be developed as new sources of data and methods for measuring identified impacts become known.

The final product of this research will be a measure of the impact of money laundering and terrorism financing in Australia that is considered credible and supported by evidence. The duration of stage two, and the number of pilot studies, will depend on an assessment of the likely value of these studies in informing the econometric domain analysis and contributing to an overall measure of the net harms associated with money laundering and terrorism financing that captures as many of the impacts identified in this initial feasibility study as possible.

Money laundering and terrorism financing opportunities

Key findings

- Measures of the true global or national scale of money laundering remain elusive. Understanding the impact of money laundering in Australia requires a more focused approach examining specific opportunities and impacts.
- The economic characteristics of Australia as an open, stable and developed economy, as well as its geographic location, are relevant to the money laundering and terrorism financing opportunities that exist. These characteristics, and the attractiveness of certain predicate offences, also affect the nature and direction of the flow of illicit funds.
- Interviews with stakeholders indicate the current highest risk money laundering opportunities in Australia are longstanding, enable large volumes of money to be moved and are included in the AML/CTF regime. High-risk opportunities also exist outside the regime, including in the unregistered remittance sector. Trade-based money laundering was also identified as one of the main opportunities in Australia.
- Stakeholders also identified emerging opportunities for money laundering, characterised as more sophisticated, involving professional facilitators and corporate structures. Some stakeholders highlighted emerging opportunities exploiting new technology, while others emphasised the cyclical nature of money laundering opportunities, with offenders continuously returning to the longstanding opportunities and reliance on established networks.
- Similar opportunities exist for terrorism financing as for money laundering. Methods of financing of terror attacks vary according to the target, type and scale of the attack. Small-scale attacks (a higher risk in Australia) can be financed at very low or no cost. The funds used to finance these attacks can be illicit but are often from legitimate sources.

- Many stakeholders referenced the disruptive effect of the COVID-19 pandemic on both money laundering and terrorism financing opportunities. COVID-19 restrictions were described as making some money laundering methods more difficult and some members of the community more vulnerable to being targeted for recruitment by criminal organisations and money laundering syndicates.
- In the terrorism financing space, stakeholders referenced both COVID-19 restrictions and the fall of Islamic State as having reduced the previously high risk of international terrorism financing. Domestic self-funded terrorism activities remain a risk, but incoming terrorism financing is generally not observed in Australia.

Measuring the scale of money laundering and terrorism financing and understanding the range of money laundering and terrorism financing opportunities, both in Australia and internationally, is key to developing robust measures of harms more broadly. Money laundering has advanced significantly with technology and globalisation since the 1920s when Al Capone disguised illegal proceeds through cash intensive laundrettes—the first example of money laundering and the origin of the term (Lilley 2006). However, the process of laundering money is still broken down into the same three stages: placement of illicit funds into the financial system, layering through a series of complex transactions to conceal the source of these funds, and integration of the funds into the legitimate economy through ‘clean’ investments (Albanese 2011). As financial flows become increasingly digital, the placement stage can occur as part of the predicate offence, such as when offenders commit fraud by deceiving victims into transferring money. In addition, money laundering is increasingly a transnational activity due to the globalisation of financial markets and the opportunities that come with globalisation, the need to divert away from areas of regulatory focus or to exploit regulatory gaps and weaknesses, and the ability to frustrate or impede criminal investigations by crossing jurisdictional boundaries.

Different jurisdictions vary in their susceptibility to different stages of money laundering depending on their characteristics. There are also distinct directions of money laundering. Money can be incoming (entering a jurisdiction to be laundered), outgoing (transmitted from a jurisdiction to be laundered offshore), moving through a jurisdiction as part of the layering process or returning to the original jurisdiction as apparently legitimate funds following offshore money laundering (AUSTRAC 2019; Bartlett 2002).

The characteristics of the jurisdiction will influence the stage and direction of money laundering that most commonly occurs. Furthermore, this will contribute to the impacts of money laundering that the jurisdiction is most at risk of. For example, in jurisdictions with high financial secrecy, a higher proportion of funds flowing through the financial sector may behave less predictably than legitimate funds. Money laundering can also be entirely domestic, where the funds remain in and are laundered in the country where the predicate offence occurred. As terrorism financing is impacted by the same regulation, whether the source of the funds is legitimate or illegitimate, similar strategies are used to avoid regulatory focus and oversight.

The global AML/CTF regime has evolved significantly over the last 30 years, since the original focus was on funds generated from drug trafficking. However, many stakeholders noted that drug trafficking remains an important influence over the nature and direction of money laundering that occurs in Australia. This is due to the premium paid for illicit drugs in Australia compared to other regions of the world. This makes Australia an attractive destination for criminal organisations to export illicit drugs for sale and results in the proceeds from those sales being generated in Australia. Many stakeholders also recognised Australia as a stable, developed economy, which makes it an attractive destination for the integration stage of money laundering, where illicit funds can be safely held in high-value assets.

The scale of money laundering

Money laundering occurs in the shadows and is only analysed when it is detected, meaning attempts to measure the scale of money laundering are attempts to measure something that is hidden. When instances of money laundering are detected, it may be inaccurate to draw conclusions as to whether the individual case, the value of funds involved or the techniques used are representative of money laundering more broadly. As a consequence, literature on money laundering and its impacts has been largely speculative (Unger et al. 2006). This has important implications for the measurement of associated harms. For example, for money laundering to be a threat to the integrity of the financial system or to have macroeconomic significance, it must take place on a large scale. Measuring the size of the problem—or at least developing better estimates of the size of the problem—will allow us to better understand the harms related to money laundering.

In February 1998, International Monetary Fund (IMF) Managing Director, Michel Camdessus, stated that estimates of money laundering were between two percent and five percent of global gross domestic product (GDP). This estimate has since been cited repeatedly in the literature as a demonstration of the scale of the problem and as a measure of consistency with more recent research (Gold & Levi 1994; UNODC 2011; Walker 1999, 1995; Walker & Unger 2009). However, this estimate was not the result of any intensive studies conducted by the IMF but should be interpreted as a consensus range based on expert opinion (UNODC 2011; Walker & Unger 2009). In the years since, multiple attempts have been made to measure the scale and extent of money laundering (Ferwerda et al. 2020; Quirk 1996; UNODC 2011; Walker 1995; Walker & Unger 2009). These attempts have used various methods, such as considering predicate crime levels, expert opinion and suspicious matter reporting data, all of which have attracted criticism for various reasons (Reuter 2013). Many of these studies have cited earlier estimates, particularly the IMF's, as a measure of accuracy and these estimates have become 'facts by repetition' (Levi & Reuter 2006: 327).

Reuter (2013) has made the argument that there is no prospect of developing persuasive estimates and any estimate would hold limited value. FATF no longer provides estimates on the size of global money laundering as no methodology could be agreed on (Alldridge 2016; Redhead 2019). In addition, the diversity of definitions used across jurisdictions and the sophistication of money laundering techniques make it impossible to estimate (FATF nd). The research and reporting that does exist suggests money laundering takes place on a scale large enough to warrant policy attention (McDowell & Novis 2001; Unger et al. 2006; UNODC 2011).

To consider the impacts from a domestic perspective, the characteristics of the jurisdiction are also relevant, such as whether it has a large economy, a highly developed economy, a high level of corruption or high financial secrecy (Ferwerda et al. 2020). Jurisdictions with one or more of these characteristics may be particularly susceptible to some of the impacts of money laundering identified and this may alter the scale that is required for the impact to be realised.

The status of a country's economy, as well as its geography, are relevant to the scale of money laundering. Stakeholders identified Australia as a prominent open economy in the Asia-Pacific region with open access to finance and the financial system. This has obvious benefits for legitimate trade but also risks for exploitation. Australia is considered a magnet for business in the Asia-Pacific region and also has close proximity to other countries considered global financial hubs. In addition, stakeholders suggested that the fact Australia is an island and does not have any international borders influences the nature and direction of money laundering. There is heightened government focus on what enters the country but less focus on what leaves the country.

Sectors, methods and enablers

Approaches to money laundering and terrorism financing often focus on specific sectors and employ certain methods and enablers. The techniques used by offenders to conceal, launder and move illicit funds are referred to as typologies. The FATF and similar regional bodies such as the Asia/Pacific Group on Money Laundering (APGML) release reports where case studies are used to describe high-risk and emerging typologies, to assist members to implement an effective and responsive AML/CTF regime (APGML 2020; FATF 2020d).

One of the major challenges in relation to the AML/CTF regime is that offenders gravitate to new money laundering typologies to divert away from areas of regulatory focus. This, coupled with the emergence of new technologies, means the AML/CTF landscape continually evolves. Stakeholders with experience in these emerging areas considered the perceived lack of law enforcement expertise in some technology-enhanced typologies to be a motivating factor. However, many stakeholders also emphasised the cyclical nature of money laundering and terrorism financing opportunities. While typologies continue to evolve, criminal organisations constantly return to or increase their use of older and often simpler methods. This is particularly relevant to self-laundering criminal organisations. Professional money laundering syndicates offering money laundering as a service may also exploit new technology, but rely heavily on established networks with structured systems, using multiple methods simultaneously to break down and launder proceeds of crime. Stakeholders considered criminal organisations to be adept at stress testing for money laundering opportunities and finding ways to circumvent action taken by government or industry.

A large proportion of stakeholders referenced the disruptive effect of the COVID-19 pandemic as a significant factor driving money laundering and terrorism financing opportunities. The COVID-19 pandemic was considered to have made money laundering more difficult, with criminal organisations suspected to be holding large cash reserves unable to move or legitimise the funds for a long period of time as economies closed down and international travel reduced. Conversely, the COVID-19 pandemic was also seen as an opportunity for criminal organisations and professional money laundering syndicates to target vulnerable people who had lost work and income. These vulnerable people were recruited into roles such as cash collectors or money mules, in some cases unaware they were involved in money laundering. They had no knowledge of the broader criminal organisation and would be compensated poorly and treated as dispensable. In addition, COVID-19 opened up other opportunities for exploitation such as the market for personal protective equipment.

Furthermore, stakeholders identified that a risk relevant to all forms of money laundering and terrorism financing was the growing availability of identity information stolen through data breaches and scams. Knowing the identity of the individual transferring money is one of the foundations of the AML/CTF regime and often the first step for reporting entities. Using identity data stolen through hacking or scams was recognised as an increasingly common occurrence and the ability to rely upon identity confirmation was said to be weakening.

The most common forms of money laundering and terrorism financing, and the forms therefore most likely to incur social and economic harms, are described below.

Financial institutions

As the main gatekeepers to the international financial system and with a significant volume of global transfers conducted at rapid speed, financial institutions are at high risk of money laundering and terrorism financing and are integral to many money laundering typologies. Financial institutions globally have been identified as being involved in money laundering and as having systemic failures in implementing the AML/CTF regime, and therefore invest significantly in AML/CTF compliance (Redhead 2019).

Financial institutions have large customer bases (retail and corporate) and offer a range of products and services including accepting deposits, lending, leasing, financial guarantees, foreign exchange and individual and collective portfolio management (FATF 2020a). Many of these services can be exploited, with varying levels of sophistication, for the purposes of laundering money and financing terrorism. However, financial institutions are traditionally the focus of the placement stage of money laundering, where criminal groups deposit cash proceeds from a crime into bank accounts in a way that will not trigger reporting obligations. Stakeholders viewed the risk in financial institutions as likely to be consistently high due to the size of the sector and the nature of the business.

Conversely, some stakeholders, who were not directly linked to any financial institution, suggested that the risk in financial institutions was no longer what it was because of the regulatory focus. While in previous decades the money laundering problem was considered almost entirely confined to financial institutions, the regulatory focus on these institutions means that the risk has been displaced. From this perspective, the continued focus on financial institutions was viewed as one of diminishing returns, whereby the capability and culture of financial institutions had improved significantly and the ongoing focus of resources was enabling greater risks to thrive in other sectors.

Despite this, The FATF recommendations require financial institutions to report suspicious transactions and transactions over a designated threshold. In Australia, the threshold for cash transactions is \$10,000 and the methods used to avoid threshold reporting obligations include dividing large amounts of cash into smaller deposits, each less than \$10,000—a practice known as structuring. ‘Cuckoo smurfing’ involves a complicit alternative remittance service provider moving the illicit funds simultaneously with a legitimate remittance, and making small deposits into the account of one or more innocent victims who are expecting a legitimate transfer of funds from overseas (APGML 2020). When money launderers attempt to avoid threshold reporting with these methods, suspicious matter reporting may be triggered (Smith & Walker 2010). The AML/CTF regime is most likely to detect money laundering in this placement stage.

While financial institutions are typically associated with money laundering at the placement stage, they are exposed to all stages of the money laundering process. Once deposited, illicit funds are layered, including by transfers through onshore or offshore bank accounts and accounts in the names of corporations. Transaction types may include loans between corporations or the payment of false invoices, as in trade-based money laundering. When the transfers onshore or offshore have obfuscated the transaction flow, sufficiently separating the funds from their criminal origins, the funds can be integrated into assets that appear legitimate. These more sophisticated enablers increase the risk of money laundering in financial institutions by making it more difficult to detect.

International stakeholders recognised the relationship between financial institutions and regulators in Australia was unique. The Fintel Alliance was described as a successful model that should be replicated in other countries. The ability of financial institutions to compartmentalise significant enforcement action while still being directly involved and dedicating resources to work collaboratively with the same regulator was noted as a potential source of tension, meaning the relationship could decline over time. Continued monitoring of this arrangement is therefore required.

Remittance services

Similar to financial institutions, remittance services accept instructions from customers to transfer money or property and are also subject to AML/CTF regulation. However, stakeholders considered remittance services as posing a higher risk due to the rapid and opaque movement of money or value as well as their susceptibility to criminal organisations, including professional money laundering syndicates. Registered remittance services vary significantly in size. Stakeholders noted the potential for the risk profile to be heightened in services that have a lower capacity to implement effective AML/CTF policies. Stakeholders suggested some remittance services were non-compliant with the AML/CTF regime and that they had at times attempted to rely upon what they interpreted as technicalities in the regime, such as not reporting cash deposits that were collected beyond the business premises.

Unregistered informal services operate outside the AML/CTF regime, are difficult to identify or locate, pose a further heightened risk, and are considered one of the leading channels for money laundering and terrorism financing (FATF 2013a; McCusker 2005). The main service offered by unregistered and therefore unregulated remittance services is moving money or value through global networks without the need to physically move cash, and settlement outside the banking system (McCusker 2005; Rees 2010a). However, services can also include foreign currency exchange, loans, safe-keeping and gold dealing (FATF 2013a). Hawala is the most well known informal remittance service and has operated extensively through South Asia, the Middle East and African regions (FATF 2013a; McCusker 2005). Stakeholders reported that exploitation of unregistered remittance services, which occurs entirely outside of the AML/CTF regime, was a common feature of money laundering investigations.

Hawala-like services, which are another money or value transfer service, often have ties to specific communities and regions around the world and are referred to by different terms (McCusker 2005; Rees 2010b). Many stakeholders noted Australia has a culturally diverse population and that using these services is a cultural practice or can be necessary to move funds to certain regions of the world. While these services can be used for legitimate transfers, they can also be exploited by money launderers and terrorist organisations to move value (AIC 2010; Rees 2010b). In some cases, services can operate solely for criminal organisations or terrorist organisations. These remittance services pose the highest risk and often play a role in other sophisticated money laundering typologies such as trade-based money laundering, cash smuggling and cuckoo smurfing (Rees 2010b; APGML 2020). There are also many case studies of terrorists using unregistered remittance services to move small and large amounts of money to support attacks (FATF 2013a).

In Australia and other western countries, the highest risk domestic terrorist attacks require very low or no financing and are often achievable using legitimate funds (Keatinge & Keen 2020). However, the use of unregistered remittance services is still relevant for outgoing terrorism financing, where they can be used to avoid sanctions and support organisations or foreign fighters in other regions (Keatinge & Keen 2020).

While it is difficult to estimate how common illegal activity is in the unregistered remittance sector, or to estimate the size of the unregistered remittance sector as a whole, increased enforcement of the AML/CTF regime in the financial and registered remittance sector could lead to increased exploitation of the unregistered remittance sector (AIC 2010). Despite operating underground, unregistered remittance services are required to interact with registered services such as financial institutions at different stages in their business model. These services may identify the unregistered remittance service through discrepancies in transactions, prompting suspicious matter reports and leading to law enforcement investigation. However, the financial institutions that unregistered remittance services chose to interact with when required may also be offshore and may be indifferent to the potential for money laundering or terrorism financing (FATF 2013a). The potential for exploitation of the unregistered remittance sector, including links with offshore institutions, poses significant potential harms to Australia and overseas.

Gambling

While casinos have been a recent focus, Australia's gambling sector extends from casinos and betting on racing or sport to electronic gaming machines—all of which hold money laundering risks (Armstrong & Carroll 2017; Leighton-Daly 2021). In addition, online gambling presents emerging money laundering risks, although assessments vary as to whether this risk is low or high (Levi 2009; Moiseienko 2019).

Gaming and betting

Pubs, clubs, betting agencies and bookmakers are all reporting entities regulated under Australia's AML/CTF regime. However, stakeholders identified a key difference between the financial sector and the gambling sector as being barriers to entry. Specifically, there are fewer barriers to entering and becoming an entity in the gambling sector in comparison to the financial sector. This is particularly true when considering gaming and betting as opposed to casinos. This means that less sophisticated entities, with a lower capacity to implement AML/CTF policies, are able to enter the market and, as a consequence, may be exploited by criminals. Australia has a disproportionately high number of poker machines—we account for 18 percent of the world's poker machines and 76 percent of pub and club poker machines (ie those not in dedicated gambling venues such as casinos; Browne & Minshull 2017). As outlined in the explanatory memorandum to the Anti-Money Laundering Amendment (Gaming Machine Venues) Bill 2012 (Cth)—a bill that did not proceed—there are two main ways in which money laundering can occur in poker machines. The first is simply paying larger amounts of money into a machine to play only a few games and cashing out the remaining credits. The second is buying cheques or docketts for winnings from other players. Poker machines in pubs and clubs in Australia have received public attention for the money laundering risk associated with the capacity of the venues and staff to detect suspicious activity and fulfil their reporting obligations (Buchanan 2018; Cannane, Taylor & Blumer 2020).

Betting generally and various forms of sports betting also present a money laundering risk. For example, sports betting can be used for both generating illegal funds from game fixing, fraud and corruption and for pure money laundering, where it is attractive to criminals as a result of the large amounts of money connected to sports (FATF 2009a). Further, some entities may operate with a reduced awareness of or capacity or willingness to enforce AML/CTF policies. Stakeholders also identified that sports betting entities can operate on a business model similar to casinos. Namely, they can offer traditional gambling services to the public and simultaneously offer VIP services to clients, which may include reduced transparency and higher betting limits.

Stakeholders speculated that any breaches of compliance with the AML/CTF regime were more likely to be detected if they involved larger, well-established gambling services rather than smaller entities. This gives a competitive advantage to smaller entities. Smaller entities have less awareness of their risks, whereas larger entities have more sophisticated compliance expertise and are required under the regime to address the risks they identify.

Casinos

Casinos have long been identified as being vulnerable to exploitation and money laundering. Features that make them high risk include the fact that they are cash intensive, often operate 24 hours per day and are capable of processing high volumes of cash very quickly (FATF 2009b). Casinos also offer services similar to financial institutions including foreign exchange, holding accounts and safety deposit boxes, particularly for VIP clients (FATF 2009b). Stakeholders noted in relation to these services, particularly accounts, that casinos often operate in multiple jurisdictions, and as a consequence funds can be transferred internationally and accessed in different jurisdictions. As a result of these vulnerabilities, casinos are included in the FATF recommendations and regulated in most jurisdictions, to varying levels of effectiveness (FATF 2020c).

Casinos often operate on two business models simultaneously. The first is the traditional gambling experience for tourists and the general public. The second model is VIP rooms and services for individuals with a high propensity to gamble, often involving high wealth patrons (Kleiman 2015). This second model operates by invitation of the casino and, in addition to local VIP clients, a casino may attempt to attract interstate and international VIP clients including for junkets.

While money laundering can occur in both these business models, VIP rooms and services such as junkets deal with much higher volumes of cash and are significantly less transparent (FATF 2009b). Despite being the minority of patrons, VIP patrons produce most casino revenue (Kleiman 2015). The opaque nature of the services offered could suggest intentionally attracting or being recklessly indifferent to the potential for criminal organisations and money launderers to use these services is part of the casino business model. This may contribute to casinos implementing AML/CTF regulation with a high tolerance for risk, which conflicts with the risk-based design of the regime.

Several indicators have been identified as suggesting money laundering is occurring in casino accounts, including the presence of junket operators, paying large amounts of money via multiple smaller deposits, the use of third parties to process transactions, transfers into casino accounts with no apparent purpose, large amounts of unexplained cash and transfers from corporate accounts to casino accounts (FATF 2009b; Independent Liquor and Gaming Authority 2021). The recent findings of an inquiry under section 143 of the *Casino Control Act 1992* (NSW) noted the presence of indicators such as these in the bank accounts of Crown Resorts held in the name of its subsidiaries, Southbank and Riverbank (Independent Liquor and Gaming Authority 2021).

Casino junket operators have also gained attention as a money laundering opportunity that is ongoing but growing in public awareness. Speculation over the links to organised crime and the opaque nature of junket operations have been reviewed in jurisdictions including the United States, Macau and Canada, where it was suggested the 'Vancouver Model' of money laundering involving casinos and integrating funds into real estate would be exported to Australia (German 2018; Independent Liquor and Gaming Authority 2021; Lo & Kwok 2017).

Locally, one of the recommendations of the Independent Liquor and Gaming Authority (2021) statutory report was that the *Casino Control Act 1992* (NSW) be amended to prevent casino operators in New South Wales dealing with junket operators due to the risks.

Stakeholders identified that the risks that exist in casinos have increased over time as regulation and enforcement have focused on financial institutions. Stakeholders noted this was changing, with casinos recently receiving more attention in the Australian context. However, it was considered that there may be a delay in this risk being addressed, citing the time that financial institutions have had to build their compliance capabilities, such as by attracting and recruiting expertise in compliance.

Trade-based money laundering

Trade-based money laundering (TBML) refers to the numerous ways in which money launderers or terrorists abuse the international trade system. It is one of the oldest techniques to avoid law enforcement scrutiny but has also been described as the next frontier and weakest link in the fight against money laundering and terrorism financing (FATF & Egmont Group 2020; Zdanowicz 2009). Rather than being a specific technique, TBML employs many methods and enablers in the international trade system. These include the use of complex corporate structures and shell companies, professional facilitators and alternative remittance as sophisticated methods of money laundering (Cassara 2016). TBML is also complex due to the involvement of multiple parties, jurisdictions and financial institutions.

Common techniques to exploit the trade system include the following, often in combination:

- over- and under-invoicing for goods and services;
- multiple invoicing of goods and services;
- late changes to payment arrangements;
- use of transit or pay-through accounts to route payments back to the country or origin;
- falsely described goods and services;
- short shipping and over shipping;
- deliberate obfuscation of the type of goods; and
- phantom shipping (FATF & Egmont Group 2020; Sullivan & Smith 2011; Wolfsberg Group, ICC & BAFT 2019).

The international trade system itself is complex and likely of limited use to organised crime groups, professional money launderers and terrorist financing networks. Despite the complexity of TBML techniques exploited by criminal organisations to avoid direct regulation, TBML can require the involvement of regulated services such as financial institutions, particularly in the financing process (Sullivan & Smith 2011). However, the complexity of the techniques and fraudulent documents involved make it difficult to detect and disrupt. Furthermore, TBML poses a higher risk in international trade carried out under 'open account' terms, or undocumented financing of goods, where payment is made after goods are delivered, not before (Wolfsberg Group, ICC & BAFT 2019). In contrast to documented trade financing, which accounts for only a small minority of international trade, financial institutions do not have any visibility of the transaction unless the institution is providing credit facilities in undocumented trade (Wolfsberg Group, ICC & BAFT 2019).

Stakeholders also noted the lack of documentation at the border to identify goods, particularly those leaving Australia, as a risk. As previously noted, it was suggested that Australia's status as an island country contributed to the focus on goods entering through the border. In the case of goods leaving, documentation can be lodged weeks after the goods have been exported, making it impossible to compare the goods with the documentation. One way of addressing this issue is through Trade Transparency Units, which exist as bilateral agreements between Australia and other countries where exports and corresponding imports can be compared.

Organised crime groups are often familiar with international trade through connected predicate offences such as drug trafficking, where importers and exporters may also be complicit. Similar strategies can be used to move the funds generated from the sale of illicit goods. The magnitude of money laundering in the trade system is unknown but estimated to be substantial (Cassara 2016). Cassara (2016) speculates that in all its varied forms TBML could be the largest and most pervasive form of money laundering, with successful enforcement action accounting for a negligible proportion of the issue. TBML can also have a greater economic impact than some other forms of money laundering as it directly places legitimate business at a competitive disadvantage and crowds out legitimate economic activity (Cassara 2016). With estimates it is already significant, it may become more prevalent as the AML/CTF regime is increasingly applied to less sophisticated methods of money laundering. The prevalence of TBML may also be affected by economic policies such as free-trade zones, designed to attract trade but also reducing customs oversight (Moiseienko, Reid & Chase 2020).

In the Australian context, stakeholders identified TBML as one of the main methods of money laundering and terrorism financing. TBML was also recognised as an opportunity that had increased in recent times, particularly during the COVID-19 pandemic. When other forms of international travel slowed or stopped, international trade continued and became one of the few opportunities for transnational money laundering. Stakeholders also noted that despite recent guidance on TBML indicators, there are no specific recommendations from FATF related to TBML, which would otherwise help shape a national strategy on how to focus Australia's efforts in the TBML space. Stakeholders further noted that one of the complexities of addressing TBML is that supply chains can be extensive and each step in the trade process operates in isolation, making it possible for a legitimate supply chain to be corrupted by one individual in the process. These facilitators are customs brokers, who are not regulated under the Australian AML/CTF regime. However, stakeholders also recognised the need to balance the efficiency of trade with the benefits of regulation.

Cash

Despite advancements in technology and the growing digital economy, cash remains an important enabler of money laundering. Criminals use cash for many reasons, including that it is traditionally the way they receive funds generated from crimes such as drug sales, but also because of its desirable features (Europol 2015). More specifically, cash is generally untraceable, transfer can be immediate and exchange is anonymous because it does not require an intermediary (Sands et al. 2017). As a consequence, cash is considered the vehicle of choice for criminals laundering money and is also the primary mechanism for tax evasion (Sands et al. 2017). Money laundering can involve using cash intensive front businesses to commingle licit and illicit funds, thereby legitimising profits. Stakeholders also raised the exploitation of daigous by criminal organisations. Daigous are individuals who purchase goods in Australia for customers in mainland China—usually goods that are in high demand, such as baby formula. The cash intensive nature of these arrangements makes them vulnerable to exploitation by money laundering networks. The COVID-19 pandemic and reduced access to retail centres in some regions was considered to have had a negative impact on this business model. However, it was still considered a high risk in Australia to be exploited for money laundering.

The Reserve Bank of Australia's most recent cash use survey noted cash use in general continued to decline in Australia as electronic payment methods increased (Delaney, McClure & Finlay 2020). This survey was conducted prior to the impact of COVID-19 and social distancing measures. However, further analysis determined COVID-19 increased the demand for \$50 and \$100 banknotes, suspected to be for the purpose of storing wealth during a time of uncertainty. The total value of banknotes in circulation grew by 5.6 percent overall in the March quarter of 2020 (Delaney, McClure & Finlay 2020), and stakeholders suggested a proportion of this may have been reserves held by criminal organisations as cash laundering became more difficult during the pandemic.

Suspicion that criminal organisations were holding increased cash reserves was supported by anecdotal examples of increased values of cash seizures. Further research by the Reserve Bank of Australia prior to the COVID-19 pandemic estimated that just under one percent of banknotes in circulation were used to facilitate illegal production and purchase of illicit drugs, an indication of the proceeds of crime in the form of cash generated more generally (Finlay, Staib & Wakefield 2018).

Cash can be placed into the financial system through structured deposits to be laundered or smuggled offshore to enter the financial system and be laundered. International money laundering syndicates, often with the involvement of unregistered remittance services, employ cash-based strategies such as cuckoo smurfing and recruiting money mules to place large amounts of money into the financial system (AIC 2007; Europol 2015). As noted, stakeholders suggested that a further impact of the COVID-19 pandemic was that criminal organisations were capitalising on the opportunity to target vulnerable people who had lost work and income, including in Australia, and were recruiting them into roles as cash collectors or money mules.

As a money laundering enabler, cash can be addressed to a degree by the AML/CTF regime. For example, cash can be used to purchase high-value assets that may appear legitimate and be moved across borders. These suspicious cash transactions would be captured by regulating high-value dealers. Cash transactions over a certain threshold are already reportable but are only captured in the AML/CTF regime when they involve a reporting entity such as a financial institution.

Online payment platforms and virtual assets

Online payment platforms present an increasing money laundering and terrorism financing risk due to their rapid growth, customer uptake and ability to operate across jurisdictional boundaries. These platforms offer services including customer loans and cross-border payments that are regulated and must therefore comply with the AML/CTF regime. However, as an emerging market there is often a lack of awareness or compliance with the regime, allowing money launderers and terrorists to exploit them to move value or finance terrorism. In addition, as online services, entities located in one jurisdiction may be offering services to customers in many other jurisdictions. An entity may be compliant with the AML/CTF regime of the jurisdiction they are based in but not the AML/CTF regimes of the jurisdictions where services are offered. This is of particular concern when the entity is based in a jurisdiction with a weak AML/CTF regime or one that is not enforced in practice (FATF 2013b).

Stakeholders with experience in online payment platforms offering cross-border remittance services also identified the risk associated with social media and other platforms that enable the 'gig economy', such as ride sharing or accommodation sharing. They provided examples of the misuse of platforms that involve the transfer of value. These included sophisticated scams in which fake, high-value accommodation stays were processed through a platform, appearing to produce clean money. Stakeholders from other sectors with experience in identifying suspicious transactions also considered the emerging risk of platforms such as content sharing that operate on a subscription or payment for services basis. These risks were believed to have increased since the start of the COVID-19 pandemic, in line with the popularity of the platforms.

Virtual assets are also not contained within jurisdictional boundaries. Virtual assets are an attractive method of value transfer capable of incorporating anonymity enhancements as well as new methods to obfuscate transaction flows. Virtual assets can be exploited by all criminal organisations but are particularly attractive to those involved in cybercrime such as hacking exchanges or the use of ransomware and phishing techniques.

Stakeholders expressed contradictory views in relation to virtual assets, likely as a result of their direct experiences. Some viewed virtual assets as high risk, with the potential for this risk to increase further, while others suggested the risk was overstated with only a few anecdotal examples. One stakeholder suggested this might be explained by law enforcement lacking the expertise needed to identify money laundering through virtual assets. As specialist skills increase, there may be an increase in the identification of money laundering and the level of perceived risk associated with virtual assets.

Stakeholders who identified virtual assets as being high risk described the evolution of virtual assets over the past few years, noting that the involvement of virtual assets in crime was relatively rare only a few years ago but had rapidly increased. Some considered the COVID-19 pandemic a contributing factor, as more of the population went online and cyber criminals, who may be more likely to exploit virtual assets, had access to an increased number of potential victims. Stakeholders also identified a shift to virtual assets as an example of new money laundering techniques emerging alongside new technology-enabled crimes. Where there are new crime types, there are often new money laundering techniques.

Virtual assets also raise new issues such as peer-to-peer payments. In banking transactions, it is the financial institution, as the gatekeeper or intermediary in the transaction, that directly applies the AML/CTF regime. This may involve seeking customers' identity documentation and monitoring transactions for suspicious activity (Redhead 2019). Peer-to-peer virtual asset transactions between decentralised 'currencies' do not require an intermediary, so there is no third party in the transaction enforcing the AML/CTF regime (Naheem 2019). The risk of these peer-to-peer payments is currently constrained by the fact adoption has not been widespread and users must still interact with a regulated entity to realise the value of their assets (FATF 2020g). However, the emergence of so-called 'stablecoin' projects such as those being developed by technology corporations is likely to significantly increase customer uptake (G7 Working Group on Stablecoins 2019). These projects may initially increase financial surveillance as the technology corporation and other connected service providers will be regulated entities (Diem Association 2021). An example of this is Facebook forming an association of partners to move into virtual asset payments with Diem. However, with increased user uptake a proportion of the new users may gravitate away from centralised systems, enabling peer-to-peer transactions on decentralised systems at scale.

Virtual assets are not only a way to move funds such as proceeds of crime or those destined for terrorist organisations but can also be used to directly fundraise for terrorist organisations through social media enabled campaigns (US Department of Justice 2020).

Professional facilitators and corporate structures

Professional facilitators are individuals with specialised skills such as lawyers, accountants, real estate agents and financial advisers. Professional facilitators can be enablers to money laundering, particularly more sophisticated methods of money laundering, drawing on their knowledge of commercial and legal systems (Chaikin 2018). Although some money launderers have responded to changes in regulatory focus by returning to more traditional methods, a recurring theme in interviews was that the emerging opportunities are often more sophisticated. In this way, the increasing enforcement of the AML/CTF regime increases the demand for professional facilitators (He 2006; Newbury 2017). Stakeholders also identified that, where professional facilitators are involved, the value of proceeds of crime is often higher. Professional facilitators or designated non-financial businesses and professions (DNFBPs) are also included in the FATF recommendations. The FATF recommendations include casinos, real estate agents, bullion dealers, lawyers, accountants and trust and company service providers as designated non-financial businesses and professions (FATF2020c). In Australia, casinos and bullion dealers are regulated; however, the remaining service providers are currently not regulated entities under the AML/CTF regime.

Most stakeholders were of the view that these remaining professional facilitators contribute to high-risk money laundering and terrorism financing opportunities. Stakeholders from various sectors—government policy, law enforcement, private sector, other regulated entities and international organisations—identified professional facilitators as playing a role in money laundering. In particular, stakeholders from the financial sector noted that the information these currently unregulated professions could report would fill an intelligence gap and contribute to the effectiveness of financial analysis of certain transactions.

Stakeholders also raised concerns around specific impacts, particularly on the real estate market, considered to be heightened by the involvement of professional facilitators in the Australian context (see *Artificial increase in prices*). Professional facilitators may be complicit in the criminal activity or engaged legitimately to unknowingly participate. Indeed, many cases resulting in the conviction of professionals in the United Kingdom involved ‘negligent money laundering’ (Levi & Reuter 2006: 318). They may also operate onshore or offshore and allow criminal organisations to maintain distance from the management of their illicit funds. In the Australian context, stakeholders also referred to both actively involved professional facilitators and professional facilitators that were exploited by criminals and criminal organisations.

There is a close connection between professional facilitators and other enablers. For example, lawyers can create complex corporate structures to add layers between legal vehicles and their beneficial owners. The use of corporate structures enables money laundering by masking beneficial ownership (Van der Does de Willebois et al. 2011). The ability to mask beneficial ownership is a useful strategy in all money laundering and terrorism financing typologies. Interviews with law enforcement identified these strategies as contributing to labour intensive investigations. Many stakeholders identified the need for increased surveillance of corporate structures, including of the establishment of corporations and appointment of directors. They also recognised the value of a beneficial ownership register.

Terrorism

Terrorism financing employs many of the same methodologies as money laundering and, despite their differences, they are subject to the same regulation. However, the objective of the AML/CTF regime in the context of terrorism adopted a specific and narrow focus. This focus was to deprive terrorists of funds following the 11 September 2001 attacks. This focus has influenced the ongoing and emerging terrorism financing risks and opportunities.

Importantly, measures to deprive terrorist organisations of funds are likely more suited to terrorist groups such as al-Qaeda, which rely on limited income streams. Depriving terrorists of funds has become a less achievable objective since September 11, as terrorist organisations have grown beyond dependence on external funding, increased their income streams and expanded their fundraising methods (Keatinge & Keen 2020). The fundraising strategies employed by terrorist organisations depend on their status, structure and resources. These strategies range from seeking taxation from claimed territory, committing criminal offences such as drug trafficking and fraud, to employing social media and new technologies (Alldridge 2008; Zdanowicz 2009).

Stakeholders noted there have been many changes in how terrorist groups finance their activities that have affected the risks of terrorism financing in the Australian context. Stakeholders considered Islamic State to have been one of the most influential groups to change how they financed their activities, leading to changes by other groups. In the Australian context this involved financially supporting overseas terrorists and foreign fighters. The fall of Islamic State and the implementation of travel restrictions resulting from the COVID-19 pandemic have led to a decrease in this activity. However, stakeholders considered the threat of lone actor style terrorism and right-wing extremism to be current issues relevant to terrorism financing in Australia. While the risk of financing offshore terrorism has decreased, there is growing awareness of the risk of self-funded domestic terrorism. The low cost of these attacks significantly reduces the financing required.

Terrorist funds can be raised from both legitimate and illicit channels. Stakeholders noted examples of terrorism financing coming from criminal activity on occasion. However, investigations have identified legitimate sources, including welfare payments, being used as a source of finance for low-cost domestic attacks. Despite the reduction observed in outgoing terrorism financing, particularly to foreign fighters, stakeholders also discussed the risk of charities being used to target sectors of the community at religious institutions. Stakeholders noted in some cases donors were aware of the intended purpose of the funds but in others they were deceived. This may affect donor behaviour. If individuals believe they are supporting a humanitarian cause, there is no reason to act suspiciously and the ability to detect and disrupt suspicious activity under the AML/CTF regime may be reduced (Durner & Cotter 2019). Stakeholders also noted unregistered remittance services such as hawala pose a large risk, as they move funds without financial surveillance. It is also relevant in the Australian context, although not unexpected, that stakeholders had not observed money coming into Australia for the purpose of financing domestic terrorism. While the risk of domestic terrorism exists, due to Australia's status as a high-wealth country these attacks are funded domestically rather than from offshore sources.

Summary

This section has briefly considered some of the most common forms of money laundering, as well as the sectors, methods and enablers involved and their relevance to Australia. Understanding the range and scale of money laundering is crucial to measuring associated harms. Different types of money laundering may be associated with different harms, or indeed benefits, and these harms and benefits will impact sectors differently.

The methods of money laundering that relate to specific sectors, such as the financial sector, gambling sector and remittance sector, will inevitably have an impact on those sectors. For example, an increase in money laundering in the financial sector may increase the harms relevant to financial institutions, such as reputational damage to institutions and, by extension, the wider sector. Financial institutions also face the financial cost of enforcement action and subsequent remediation action following identification of deficiencies in their AML/CTF capabilities. In addition, opportunities that involve professional facilitators and enablers such as corporate structures will directly impact on the harms and benefits felt by professional facilitators in the private sector.

Importantly, however, the money laundering and terrorism financing opportunities described in this section will collectively contribute to the scale of money laundering in the national and global economy. The suspected scale of money laundering and terrorism activity contributes to more indirect harms examined in later sections of this report, such as the impacts on the economy and the public sector.

A major challenge for measuring the harms of money laundering is determining the scale of money laundering activity. This has, to date, proved challenging. It may be that, with substantial improvements in information collected by law enforcement and by financial regulators, data on the size of the problem will be more readily available. Even so, measures of the total volume of money laundering may prove elusive, suggesting the need for a more focused approach on specific forms of money laundering or specific sectors.

Economic impacts

Key findings

- The distortion of rates, leading to less effective macroeconomic policy, has potential consequences for savings, consumption, imports, exports, capital flows, investment and exchange rates. This impact was considered to be largely speculative by many Australian and international stakeholders interviewed for this project. For there to be evidence of this harm, it would be necessary for the distortion in rates to be attributed to money laundering and for the distorted rates to have resulted in less efficient macroeconomic policy. This would be extremely challenging to quantify.
- Research into specific components that may be more relevant to Australia—savings, consumption and investment—could provide evidence of these harmful effects and consider the impact on macroeconomic policy.
- Australia’s open, stable and developed economy make it an attractive destination for legitimate foreign investment. Non-compliance with global AML/CTF standards may make Australia a more attractive destination for illicit foreign investment. However, in the long term this would likely reduce the attractiveness of Australia for legitimate foreign investment. The net effect of this would be an economic harm.
- Some stakeholders believed increased illicit funds had a short-term positive impact on economic growth. However, stakeholders also considered that long-term economic harm was caused by the cumulative effects of money laundering on economic growth. In the long term, this could include the possibility of reduced legitimate foreign investment and an increase in crime.

Research that considers the impact of money laundering on the economy approaches it from two angles. The first is the indirect consequences of the illicit funds. Specifically, the way in which money laundering is alleged to impact the economy concerns the threat posed to the integrity of the financial system, the instability caused by distorted economic statistics, the undermining of the market mechanism and the cumulative impact of this on economic growth (Bartlett 2002; Jojarth 2013; Quirk 1996).

The scale of money laundering is an important factor when considering its impact on the economy through these indirect consequences. Critics claim there is little evidence money laundering has had macroeconomic significance (Alldridge 2002; Reuter 2013). However, this is likely to depend on the characteristics of the jurisdiction in question, such as whether it has a large economy, a highly developed economy, a high level of corruption and a high level of financial secrecy (Bartlett 2002). In addition, the scale and sophistication of the criminality and relationship between organised crime and the state—such as economic dependence—will be relevant. Jurisdictions with one or more of these characteristics may be particularly susceptible to some of the impacts of money laundering identified and this may alter the scale that is required for the impact to be realised. In addition, the international framework and domestic evaluation of the AML/CTF regime can have economic consequences itself. These consequences arise as a result of the international pressure applied by members of FATF to restrict access to international markets for countries found to have strategic deficiencies in their AML/CTF regime.

The other approach to understanding the impact of money laundering on the economy relates to the impact of crimes that are enabled by money laundering. There is some overlap with the impacts considered in the section *Crime and criminal justice*; however, estimates of the cost of crime presented in that section rarely consider the wider economic effects.

Distorted rates

The ability to launder money makes crime worthwhile. The associated criminal offence results in resources being unfairly or illegally transferred from the victim to the alleged offender. This reallocation of resources results in the distortion of savings, consumption and investment rates as the funds are dealt with differently in the hands of criminals than they would be by law-abiding citizens who are not motivated to conceal the money (Reuter 2013; Unger et al. 2006; Walker 1995).

This collateral damage to the economy has been described as the third impact of crime for financial gain, the first being the loss to the victim and the second being the gain to the criminal (Walker 1995). The broader economic impact of distorting rates is that these measurement errors cause macroeconomic policy to be less effective (Quirk 1996; Takáts 2007; Unger et al. 2006). However, Alldridge (2002) has questioned whether this is a valid concern, given the huge expenditure on the regulatory structure, noting that errors in these economic measures should always be taken into consideration in developing economic policy. Several stakeholders questioned the feasibility of attributing a distortion in rates and the reduced effectiveness of macroeconomic policy to money laundering.

Savings and consumption

The reallocation of resources from victim to criminal and the need to disguise the origins of the funds reduces the spending of ordinary citizens and increases the spending of criminals (Quirk 1996). By way of example, a victim of a superannuation fraud scam would have spent the funds in retirement on everyday living expenses, contributing to economic activity, whereas the perpetrator of the scam will deal with the funds motivated by a desire to disguise them (Walker 1995). The spending patterns of criminals are often associated with an extravagant lifestyle and the purchase of luxury items and other high-value assets, rather than the living expenses motivating ordinary citizens' consumption (Bartlett 2002; Kruisbergen, Kleemans & Kouwenberg 2015). Where the proceeds of crime being laundered are significant, this impact will be more pronounced, and this will be particularly true for developing countries, where a greater distortion in rates is possible (Bartlett 2002; Ferwerda 2013). As Australia is not a developing country, this impact may not be detectable.

The purchase of luxury items such as jewellery, motor vehicles, art or real estate is also relevant to the money laundering process itself, where cleaned funds are integrated back into the economy to purchase apparently legitimate assets (Bartlett 2002; Unger et al. 2006). The criminalisation of money laundering and the AML/CTF regime in place to detect it provide a strong incentive to conceal the origin of the funds. One Dutch study analysed the spending behaviour of a sample of Dutch criminals and found their spending patterns to be very similar to the national average (Meloan et al. 2003, cited in Unger 2007). The research did find differences in savings and consumption behaviour, depending on the type of predicate offence. A proportion of the proceeds of crime generated from drug offences was more likely to be hoarded and reinvested in crime, compared with the proceeds of crime generated from fraud (Meloan et al. 2003, cited in Unger 2007). In addition, higher wealth criminals tended to save a larger proportion of their wealth, whereas lower wealth criminals were more likely to spend a larger proportion of their wealth (Unger 2007). This is consistent with the spending and saving patterns in the general population. These findings indicate that the savings and consumption behaviours of criminals are very similar to those of non-criminals, which means a substantial distortion in consumption and savings rates is unlikely. However, the research noted most of the criminals included were higher wealth, with a smaller sample of lower wealth criminals, which were compared with the average Dutch household (Meloan et al. 2003, cited in Unger 2007). A further review of the research noted a more precise study would be required to make conclusions beyond this first impression of relatively similar spending patterns (Unger et al. 2006).

In the Australian context, stakeholders referred to anecdotal examples of criminals spending their proceeds of crime on luxury items to improve their lifestyle. It is possible this also has an impact by promoting participation in crime.

Imports, exports and capital flows

Despite the Dutch research indicating the spending patterns of criminals and non-criminals are relatively similar, the characteristics of the country are likely to impact significantly on whether these findings hold in other contexts. For smaller and developing economies, spending patterns are likely to be more distinguishable. In these circumstances, criminals will purchase comparatively more luxury items. When the luxury items are produced overseas, as they often are, the purchases affect import and export rates (Bartlett 2002; Ferwerda 2013). In addition, because these items are imported, their production is not contributing to domestic economic activity (Unger 2007).

This is not the only way illicit funds are detracting from economic development. Research has found capital flows to be clearly concentrated in Europe and North America (Unger et al. 2006; Walker 1999). While much of this activity is legitimate, it is likely illicit fund flows are contributing, as corrupt officials in developing economies send money to financial systems that are larger and more advanced, where money can more easily be hidden (Walker 1999). Money laundering is therefore contributing to the loss of capital from economies that could be used for development (Bartlett 2002; Ferwerda 2013). The relevance of this in the Australian context is the impact on national reputation. As a developed and stable economy, Australia is more likely to receive the capital flows from developing economies. Where those funds may be the proceeds of crime or corruption, Australia may be seen to be benefitting economically, which would be in conflict with Australia's aim to be a leader in addressing illicit financial flows.

Simultaneously, the AML/CTF regime can contribute to a loss of capital for developing economies. Many migrants send money back to their family in their country of origin through the registered remittance sector. In 2013, excluding investments made by China, these remittance payments exceeded foreign direct investment flows to developing countries and were more than three times the size of official development assistance (Stanley & Buckley 2016). Many financial institutions have implemented policies that consider these transactions to be high risk. Financial institutions may have a low appetite for risk regarding customers who offer smaller potential profits, and the remittance services can become victims of debanking, further reducing capital flows to developing economies (Stanley & Buckley 2016). In the Australian context, this would impact on developing economies, particularly those in the Asia-Pacific region, and the relationship between Australia and neighbouring countries.

Investment

The literature also suggests a distortion in investment occurs because criminals laundering money are motivated by a desire to avoid detection or the seizure of proceeds of crime, rather than to maximise returns. As a consequence, funds are redirected from high-quality investments to low-quality investments, eroding the signalling role of profits (McDowell & Novis 2001; Quirk 1996).

In this way, money laundering undermines the effectiveness of the market mechanism to allocate capital in the legal economy, where projects should compete purely on economic grounds (Jojarth 2013). Illicit funds are invested in projects with the lowest risk of detection rather than the highest rate of return. The economic impact of this is the misallocation of resources to investments that generate little economic activity or employment (Bartlett 2002). However, many of the stakeholders interviewed for this study did not support this assertion, surmising that criminal organisations are equally motivated by profit and return on investment. Any redirection from high-quality to low-quality investment is likely to be minimal and would therefore not have macroeconomic significance.

Unger (2007) suggests that money launderers will be attracted to different sectors in different countries—finding, for example, that the Netherlands real estate sector is an attractive investment. The real estate market is non-transparent, value cannot be easily estimated and large increases in value do legitimately occur (Unger 2007; Unger & Ferwerda 2011). Furthermore, as a large market, large amounts of wealth can be invested and enablers such as corporate structures employed to mask beneficial ownership. Similarly, Australia’s real estate market is attractive to domestic and foreign investors, both legitimate and illegitimate, as a stable and high-value market. Walker (1995) found investment in the real estate market in Australia by money launderers can have a ripple effect across the economy. As noted, the appeal of the Australian real estate market was widely recognised by stakeholders. If money launderers are using the market to integrate illicit funds, the value may have been transferred from relatively poor law-abiding individuals to criminals. These victims of crime would have been more likely to spend the money on necessary goods and services, contributing to higher demand for the goods and services, higher income for those producing and selling the goods and services and more jobs in the economy. Despite acknowledging the redistribution of the funds may also reduce imports of goods and services for the same reason, Walker (1995) concluded the effect to be a net loss to the economy.

Exchange rates and interest rates

The change in imports and exports and unanticipated capital inflows and outflows lead to volatility in exchange rates and interest rates (Ferwerda 2013). A large inflow of illicit funds will cause the depreciation of the exchange rate, and an increase in the exchange rate may reduce exports, in turn increasing the reliance on imports (Unger 2007). The impact on interest rates is also caused by the money launderers prioritising their risk of detection over their rate of return for investment (Unger 2007). The consequences of this volatility are reduced predictability and greater financial instability. However, Alldridge (2002) argues such volatility is an inherent feature of the market and there is no evidence to support the notion that any such volatility is caused by money laundering.

Foreign direct investment

FATF's ability to apply international pressure by publicly identifying countries as having strategic deficiencies in their AML/CTF regime can damage national reputations. There is limited evidence as to whether the FATF recommendations for measures to combat money laundering and terrorism financing and the practice of 'naming and shaming' countries that do not implement them are effective in addressing money laundering. Many sources note the recommendations have not been independently reviewed or proven to be effective and criticism has been levelled at FATF's effectiveness methodology (Ferwerda, Deleanu & Unger 2019; Levi 2002; Pol 2018a). Despite this, FATF encouraging members to take into consideration a jurisdiction's strategic deficiencies in their AML/CTF regime in theory has economic consequences. These consequences may include barriers to accessing international markets, being the subject of economic sanctions and a reduction in foreign investment. However, there has been no evidence of direct harm to an economy occurring as a result (discussed below; Nance 2018).

Competing for criminal money

The deregulation of global financial markets and the desire to attract international capital led some countries to introduce legislation making them more vulnerable to money laundering at a time when there was little awareness of the impacts of illicit funds and capital was viewed as neutral (Masciandaro 1999). Regimes were, in some cases, offshore tax havens with banking secrecy and minimal taxation regulation and, in other cases, industrialised democracies unintentionally competing for foreign capital that included comingled funds from legitimate and illicit sources (Unger & Rawlings 2008).

Either intentionally or unintentionally, and to varying degrees, some countries were competing for criminal money. The most extreme example of this is referred to as the Seychelles strategy (Masciandaro, Takáts & Unger 2007; Unger et al. 2006; Unger & Rawlings 2008). In 1995, Seychelles passed the *Economic Development Act 1995*, which granted incentives and concessions to individuals investing in Seychelles (Unger & Rawlings 2008). The incentives included immunity from prosecution and protection of assets from forfeiture if a minimum of US\$10 million was invested. This bold solicitation of criminal funds was met with international opposition and public condemnation. Ultimately, international pressure led Seychelles to repeal the Act and introduce the *Anti-Money Laundering Act 1996* and the *Mutual Assistance in Criminal Matters Act 1997* (Unger & Rawlings 2008). In the short period of time the *Economic Development Act 1995* was in force, immunity was not granted to any investors and foreign direct investment was found to have reduced rather than increased, as legal investors lost confidence in the country—referred to as the 'Seychelles effect' (Unger et al. 2006).

A policy of openly soliciting criminal funds is not foreseeable in the Australian context. However, stakeholders did note the risks for Australia of appearing to benefit economically from the proceeds of crime from other countries through identified gaps in the AML/CTF regime (discussed further in the *National reputation* section). While this may not have an impact on foreign direct investment initially, it could damage international relationships.

This could occur, despite the significant investments and long-term outreach Australia has committed to in the Asia-Pacific region, if there were a perception that gaps in the AML/CTF regime were economically benefitting Australia. Stakeholders noted Australia is attractive for legitimate foreign direct investment because it offers a stable and developed economy. It is possible Australia may become a less attractive destination for legitimate foreign investment if international relationships are damaged or Australia is perceived as higher risk. This reputational damage may increase the investment of foreign illicit funds. However, a reduction in legitimate foreign investment is likely to outweigh any increase in illicit funds, as the legitimate economy is larger than the illegitimate economy.

Economic growth

A country attracting illicit funds may initially appear to prosper from the increased flow of funds. Several stakeholders reported that illicit funds have clearly added to global economic growth, with reference also made to illicit funds contributing to overcoming the global financial crisis. However, when focused on individual economies, research suggests the long-term effects of illicit funds on the economy will be negative as a result of the cumulative impacts of money laundering (Unger 2007; UNODC 2011). Research undertaken by Quirk (1996) examined 18 economies and found that an increase of 10 percent in money laundering produced a reduction in annual economic growth of 0.1 percentage points. Unger (2007) confirmed these results with a study of 17 economies, finding that, if money laundering increased from its initial level by US\$1 billion, economic growth decreased by between 0.03 and 0.06 percentage points. However, Unger's (2007) research went further and attempted to separate money laundering from predicate crime, finding if crime did not impact on the economy the effect of money laundering on economic growth was positive, increasing rates between 0.06 and 0.14 percentage points. However, Unger (2007) notes the separation of crime from money laundering is theoretical, as they are connected in three ways: the proceeds of crime are laundered, money laundering is a crime itself and money laundering attracts crime because it signals weak crime controls and opportunities to hide criminal proceeds.

These findings suggest that, if a country can attract illicit funds without attracting the connected crime, the impact on the economy may be positive. In other words, money laundering in and of itself does not produce a net harm to economic growth. This supports the policy of some jurisdictions to compete for criminal money through preferential legal regimes such as secrecy provisions. The bold approach of Seychelles attracted global condemnation, but a more discreet policy, or one where the AML/CTF regime may exist on paper but not in practice, has the potential to have a positive impact on growth, at least in the short term. As has been noted, increased illicit foreign investment may also, in the longer term, lead to a decrease in legitimate foreign investment. Also relevant to the issue of economic growth is how the funds are invested. Some investments may increase productivity more than others (Walker 1995).

However, any economic growth resulting from criminal wealth may also be impacted by competition in the market for these illicit funds. If a country has a monopoly on the money laundering market, it can effectively set the price for money laundering services. Criminals are willing to pay a premium for money laundering services because the cost is still less than disclosure (Alldridge 2002). Stakeholders acknowledged criminals will accept the loss of a significant proportion of their funds through the money laundering process. They also suggested that in Australia the commission that professional money laundering services charge has declined. The reduced commission was argued to be a result of the lower cost of certain techniques, particularly in an environment where methods are now established and services must compete for the business of criminal organisations, including by offering discounts.

Furthermore, the idea of economic growth arising from illicit funds assumes it is possible to attract money laundering without attracting the associated crime. A country that is known for money laundering may eventually attract crime as criminal organisations become comfortable there. Transaction costs would decrease because criminal organisations would be willing to integrate the funds into assets in the area, rather than incurring the additional cost of transferring the funds to another jurisdiction (Romero 2020; Unger et al. 2006). Further, as more criminals are attracted to the area, territorial crime and violence are likely to increase (Romero 2020). Ultimately, any economic growth may be lost to the economic costs of increased crime. While there is some support for this argument, some stakeholders argued that crime does not follow the money; rather, it is the money that will eventually return to the beneficial owners offshore. This relationship may depend on the nature of the money laundering activity occurring onshore. If the funds only move through a jurisdiction, they will rapidly return to the beneficial owner offshore and crime may not follow the money. However, if the money laundering activity involves the long-term integration of funds into assets, the offshore beneficial owner may move to the high-value asset to enjoy the lifestyle. In this case, crime may follow. Some stakeholders also raised the broader question of what the best measure of economic growth is. The current measure of economic growth considers GDP. If an economy grows due to money laundering, this may initially reflect positively in GDP; however, GDP does not measure welfare or quality of life and it fails to capture the distribution of wealth across society.

Summary and measurement

The impacts of money laundering on the economy are generally longer term economic harms, but they vary based on the characteristics of the jurisdiction and require money laundering to take place on a significant scale. Money laundering may distort economic statistics including savings and consumption rates, imports, exports and capital flows, exchange rates and investment. This effect on savings and consumption rates assumes criminals save or consume funds differently to non-criminals, an assumption for which there is some limited support. There is also some support for the notion money laundering affects imports, exports and capital flows. However, this impact is likely to vary based on the characteristics of the jurisdiction and will be more significant in developing economies and therefore less relevant to Australia. The impact on investment is also an economic harm, as funds are reallocated from high-quality investments to low-quality investments. This also contributes to further longer term economic harms of misallocated resources. There was scepticism among stakeholders about whether this would occur in the Australian context.

The potential effect of money laundering on exchange rates and interest rates is an economic harm of increased volatility. The net effect of money laundering distorting rates is very likely a longer term economic harm. Importantly, all these rates can be affected by many internal and external factors and the ability to attribute any distortion to money laundering is, at present, limited. What must also be established is that the distorted rates lead to the reduced effectiveness of macroeconomic policy. This is an additional layer to an already complex relationship, which makes attributing the outcomes of ineffective policy to money laundering more challenging. However, one element that could be the subject of further research is the spending patterns of proceeds of crime by criminal organisations, to ascertain whether criminals save and consume differently to the general population in Australia. In addition, given concern among stakeholders regarding integration of funds into the Australian real estate market, there may be scope for further research on the effect this has on economic growth as a less productive investment.

The impact of money laundering and the AML/CTF regime on foreign direct investment relates to the national reputation. It is possible in the short term a jurisdiction with favourable money laundering conditions will experience an increase in foreign direct investment, an economic benefit. However, the longer term effect of favourable conditions for money laundering, considering the functions of the global AML/CTF regime, is likely to be reduced foreign investment—an economic harm—particularly in extreme cases of competing for criminal funds. As a stable, open economy, Australia could be considered an attractive destination for legitimate foreign investment. If Australia were perceived to be non-compliant with global AML/CTF standards, this could initially attract increased illicit foreign investment but it would ultimately lead to a decrease in legitimate foreign investment. As the legitimate economy is larger than the illegitimate economy, this would be a net harm in the long term.

The cumulative effect of money laundering on the economy is likely to be a decrease in economic growth. There may be short-term benefits to economic growth from an initial increase in foreign investment of illicit funds. However, the reduced legitimate foreign investment and, potentially, misallocated investment could lead to a longer term decrease in economic growth. There was more support for the idea that money laundering has negative effects on economic growth when the economic harms of the associated crime—often not accounted for in estimated crime costs—are considered.

Societal impacts

The identified societal impacts can be classified into two primary categories:

- crime and criminal justice; and
- terrorism.

Crime and criminal justice

Key findings

- The impact of money laundering on crime is one of the most direct impacts of money laundering recognised in the literature and supported by interviews with stakeholders.
- The degree to which the criminalisation of money laundering and the AML/CTF regime deter crime is not clear. However, the existence of the AML/CTF regime provides valuable financial intelligence and is a tool for law enforcement in investigating crime.
- An increase in crime levels in the short term and long term is a social and economic cost of money laundering. This increase can result from the financing of further crime from the proceeds of past crime. It can also result from crime migrating to a jurisdiction with favourable money laundering conditions.
- The ability to trace, restrain and confiscate the proceeds of crime is an economic benefit of the AML/CTF regime. However, this likely offsets only a small proportion of crime costs.

Crime levels

As noted, the purpose of much crime, and particularly organised crime, is to profit. By disguising the origin of proceeds of crime as legitimate transactions, a criminal can spend the funds as if they were obtained from a legal source (Levi 2002; McDowell & Novis 2001). If the funds were spent in the legitimate economy without the money laundering process, law enforcement could more easily identify the funds as being unexplained wealth and derived from an illicit source. The risk for the offender is that illicit financial flows may lead law enforcement to the criminal activity and the funds or assets can be confiscated. This reduced opportunity to profit would likely deter many from committing crime. Money laundering allows offenders to enjoy the profits while minimising the risk of confiscation and criminal charges (Levi 2002; McDowell & Novis 2001). Part of the appeal of organised crime is the opportunity

to enjoy an affluent lifestyle. Money laundering enables this through the spending of proceeds on luxury items, legitimising the funds and also legitimising the offenders (Levi & Soudijn 2020).

Money laundering also allows the proceeds of crime to flow into the economy, converting potential purchasing power to effective purchasing power (Masciandaro 1999; Van Duyne, Groenhuijsen & Schudelaro 2005). These funds grow the economic power of the offenders and can be reinvested in further crime. In this way, money laundering enables crime and may impact on crime levels. Some consider this connection, and the social and economic harms that result from crime, enough to make money laundering itself socially and economically harmful (Bartlett 2002; Ferwerda 2009; Masciandaro 1999; Takáts 2007).

Predicate offences

Predicate offences are those that generate the funds (proceeds of crime) which must be laundered. Cleaned funds from these predicate offences are then invested in the legitimate economy or reinvested in further criminal enterprises (Figure 4). Australian legislation does not restrict the offence types that can be predicate offences for the purpose of money laundering. However, some of the most common offences, particularly for larger volumes of illicit funds, involve the trafficking of illicit commodities such as illicit drugs, and serious fraud offences.

These offences are profit motivated, and the income generated must be laundered to dissociate the funds from the crime and produce a seemingly lawful income. If the funds are not laundered they can be traced by law enforcement. Funds that are associated with crime can be restrained, confiscated and used as evidence in a criminal prosecution. By way of example, funds generated from the trafficking of illicit commodities could be considered unexplained wealth, while funds obtained through fraud that are not laundered may be traceable and can lead law enforcement from the victim to the offender. A proportion of funds generated can also be reinvested into the criminal enterprise. Like any business there are costs involved in running a criminal enterprise and these funds enable further predicate offences.

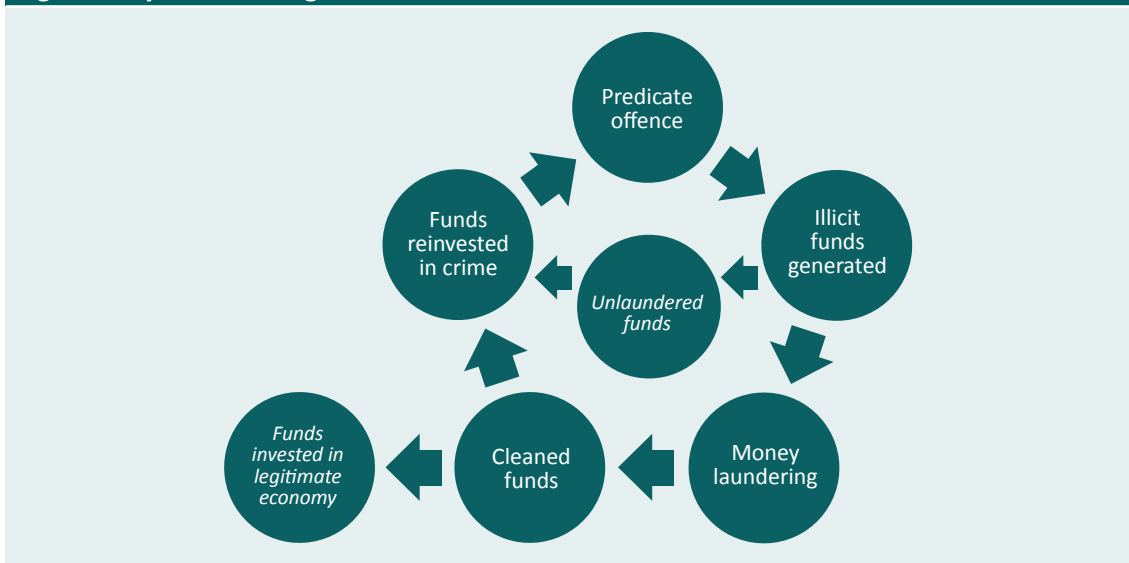
A large proportion of stakeholders focused on these features of money laundering as central to the motivation to commit crime. The implication is that, if money laundering is not possible (or more difficult), the incentive to commit crime and ability to fund further crime is reduced and crime levels would decrease. Conversely, crime will increase when money laundering is possible (Ferwerda 2009; Masciandaro 1999). This has obvious implications for the cost of predicate crime. The types of costs that are generally attributed to crime include medical costs (eg relating to illicit drug use or crimes against the person), the direct losses incurred by victims and costs of lost output (McDowell & Novis 2001; Smith 2018). The cost of different crime types varies depending on their nature and the impact on victims, governments and the broader community. These costs have been estimated and are significant; for example, the estimated costs of illicit drug activity related to serious and organised crime in Australia in 2016–17 was \$9.6 billion, while the cost of organised fraud was \$8.6 billion (Smith 2018). This is before the costs associated with public and private sector prevention strategies and responses are included. What is less clear, however, is the extent to which these crimes—or what proportion of these crime costs—can be attributed to money laundering.

A relevant point raised by many stakeholders in relation to predicate offences is the way in which the AML/CTF regime has created a demand for professional money laundering services. Professional money laundering syndicates provide an independent service to other organised crime groups to launder money and are not involved with the predicate offences. Stakeholders noted this is generally the case in larger scale money laundering investigations and it inhibits law enforcement's ability to connect funds to a specific predicate offence. Not only does this disconnect between predicate offence and money laundering inhibit investigations, the outsourcing of money laundering to syndicates may enable the money laundering to occur more efficiently at a greater scale. Stakeholders discussed the established networks with structured systems professional syndicates use to break down and launder proceeds of crime. This ability to efficiently launder money at scale has the potential to facilitate more costly predicate offences on a larger scale over a sustained period of time. Using professional money laundering syndicates is one way criminal organisations avoid the detection methods that exist as a result of the AML/CTF regime. Attempts to avoid detection have expanded into a 'continuous cat and mouse game with the authorities' (Levi & Soudijn 2020: 580).

Stakeholders also considered the impact of the COVID-19 pandemic as a test of the direct correlation between the ability to launder money and crime levels. However, it also illustrates the complexity of disentangling the direction of the relationship between predicate offences and money laundering. A large proportion of stakeholders cited the COVID-19 pandemic as making money laundering more difficult, as many sectors and industries closed down and could not be used to commingle legitimate and illegitimate funds. The suspicion that large volumes of cash were held, unable to be laundered, was supported by anecdotal examples of increased volumes of cash seizures. Stakeholders considered illicit drug consumption as a proxy for crime, noting there had been changes in the types of illicit drugs consumed due to restrictions on large scale social events that attract certain illicit drugs, but suggested there had been no decrease in drug consumption overall. However, the measure for establishing drug consumption is likely drug possession charges by law enforcement. Rather than an accurate representation of drug consumption, possession charges may reflect increased focus on this crime type by law enforcement as other crime types reduced due to COVID-19 related restrictions. If there was increased drug consumption, this may indicate drug trafficking and sales were continuing at the same levels despite the reduced opportunities to launder money. However, regardless of the ability to launder money, it is unlikely drug trafficking would be able to continue at the same level as it had before COVID-19 related international travel restrictions were implemented.

Despite this, the duration of the COVID-19 pandemic presents an opportunity to analyse the connection between crime and money laundering. Analysis of this could extend beyond illicit drugs to other crime types such as fraud or cybercrime. As the proceeds of past crime finance future crime, at some point, the inability to launder money could disrupt the business model of offenders. Any disruption to the financing of further crime is likely to have a lag effect and the length of this lag may vary across crime types. However, the prevalence of these different types of crime will also be affected by the circumstances of COVID-19 beyond the ability to launder money and this would need to be controlled.

Figure 4: Cycle of funds generated from crime



Money laundering as a criminal offence

Money laundering is a crime itself in many jurisdictions, including Australia. The crime of money laundering is ambiguous, not only because it can be defined differently across jurisdictions, but also because in a single jurisdiction the concept of money laundering may differ from the legal interpretation of the legislated offence. The concept of money laundering is to disguise illicit funds through the stages of placement, layering and integration. In contrast, the criminal offence of money laundering can be as simple as holding or placing proceeds of crime in a bank account (Levi & Reuter 2006). In Australia, Commonwealth money laundering offences are contained in the *Criminal Code Act 1995* (Cth), which refers to 'dealing in the proceeds of crime'. This offence can involve no more than having possession of these proceeds. This broad definition is useful for the purpose of prosecuting money laundering as a criminal offence, particularly when professional money laundering syndicates are involved and there is a disconnect between the laundering and the predicate offence. However, this definition does not provide a basis for analysing the relationship between money laundering and crime. In practice there is a direct relationship between the predicate offence and money laundering and it is this connection that is being examined.

FATF's recommendation 3 is for countries to criminalise money laundering on the basis of the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances and the United Nations Convention against Transnational Organized Crime (FATF 2020c). Due to this focus on compliance with international law, rather than the harm caused, Alldridge (2002) has questioned the legitimacy of the criminalisation of money laundering, finding it unjustifiable and unnecessary. Despite this, there is broad compliance amongst FATF members with Recommendation 3. As a consequence, in these jurisdictions, to benefit financially from crime, criminals must engage in or outsource this additional criminal act. Arguments for the criminalisation of money laundering are based on the principle that crime should not pay and that the potential for additional criminal punishment will deter predicate offences (Alldridge 2002; Ferwerda 2009; Levi 2002). In the Australian context, stakeholders raised the fact that the outcomes of criminal prosecutions often do not reflect the way money laundering was involved in the criminal enterprise. Money laundering charges may be dropped, with the predicate offences carrying their own substantial penalties. This approach was discussed in Australia's most recent FATF evaluation, which suggested that the money laundering charges should be pursued (FATF 2015).

Ferwerda (2009) analysed the effect of criminalisation and the AML/CTF regime on crime levels, drawing on the theory of the economics of crime and the need to develop a system where the cost of committing an offence is greater than the benefits. The criminalisation of money laundering means an offender must commit two criminal acts to profit from crime. The AML/CTF regime makes laundering more difficult and therefore more expensive (Levi & Reuter 2006). Stakeholders also raised how law enforcement faces increased costs as offenders adapted to the enforcement of the AML/CTF regime, since more sophisticated money laundering methods result in more labour intensive investigations.

Ferwerda (2009) also found that potential criminals are deterred not only from committing the illegal act of money laundering but from committing the predicate offences. The extent of this disincentive can vary between jurisdictions because of the variation in the predicate offences. Variance may also occur between jurisdictions due to the lack of consistency regarding the interpretation of the criminalisation of money laundering (Levi 2010; Levi, Reuter & Halliday 2018). Also relevant is the tension between common and civil law jurisdictions. While some jurisdictions require that there be an attempt to conceal the origin of the funds, other jurisdictions only require a person to have been dealing with funds. Consequently, an individual who is simply in possession of the proceeds of crime in some jurisdictions, including Australia, will be considered to be laundering money. In other jurisdictions that individual will only be considered to be involved in money laundering if they also attempt to conceal the source.

Alldrige (2002) has made two compelling arguments against the simplicity of these and similar findings. The assertion that criminalisation of money laundering and the AML/CTF regime requires the benefit to be greater to justify participation in the crime may be accurate. However, the profits to be made from predicate offences such as drug trafficking are such that there would still be ample incentive to commit such an offence (Alldrige 2002). In addition, as the offender is already willing to engage in the predicate offence, the criminalisation of money laundering would only act as a deterrent if the punishment were more severe than that of the predicate offence or the chances of detection greater (Alldrige 2002). While it is possible money laundering may be detected when the predicate offence was not, and that the money laundering leads investigators back to the predicate offence, there is no evidence the chances of detection are higher for money laundering. In fact, law enforcement stakeholders argued that, while financial intelligence was a valuable investigative tool and could open alternative avenues into investigations, money laundering offences were no easier to detect than predicate offences. From this perspective, while money laundering may facilitate predicate offences, the criminalisation of money laundering may not deter offenders from committing these predicate offences. In this scenario, there would be no reduction to the economic costs of money laundering.

It is also relevant that the marginal deterrence effect was not included in Ferwerda's (2009) analysis and this could lead to an increase in crime. According to Ferwerda, in theory, the penalty from the criminalisation of money laundering and an effective AML/CTF regime may deter a potential criminal from money laundering, but not necessarily the predicate offence. Without the ability to spend the funds in the legitimate economy, profits will be hoarded and reinvested in the criminal enterprise (Ferwerda 2009; Levi 2010). As the purpose of money laundering is to legitimise illicit funds, it is in theory not necessary when the funds are reinvested in the illicit economy. Despite the differing definitions of money laundering across jurisdictions, the stage of money laundering that has the highest risk of detection is the placement stage. The AML/CTF regime is best placed to identify illicit funds when they are placed into the financial system. Therefore, a cautious offender may avoid money laundering and increasingly reinvest illicit funds in the illicit business. An unintended consequence of an effective AML/CTF regime may be a subsequent increase in criminal activity due to this reinvestment. Stakeholders also identified the potential for an underground parallel illegal economy to emerge as an unintended outcome the AML/CTF regime, and noted that this economy could become self-sustaining.

In contrast, Masciandaro's (1999) research assumed that at least some of the funds being reinvested in criminal activities will still be laundered. Masciandaro (1999) explored money laundering as a multiplier of crime because it transforms potential purchasing power into effective purchasing power and triggers financial flows that lead to more investment in legal but also illegal activities. This assumption was supported by the idea that rational, profit-motivated offenders and facilitators would take measures to minimise their risk of holding illicit funds regardless of their intended purpose (Masciandaro 1999). The research considered how the AML/CTF regime would impact on the proportion of laundered funds invested in the licit economy and the proportion invested back in the illicit economy. Therefore, this impact of the AML/CTF regime on crime levels will depend on whether criminals consider it necessary to launder funds intended to be reinvested in crime. It would arguably be more important to legitimise funds intended for use in the legitimate economy than those being reinvested in crime. Additionally, an individual may weigh the risk of holding illicit funds intended for reinvestment in the criminal enterprise against the risk of money laundering being detected in the placement stage.

Despite the theoretical research and anecdotal examples, the effect of the criminalisation of money laundering and the AML/CTF regime on criminals' willingness to engage in criminal activity is unknown. However, available data indicate the regime has not had major effects in suppressing crime (Levi & Reuter 2006; Pol 2018a). Even if a reduction in predicate offences were observed, it may be difficult to estimate the extent to which this reduction is attributable to the AML/CTF regime.

Transnational money laundering

The research that considers the impact of money laundering on crime levels often assumes a closed economy, where the criminal activity occurs in the same jurisdiction as the money laundering. Due to the interconnected nature of financial flows and the fact money laundering is often a transnational crime, this is not the case. Therefore, even accepting that the ability to launder money leads to an increase in crime, we cannot assume that the increase in crime is occurring in the same jurisdiction. This is the premise under which countries may intentionally compete for criminal funds, to benefit from the injection of capital without suffering from the associated harms of increased crime (Unger et al. 2006). The greatest risk from this strategy is that, in the long term, jurisdictions tolerating money laundering may attract more crime, thereby reversing any benefits. This strategy has been described as attempting to 'free ride' on crimes committed in other countries (Unger et al. 2006).

The transnational element of crime and money laundering was considered in the interviews with stakeholders. The characteristics of the jurisdiction, nature of legitimate trade that exists with other jurisdictions, and types of predicate offences that are attractive in that jurisdiction were all regarded as important factors. Geographical proximity and more extensive legitimate trade allows illicit goods and illicit funds to move between two countries undetected and more efficiently.

According to the stakeholders interviewed, Australia is a highly profitable market for illicit drugs. Where these drugs are imported by offshore organised crime groups, the funds (from local sales) are generated onshore and the profit is returned offshore. However, Australia was also identified as a stable and developed economy that is attractive for laundered funds, meaning this profit may return to Australia to be integrated into assets.

Views differed on whether crime would eventually follow the money, with some noting that the characteristics of a jurisdiction that make it attractive for crime are more relevant than the ability to launder money. For these reasons, stakeholders suggested analysis of this issue should examine the relationship between Australia and each other country separately, rather than Australia and all other countries as a whole. The potential for crime to follow the money was said to depend on factors unique to the relationship, such as the existence of substantial legitimate trade, geographic proximity and the type of predicate offence.

Recovery of proceeds of crime

The AML/CTF regime empowers authorities not only to uncover the criminal activity generating the funds but also to follow and recover the funds, or the assets they have been integrated into, on the principle that the economic benefit should be returned to the community. FATF Recommendations 4 and 38 require the AML/CTF regime to include measures to enable competent authorities, domestically and internationally, to freeze or seize and confiscate property that is the proceeds or an instrument of crime, or property of corresponding value (FATF 2020c). The implementation of these recommendations has been politically uncontroversial, justified on the principle that crime should not pay and that the threat of confiscation will disincentivise criminals. However, the legal legitimacy and social consequences of the provisions have been questioned. Concerns range from the legal right of the state to seize the property to the double jeopardy argument about a person being punished twice for the same crime (Alldrige 2002).

The strategy of confiscating criminal assets on a large scale was also considered a method to destabilise organised crime, not only making it unprofitable but undermining the structure and survival of criminal organisations (Bodrero 2013). However, the validity of recovering the proceeds of crime as part of the AML/CTF regime on this principle has also been questioned because of its ineffectiveness (Pol 2018a). Analysis of this issue suffers from the scale of money laundering being unknown. However, considering the speculated scale of money laundering compared with the value of proceeds of crime seized and confiscated, the proportion restrained or confiscated is very low. Estimates for Australia suggest around 1.3 percent of illicit funds are restrained and 0.4 percent confiscated, while global estimates of illicit funds seized were even lower (0.2%; Pol 2018b; UNODC 2011). Despite the low percentage, the value of these figures is still substantial. In the 2019–20 financial year the Australian Federal Police (2020) alone restrained more than \$250 million, and this does not include the value restrained by other Commonwealth agencies or state and territory agencies. Engagement with law enforcement stakeholders suggests there is a view that the confiscation of assets is a tool to ‘hit where it hurts most’, implying criminals are highly concerned about losing their wealth.

Dealing with confiscated assets under the AML/CTF and proceeds of crime regimes can also lead to further indirect social consequences. In Australia, the value of assets confiscated is managed by the Australian Financial Security Authority and is required to be reinvested in the community, with the approval of the Minister for Home Affairs. However, in some jurisdictions, this framework allows a proportion of the confiscated funds to be returned directly to the law enforcement authorities involved in the confiscation. This can encourage law enforcement to focus on investigations that may increase their funding, rather than investigations that reduce harm and promote community safety—or ‘policing for profit’ (Albanese 2011; Alldridge 2016, 2002; Levi 2002). While this has been raised as a concern internationally, this was not raised as an issue in the Australian context, possibly due to the design of the framework.

Furthermore, despite the economic benefits of seizing proceeds of crime, additional economic costs are often involved in the storage and maintenance of items before they can be sold. This may be particularly costly for items such as boats, cars and planes. Due to the nature of these assets, and the prolonged period of time they are often restrained, they also decrease in value. Finally, as has been noted, money laundering is an increasingly transnational crime. The identification and recovery of proceeds of crime therefore also requires international cooperation, which can increase the economic costs of recovery.

Summary and measurement

The economic and social costs of crime are significant and the necessary coexistence of criminal offences that generate illicit funds and money laundering is most likely sufficient to make money laundering socially and economically harmful.

Money laundering enables crime by allowing criminals to profit from their offending—profit that may also be reinvested to finance future crime. The funds can also be integrated into the legitimate economy, where the profits of crime can be enjoyed without them leading to the prosecution of the offender or the confiscation of their assets.

The net effect of money laundering is likely to increase crime levels. In the short term, money laundering facilitates criminal activity, while the laundered proceeds of crime may finance further crimes. Measuring this is difficult because of the challenge of linking money laundering activity to the crime that generated the profits that are subsequently laundered (at an aggregate level). One option would be to link AUSTRAC data on suspicious transactions with law enforcement data on known organised crime groups and the criminal records (charges or convictions) of group members. These data could be used to ascertain the degree to which these suspicious transactions are related to known organised crime activity. The offences by these organised crime groups (suspected based on law enforcement intelligence or known based on criminal records) could be analysed to identify predicate offences that may have been enabled by money laundering. The transactions that are linked with organised crime groups could also be compared with the transactions that are not to develop estimates of the likely extent of money laundering activity associated with organised crime groups not known to law enforcement. The challenge is determining the extent to which the crimes committed by organised groups would have been committed in the absence of money laundering.

Other, more sophisticated methods have been used in the Netherlands, where agent-based modelling is being used to evaluate the spread of criminal activity and assess how criminal activity might increase in a community and undermine the legitimate economy.

As noted, the COVID-19 pandemic also provides an opportunity to test the relationship between money laundering and crime levels. Stakeholders suggested the COVID-19 pandemic made money laundering methods more difficult. The effect of this reduced ability to launder money could be examined against the levels of different crime types. This would control for the impact of COVID-19 restrictions on the prevalence of the specific crime type that is unrelated to the ability to launder money. Depending on the nature of the crime, the ability to launder money and the need to finance future crime will also vary. This may present as a change in crime levels with a lag effect of differing lengths. The impact of the change in crime levels over this period, controlling for other factors, could be attributed to the reduced ability to launder money. This would indicate the proportion of crime costs—previously estimated for serious and organised crime (see Smith 2018)—attributable to money laundering.

In the longer term, criminal organisations may migrate to a jurisdiction viewed as favourable for money laundering. One way this migration could be measured is by determining the jurisdiction suspected illicit funds are being generated in before being transferred to Australia. By exploring the types of criminal activity likely to be generating the illicit funds in the other jurisdiction, whether these crimes emerged or increased locally could be examined. This would require controlling for external factors that could influence the increases in specific types of offending, such as law enforcement focus on a type of offending that leads to increased charges and convictions.

The AML/CTF regime empowers authorities to trace, restrain and eventually confiscate the proceeds of crime—an economic benefit. The degree to which the costs of organised crime are offset by the ability of government to recover the proceeds of crime or the deterrent effect of enforcement of the AML/CTF regime is not clear, but likely to represent only a small proportion of all crime costs. It may be possible to compare the total value of assets confiscated by the Commonwealth and states and territories—assuming these assets are returned to the economy—with the total costs associated with serious and organised crime (see Smith 2018). This would provide insight into the degree to which recovery of proceeds of crime resulting from the AML/CTF regime has offset the costs. The New Zealand Ministry of Justice (2017) has compared the restraint and seizure of assets directly with the social harm of illicit drugs at a macro level. The estimate, considered indicative only and based on many assumptions, suggests NZ\$800 million in social harm from illicit drugs would be avoided by the restraint and seizure of funds from money laundering (NZ Ministry of Justice 2017).

Terrorism

Key findings

- Stakeholders highlighted the benefits of access to financial intelligence through the AML/CTF regime. This impact was considered relevant and significant in relation to terrorism financing in Australia.
- In addition to helping to identify networks, financial intelligence is used by Australian law enforcement agencies in conjunction with other forms of intelligence as a surveillance tool, a behavioural analysis tool and a way to corroborate other forms of intelligence.
- Financial intelligence likely contributes more to preventing attacks than to preventing the financing of terror groups.
- The impacts of terrorist attacks when they do occur is significant, including in the short, medium and long term. However, some of these effects may be less significant for smaller scale terror attacks, which are the main threat in the Australian context. In addition, Australia's developed and diversified economy and political stability may reduce the significance of economic impacts in the longer term.
- The risk to the national reputation of the counter-terrorism financing regime impeding humanitarian work also exists, although this is not unique to Australia. This risk is also likely to be small when compared with the risk to the national reputation of Australia contributing to the funding of offshore terror attacks, and the harms associated with terrorist attacks domestically and internationally.

The greatest impact of terrorism financing is terrorist attacks and their consequences. Following September 11 it was revealed that between US\$400,000 and US\$500,000 used to finance the attacks had passed through the financial system (Keatinge & Keen 2020). Targeting the finances of terrorists and depriving them of funds became a key strategy in counter-terrorism policy (Keatinge & Keen 2020; Krieger & Meierrieks 2013; Levi 2010). This connection with the financial system and the fact FATF was an established body made the existing anti-money laundering regime the best fit to incorporate policy relating to counter-terrorism financing (Levi 2010).

Despite the shared connection to the financial system, money laundering and terrorism financing do not fit perfectly together, with different processes and objectives. Their connection has been described as a very loose one and the AML/CTF regime as an unhappy marriage (Cuellar 2003; Durner & Cotter 2019; Levi 2010; Unger et al. 2006). In the Australian context, money laundering was described as circular, where the funds will eventually return to the beneficial owner, whereas terrorism financing is more one-directional since the funds will be transferred for a purpose, such as an attack or to support foreign fighters in other regions. The perception that terrorism financing is solely 'reverse money laundering' is inaccurate, as money laundering and terrorism financing are interconnected in other ways. Criminal offences can generate funds for terrorist organisations, laundered funds can be used to evade sanctions, and terrorism financing is a criminal offence that can also be a predicate offence to money laundering. In the Australian context, stakeholders suggested the financing terrorism from criminal activity is much less common than financing it from legitimate sources, including welfare. Irrespective of the source of these funds, the planned use of those funds for terrorism is a crime.

Importantly, terrorist organisations have evolved rapidly since 2001, and have access to growing income streams. They more frequently involve small cell and lone actor attacks that require very little or no financing, which means they can be self-funded from legitimate sources such as welfare (Keatinge & Keen 2020). Analysis has found only 13 percent of small cell or lone actor attacks secured additional finance (Keatinge & Keen 2020; Schuurman 2018). Therefore, the degree to which modern terrorism (and associated impacts) can be attributed to terrorism financing, as targeted by the AML/CTF regime, is unclear.

Financial intelligence

Small cell and lone actor terrorists do not operate in a vacuum. One of the findings of Tierney's (2017) analysis was that lone actor terrorists regularly engaged with a wider group and a subset of these actors engaged in fundraising in support of the wider group. Therefore, in circumstances where the terrorist attack itself is funded with legitimate funds that raise no suspicions, financial intelligence is still of value in identifying the lone actor through their transactions. In the past, the financial connections of lone actor attacks have been under-reported, likely a result of the attacks being unsophisticated and inexpensive (Keatinge & Keen 2017). However, following attacks, anecdotal evidence has emerged of financial connections and donations to terrorist or extremist organisations, such as in the case of the Christchurch terror attack (Besser 2019).

Recent recommendations in counter-terrorism financing policy include refocusing the role of financial intelligence, to integrate it further with other non-financial intelligence to support terrorism investigations (Keatinge & Keen 2020; Tierney 2017). The benefit of the AML/CTF regime is the ability to obtain and use this financial intelligence to identify networks for proactive investigation to prevent future attacks. The use of this financial intelligence is currently considered 'under-emphasised and under-exploited' (Keatinge & Keen 2020: 4). In the Australian context, stakeholders confirmed that the value of the AML/CTF regime in counter-terrorism investigations was that it provides a valuable source of intelligence. Not only would it be more challenging to obtain this information without the AML/CTF regime, except where law enforcement were alerted to suspicious activity in another way, it is unlikely law enforcement agencies would know enough to request a warrant to obtain this information. The value of suspicious matter reporting is that the information must be provided to law enforcement, who can initiate ongoing monitoring and further intelligence gathering. Stakeholders noted that any expansion of the regime would enable increased intelligence gathering, in turn allowing the further corroboration of other sources of information.

Due to the changing terrorism environment, the focus in the Australian context is not on preventing financing. This is an unachievable objective for low-cost, self-funded attacks. The financial intelligence is used to corroborate other intelligence to help identify networks and associations. This was particularly important early during the COVID-19 pandemic, when many businesses did not accept cash, making financial intelligence a more effective surveillance tool. This information can not only identify networks and associations but also be used in conjunction with models that assess patterns of behaviour. This can identify changes in patterns of behaviour that may indicate an intention to plan a terror attack. This focus on intelligence gathering also raises the issue of new payment platforms and virtual assets, which have been identified as emerging opportunities for money laundering and terrorism financing. Virtual assets are not currently considered high risk for terrorism financing. However, terrorism financing risks exist through the combined use of social networking, content hosting and crowdfunding (Keatinge & Keen 2019).

Terrorist attacks

Terrorist attacks are one of the most severe impacts of money laundering and terrorism financing (Levi & Reuter 2006). Money laundering contributes to funding terrorist attacks when terrorists use criminal activities, most commonly drug trafficking, to raise funds (Keatinge & Keen 2020; Masciandaro, Takáts & Unger 2007). Organised crime and terrorism have also been described as a continuum where criminal and terrorist organisations learn from one another and display similar characteristics. In doing so, they may converge across the continuum between alliance with a terrorist group, use of terror attacks, political crime, commercial terrorism, criminal activities and alliance with a criminal organisation (Figure 5; Keatinge & Keen 2020; Makarenko 2004).

Figure 5: 'Crime–terror continuum'



Source: Makarenko 2004

The reality of such a continuum has been questioned; however, terrorist organisations do exploit the same weaknesses in the AML/CTF regime as organised crime groups to remain undetected (Unger 2007). Widely referenced investigations of professional money launderers, particularly those in the informal remittance sector with significant global reach, have revealed they have offered services to both criminal organisations and terrorist organisations—an example of crime as a service to terrorist organisations (Keatinge & Keen 2020). In addition, following September 11, the United Nations Security Council adopted resolution 1373, requiring member states to freeze the assets of identified terrorists and terrorist organisations. This made money laundering to dissociate the assets essential for terrorists to continue their operations (Jorath 2013; McGarrity 2012).

When terrorist funds come from legitimate sources, which is often the case in global fundraising or smaller scale attacks, the money laundering logic is reversed, in what is often referred to as 'reverse laundering'. Money that is otherwise legitimate, whether it originated from welfare or employment income rather than the proceeds of any criminal activity, is used for a terrorist attack. Clean money then becomes dirty money, rather than the usual purpose of money laundering of converting dirty money to clean money (Durner & Cotter 2019; Reuter 2013).

When funds either legitimately or illegitimately obtained result in a terrorist attack, the economic and social consequences that follow are significant, but also vary widely depending on the nature of the attack and the characteristics of the jurisdiction. The impacts of a terrorist attack such as September 11 will be differ substantially to the impact of taking a single hostage. The impacts will vary again for locations where attacks such as suicide bombings are ongoing and the region is politically unstable. Terrorist attacks with specific targets, such as critical infrastructure, will also have different impacts from attacks that target certain communities. However, effects such as fear, the loss of life and economic impacts are consistent, even though they likely vary in magnitude (Frey, Luechinger & Stutzer 2004; Krieger & Meierrieks 2013; Organisation for Economic Co-operation and Development (OECD) 2002).

Further, one of the aims of terrorist attacks is to advance a political objective through economic and political destabilisation (Krieger & Meierrieks 2013). Terror attacks harm the economy immediately and economic consequences follow into the medium to long term. While large-scale terrorist attacks are a risk, stakeholders were focused on the risk of less sophisticated attacks in the Australian context. These attacks still have the potential for significant societal consequences; however, the impacts will be smaller than those of a large-scale attack. Also relevant are Australia's characteristics as a developed and diversified economy and as politically stable in comparison to some regions of the world, where ongoing attacks hold longer term consequences.

Immediate impacts

The immediate economic impacts of a large-scale terrorist attack may include the shutdown of financial markets, loss of payment infrastructure, loss of communication services, the destruction of physical assets and the loss human life (OECD 2002). The immediate impacts of a smaller scale terrorist attack may still be loss of or damage to infrastructure such as buildings, the loss of human life on a smaller scale and the disruption of transport systems, although those impacts will be less significant than those of large-scale attacks. The recovery from some of these impacts, such as the reconnection to services, is swift but others take longer. For example, the loss of human life represents a loss of human capital, which can lead to longer term consequences such as reduced productivity (Krieger & Meierrieks 2013). Terror attacks in the past have targeted transportation systems, making disruptions to transportation and movement one of their immediate economic impacts. This affects not only community movement but supply chain management (OECD 2002). In the longer term, borders may be recognised as a security risk that requires additional controls, thereby increasing the cost and reducing the efficiency of international trade and impacting on economic growth.

Foreign direct investment

Longer term costs to the economy include the impact on foreign direct investment. Investors reassess costs, returns and whether assets are likely to be damaged in a jurisdiction. This may reduce the transfer of technological know-how to the jurisdiction, further impacting future productivity (Frey, Luechinger & Stutzer 2004; Krieger & Meierrieks 2013). The loss of foreign direct investment will negatively impact economic growth, particularly where it is more heavily relied upon such as in developing economies (Frey, Luechinger & Stutzer 2004; Krieger & Meierrieks 2013). The nature of the economy will determine how significant and how prolonged the impact on foreign direct investment will be. In large economies such as the United States, for example, even September 11 had a limited lasting impact on foreign direct investment (Enders, Sachsida & Sandler 2006). A limited longer term impact may similarly occur in Australia, as a developed and diversified economy.

Savings, consumption and investment

Savings, consumption and investment rates will be impacted in diverse ways depending on whether the terrorist attack results in political instability, and this is relevant in the Australian context. Consumption may increase to convert funds to durable goods or decrease due to a loss of consumer confidence. Capital flight, where money leaves a country, may occur as individuals attempt to move funds to safe havens, the aggregate effect being a loss of investment in addition to the loss of foreign direct investment and decreased economic growth (Enders, Sachsida & Sandler 2006; Frey, Luechinger & Stutzer 2004; Krieger & Meierrieks 2013).

Government expenditure

Terror attacks also result in an immediate and long-term increase in government expenditure. The immediate impact may be an increase in government spending on emergency services, health services or crisis management. The scale of the attack is a relevant factor in the immediate government expenditure. The long-term impacts will vary depending on the nature of the jurisdiction, but may include increased defence and military expenses or increased counter-terrorism policy expenditure (OECD 2002). Security-related expenses will affect not only the public sector but also the private sector, which could lead to economic benefits due to increased demand for the private security sector.

Tourism

Tourism is one of the main industries impacted by terrorism. Tourists are often intentionally targeted in terror attacks and the fear of terrorism or restrictions on travel may reduce tourism. Depending on the scale of attacks, this may impact significantly on the economy for jurisdictions or regions that rely heavily on tourism (Frey, Luechinger & Stutzer 2004; OECD 2002).

Insurance

Insurance is another industry impacted heavily by terrorism. One of the first reactions to the September 11 terrorist attacks was the insurance industry raising its premiums and, in many cases, removing coverage for terrorism, a gap that required government intervention (OECD 2002). The costs of insurance will also be relevant to foreign investment levels. The impact on insurance will be higher for large-scale attacks compared with the higher-risk lone actor attacks in the West. However, an emerging issue for insurance and government reinsurance programs is cyber terrorism, where cyber-attacks on critical infrastructure against the government or private sector can cause similar harm as traditional terrorist attacks (OECD 2020).

Humanitarian work

Stakeholders also discussed the impact of listing organisations as terrorist organisations under the *Criminal Code Act 1995* (Cth), noting there may be different arms of proscribed terrorist organisations legitimately involved in humanitarian work. The counter-terrorism financing regime could reduce the financing of humanitarian work, which has the potential to impact on the national reputation. There is an existing body of research on the tension between counter-terrorism legal regimes and international humanitarian law that is outside the scope of this research (Hajjar 2019; McKeever 2020). However, while this issue applies more broadly across the globe and is not unique to Australia, it is possible that this tension could affect the national reputation. Conversely, there would also be a risk to the national reputation if Australia had a less effective counter-terrorism financing regime that resulted in Australia contributing to offshore terror attacks.

Summary and measurement

While terrorist attacks have a range of impacts, significant questions remain as to the degree to which these impacts can be attributed to money laundering or terrorism financing. The link between a reduction in terrorism financing and the prevention of terrorist attacks is a tenuous one. Terrorist attacks, particularly more recent incidents involving lone actors, can be financed with very little or no money. These attacks can therefore be financed entirely from legitimate funds or may include financing from proceeds of crime. Where terrorist attacks do occur, either small or large scale, it may be difficult to trace the financing of the attack back to funding sources used to support terrorist organisations generally. However, terrorist attacks do cause significant harm. The harm is also both immediate and longer term. When considering the economic damage of terrorist attacks, it is notable that these impacts will be felt significantly more and for longer in developing, less diversified and less resilient economies (Krieger & Meierrieks 2013). While it is possible to measure the impacts of terrorist attacks (see Frey, Luechinger & Stutzer 2004), the low-cost nature of attacks most relevant to Australia make the link between financing and the attack tenuous.

The benefit of the AML/CTF regime in the context of terrorism financing is the intelligence it provides. The value of the financial intelligence extends beyond directly preventing the financing of a terrorist attack to enabling the investigation of global and local networks, providing a valuable tool for investigative and monitoring purposes. These investigations may indirectly prevent terrorist attacks, a benefit that could be measured in terms of the cost of the attack had it occurred. However, as financial intelligence is just one tool, it would be difficult to attribute disruption outcomes to this financial intelligence.

The impact of the counter-terrorism financing regime on the national reputation, insofar as it may prevent the funding of some humanitarian work, may include damage to international relationships. This could be measured in terms of the impact of money laundering on the national reputation, reducing the influence and authority Australia has with global partners. Of course, this needs to be considered alongside the damage to Australia's national reputation if it were perceived to be contributing to offshore terrorist attacks, which could be more significant.

Sectoral impacts

The identified sectoral impacts can be classified as follows:

- financial sector and other designated services;
- private sector (outside of designated services); and
- public sector.

Financial sector and other designated services

Key findings

- The literature identified a number of impacts on designated services, particularly the financial sector, remittance sector and gambling sector. These impacts related to profitability, reputation, availability of credit and liquidity. The potentially beneficial impact on profitability and the harmful impact on reputation have the most support in the literature. In the Australian context, the impact on profitability and reputation also generated the most engagement from stakeholders.
- From consultation with different reporting entities, it is clear that the impact on profitability must be considered for each individual sector, rather than for reporting entities as a whole, as different sectors operate on different business models.
- Interviews with stakeholders from the financial sector did not provide support for the idea that money laundering increases profitability in the Australian context. However, the financial sector may have a vested interest in not recognising or acknowledging the potential benefits to profitability. In addition, any increases to profitability as a net effect of money laundering may be difficult to conceive in the current climate of enforcement action in Australia, especially given the significant costs of enforcement and remediation action.
- There was greater recognition of the potential benefits of money laundering on profitability in the gambling sector. However, this was only considered a short-term benefit.

- From the perspective of remittance services, the impact on profitability was considered a result of the AML/CTF regime rather than money laundering itself. More specifically, financial institutions hold the power to debank remittance services, which may reduce competition. However, financial institutions considered this a risk management issue.
- Reputational damage was the most widely supported impact and the greatest concern for reporting entities, particularly in the financial sector. The reputational damage due to association with money laundering was considered from the perspective of individual institutions. But it was also recognised as something that can be generalised across sectors, increasing the cost of doing business and redirecting resources.

In Australia, entities regulated under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) include but are not limited to financial services, remittance and digital currency exchange providers, bullion dealers and gambling services, and reporting entities are those that provide a designated service. These services are identified because of the risk they present for money laundering and terrorism financing. These services deal directly with money and value, and money laundering and terrorism financing impact these services in very similar ways, with consistent harms and benefits. However, financial institutions are often singled out as being the highest risk and therefore the most impacted due to the financial sector's size, the range of products and services, and the volume of transactions, global reach and speed of money movement (AUSTRAC 2019). Many of the following impacts will focus on financial institutions for this reason. Financial institutions are also often the focus of governments implementing national standards and equally the focus of well publicised systemic failures in the AML/CTF regime globally (Shiel & Starkman 2020).

Profitability

Income from illicit funds

One of the potential benefits of money laundering is the increased fees earned on the administration of illicit funds flowing through and being loaned out by financial institutions. These increased fees lead to increased profits, benefiting the institution, senior executives and shareholders. The fees earned on financial flows do not discriminate, and this creates an incentive problem. Financial institutions are businesses, motivated by profit competing against other financial institutions, but must also comply with the spirit of the regime to detect and disrupt money laundering and terrorism financing (Albanese 2011; Unger 2007; Unger & Van Waarden 2009; Walker 1995).

Money laundering plays or has played an important role in the business of some financial institutions internationally. In these cases, bankers are either recklessly indifferent or allegedly actively involved in money laundering schemes, acting as facilitators to the money laundering (Bartlett 2002; Levi & Reuter 2006). In other cases, the acceptance of money laundering may not be widespread. But the bankers may be negligent or the money launderers reliant on a few corrupt employees within the financial institution who are personally profiting in addition to the flow of funds increasing the profits of the financial institution (Levi & Reuter 2006; Redhead 2019).

Just as there are no accurate estimates of the scale of money laundering, there is limited information available on the value of fees to be earned by financial institutions involved in money laundering. However, it is alleged to be highly lucrative. Investigations involving leaked documents estimate the fees earned from illicit funds for one customer alone in the United States was half a billion dollars (Tatone 2020). Even if financial institutions considered the potential for enforcement action from the regulator in their risk analysis, the fees generated from money laundering may make it profitable, particularly in the short term. To avoid enforcement action while still benefiting from illicit funds, financial institutions may implement the AML/CTF regime to meet minimum requirements rather than to aggressively target money laundering (Albanese 2011; Pol 2020). Conversely, the fees may be generated from illicit funds completely unbeknownst to the financial institution.

In the Australian context, interviews with stakeholders from the financial sector did not support the literature indicating that illicit funds have a positive impact on profitability. It is notable that these stakeholders, as regulated entities, may have a vested interest in minimising the potential positive impacts of money laundering. However, the reasoning provided—that suspicious funds usually moved quickly through institutions rather than contributing significantly to an institution's profits—could be supported by well publicised examples, such as the Commonwealth Bank's intelligent automatic teller machines (*Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Limited* [2018] FCA 930). Further, stakeholders noted that, even where the potential exists for the financial institution to benefit in relation to profitability from customers, the risk of maintaining relationships with potentially criminal customers is so high that it exceeds any potential benefits. Additional impacts on profitability raised by stakeholders in relation to high-risk customers include the resources required to monitor their transactions and the resources involved in exiting customers. It is relevant that this only relates to customers who have been identified as high risk or suspicious. It is highly possible that profitability is impacted by money laundering and illicit funds that have not been identified. Generally, in relation to profitability in the financial sector, stakeholders indicated that the costs of non-compliance far exceed any potential benefits. However, interviews with other stakeholders suggested there is a public perception in Australia that financial institutions benefit in terms of profits from money laundering.

Similar risks apply to other products and services subject to AML/CTF oversight, which also have the potential to earn increased fees from illicit funds—particularly gambling and casinos. The opaque nature of services offered to VIP clients, who make up the majority of casino revenue, suggests attracting illicit funds may be part of the casino business model (Kleiman 2015). In support of this, stakeholders suggested that the gambling sector, and casinos in particular, have a greater ability to profit from illicit funds. Some stakeholders suggested the success of the casino business model is perceived as being dependent on illicit funds. However, as discussed later in this section in connection with reputation, casinos are also impacted by the connected harms of illicit funds that may result in a long-term decrease in profitability.

Stakeholders from other gambling services noted the biggest impact on profitability was that competing entities did not comply with the AML/CTF regime to the same standard. As a business that is not wholly account based, stakeholders suggested that customers, including those who are not suspected to be criminals, were not tolerant of AML/CTF policies that impact on their time and the services they are offered. Stakeholders suggested smaller, less established entities with less sophisticated AML/CTF policies and lower visibility to the regulator were able to enter the market and held a competitive advantage as they were less sensitive to risk and this attracted customers.

Costs of the AML/CTF regime

Financial institutions and other reporting entities are required to invest resources, which can be significant, in implementing the systems necessary to comply with the AML/CTF regime (Redhead 2019; Sathye 2008). Failure to comply with these regulations can also incur significant penalties arising from enforcement action, as evidenced by the recent action taken against Commonwealth Bank and Westpac (*Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Limited* [2018] FCA 930; *Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Westpac Banking Corporation* [2020] FCA 1538). This is in addition to the costs associated with money laundering activity that might occur when financial institutions and other reporting entities fail to comply with the regime (costs that might be avoided by complying with the regime). Stakeholders suggested that, in Australia, the cost of compliance was very high but the cost of non-compliance was much higher. Costs of non-compliance extend beyond enforcement action and include the significant costs of remediation work, which outweigh the costs of implementing effective systems in the first place.

Conversely, the existence of a comprehensive regulatory regime—and the associated costs—can increase the profitability of financial institutions by creating a less competitive market. Larger financial institutions are able to use their advantage as an economy of scale to compete against smaller services (Alldridge 2008). Relatedly, the power of larger institutions can also be applied more directly due to the discretionary nature of the risk-based regime. The discretion allowed means the risk appetite of the financial institution may vary depending on the profitability of the customer, with a higher risk appetite for a more profitable customer. However, in the Australian context, stakeholders suggested that these customers carry a level of financial risk that cannot be supported due to the wider impacts on profitability and reputation, which may be the result of recent regulatory focus.

The literature suggests a reporting entity may also consider whether the customer is also a competitor to the financial institution, such as a remittance service, and apply their discretion in determining risk accordingly. The AML/CTF regime in this regard may be economically beneficial for the financial institution but socially harmful for those in the community who rely on remittance services and become financially excluded. The low risk appetite for smaller, less profitable customers has been analysed through the trend of financial institution debanking (De Koker, Singh & Capal 2017; Mason 2017; McGough 2016). Debanking is the closure of accounts based on a risk assessment of the customer. The AML/CTF regime is not the only driver of debanking, but issues associated with money laundering and terrorism financing are directly or indirectly the main drivers (De Koker, Singh & Capal 2017). In this way the regulatory regime can be used to justify risk averse decisions that result in the elimination of competitors. For example, following wholesale account closures of remittance service providers, Westpac launched a competing product known as LitePay. LitePay held many if not more of the same risk factors as the remittance service providers but contributed to the financial institution's profits (Eyers 2016). Stakeholders in the financial sector acknowledged the harm of financial exclusion, but noted that there were serious financial risks that the sector was required to consider. Where those services may be small, unsophisticated or not capable of meeting their own AML/CTF obligations, that risk could not be supported by the financial sector.

Conversely, those working in the remittance sector, and representing entities that could objectively be considered established, sophisticated and compliant with other forms of regulation, also expressed concerns around the debanking of services by financial institutions. These stakeholders did not meet the definition of high risk identified collectively by financial institutions—small, unsophisticated and not capable of meeting AML/CTF obligations—and the debanking of services was limited to certain financial institutions. However, it is possible there are other factors that financial institutions consider when applying their discretion in determining risk and debanking.

The debanking trend impacts most heavily on the migrant community, who commonly use remittance services to send low-value funds to family in developing countries. This has a broader social impact on developing countries, which rely on remittances for basic needs and the longer term reduction of poverty (Stanley & Buckley 2016). Stakeholders identified that this may have a particularly high impact on some countries in the Asia-Pacific region. This is relevant to Australia, both because of the communities living in Australia who rely on these services and because of the potential effect reducing the transfer of funds to other countries would have on the relationship between Australia and its neighbours.

While debanking decreases the profits or forces the closure of registered remittance service providers, it increases the profits of unregistered and informal remittance service providers by driving customers who have been financially excluded underground. Driving customers underground to services where no oversight exists increases the risk of money laundering and terrorism financing (Mason 2017).

Illegal business drives out legal business

As noted, there are many direct and indirect consequences of money laundering and the AML/CTF regime that result in increased profitability for financial institutions and other designated services. However, the profits are from illicit sources, and this may reduce the profits generated from more desirable legal sources. As will be discussed further when considering the consequences for a financial institution's reputation, failing to effectively implement an AML/CTF regime can be interpreted as competing for illicit funds or being recklessly indifferent to their presence. This sends a signal to other money launderers and criminal organisations that the institution tolerates money laundering—a message amplified by public identification.

It follows logically that a financial institution's association with money laundering will be undesirable for a legitimate business and may result in more legal business leaving the institution. However, Alldridge (2002) identifies that there is no evidence to support this other than anecdotal examples and this should be treated sceptically. In addition, it is unclear what the net effect on profitability would be of increased illegal business and decreased legal business, as the speculated scale of money laundering suggests illegal business is more profitable.

While the gambling sector still experiences the negative effects of association with money laundering, stakeholders also raised the net effect of this illegal business on profitability. The suggestion that the casino business model generates the most revenue from VIP clients with lower transparency and higher betting limits implies that, if the business of some legitimate clients were driven out by clients laundering money, this may still have a net positive effect on profitability.

Reputation

As noted, illicit funds have the potential to increase the profits of a regulated entity. However, association with money laundering or terrorism financing may also damage the entity's reputation. In addition, comparatively good compliance with the AML/CTF regime could be a point of difference between an entity and its competitors. Whether these are costs or benefits to an entity's reputation will depend the type of business an entity is attempting to attract.

Naming and shaming

The potential for reputational damage due to money laundering or terrorism financing emerges when a financial institution is publicly identified for failures in implementing the AML/CTF regime. This 'naming and shaming' may be a result of enforcement action taken by the regulatory body, amplified in the media or in documents leaked to the media. The public does not require a detailed understanding of money laundering or its broader impacts, as media attention is likely to focus on the lack of regulatory compliance or the alleged predicate offences.

The AML/CTF regime is just one of many risk management regulatory regimes applicable to financial institutions. A publicised failure to comply with the AML/CTF regime may lead customers or shareholders to question the financial institution's ability to implement and comply with risk management procedures generally, such as liquidity risk, legal risk and market risk (Bartlett 2002). This reputational damage could result in a loss of consumer and investor confidence, lost market share and ultimately reduced future profitability (Bartlett 2002; Ferwerda 2013; Levi & Reuter 2006; Redhead 2019; Unger 2007).

In addition, the suspicious matter reporting function of the AML/CTF regime in practice links specific failures to either suspected predicate offences or criminals. Stakeholders referred to the ability to make this link as developing the underlying narrative behind the regulatory breach, which can be more damaging than the regulatory breach itself. These links can be made when enforcement action is taken but also when reports are leaked.

Stakeholders referenced the challenges when suspicious matter reports or other documents are leaked, as they have been globally on a number of occasions over the last five years, in that this occurs without any context. Through global reporting, financial institutions have been linked to criminal syndicates, oligarchs and other corrupt officials, receiving widespread media attention for failure to effectively implement or enforce regulation (Tatone 2020). It is possible the institutions may have been taking separate action with regard to these issues but are restricted by legislation from addressing this, and this can end individual careers and damage the reputation of the institutions and of the whole sector.

Stakeholders from the financial sector acknowledged the general public have been somewhat desensitised to money laundering regulatory action despite the effect on share prices and increases in customer complaints. However, the media often focus on the underlying narrative, such as the predicate offences, and this is what has the potential to cause reputational damage. This is particularly the case when a financial institution is associated with criminal activity that causes heightened community outrage. In the Australian context this was observed in relation to Westpac and transactions consistent with child exploitation (Butler 2019). The headlines linking Westpac to child exploitation are potentially damaging to the financial institution's reputation, even if customers do not specifically lose confidence in the financial institution's ability to manage financial services. This negative media attention could damage the financial institution's reputation in large sectors of the community, resulting in a loss of social capital. This loss of social capital may result in a similar loss of consumer and investor confidence, lost market share and, ultimately, lost future profitability. Stakeholders in the financial sector also noted the compounding effect: an inability to gain positive media coverage. In Australia, many financial institutions work closely with the regulator as part of the Fintel Alliance, contributing resources to further investigations, but feel they are generally unable to gain recognition or publicity for the positive outcomes achieved.

Some stakeholders agreed that money laundering affected the reputation of financial institutions, while others were sceptical and felt the public were completely desensitised to money laundering scandals. However, it is also possible that the magnitude of the reputational damage would be small, especially when compared with the economic cost to financial institutions of remediating and adjusting their risk tolerance following enforcement action.

In these circumstances, reputational damage may be confined to specific financial institutions. In the case of financial institutions being linked to widespread money laundering or significant flows of dirty money, the reputational damage is likely to extend from the individual institutions to the financial sector more generally. The consequences of the financial sector more broadly having a negative reputation are explored further in relation to the national reputation. However, these consequences also individually impact on the financial institutions and may result in reduced global opportunities, reduced access to international financial markets, slower transactions due to enhanced due diligence and therefore more expensive transactions (Attorney-General's Department 2016; Bartlett 2002; Ferwerda 2013; McDowell & Novis 2001; Unger 2007). Stakeholders raised the importance of correspondent banking relationships and the impact of reputational damage to institutions or the sector more broadly that may lead to enhanced scrutiny due to the perception of risk. This also supports the notion that comparatively good compliance with the AML/CTF regime can be an advantage. Institutions and the whole sector benefit from a low-risk reputation, with reduced delays when relying on correspondent banks if the correspondent banks do not assess a need to undertake enhanced due diligence.

Conversely, some international stakeholders suggested that the reputational impact on casinos was greater than that experienced by financial institutions. This was because money laundering scandals involving financial institutions occur more regularly, meaning the public has become desensitised to them and any effects are short lived. In contrast, casinos may face more severe consequences, including impacts on licensing arrangements.

The different relationship that customers have with their financial institution, compared with a gambling entity, was also considered. The risk of reputational damage following enforcement action affects casinos because clients, particularly VIP clients, may believe enforcement action will have a negative effect on the level of service provided by a casino due to resources being reallocated to compliance. This may be particularly true for international or interstate clients. The reputational damage may be different for non-VIP clients and local clients, who in some Australian jurisdictions have only one casino to attend.

Customer confidentiality

Another element of reputational impact raised in connection with enforcement of the AML/CTF regime explored briefly in the literature relates to lost confidentiality and the reputation an institution may gain for reporting on customers (Pellegrina & Masciandaro 2008; Unger & Van Waarden 2009). This harm may be more significant in jurisdictions where, despite the AML/CTF regime, the sector or specific institutions are known to have higher financial secrecy or be less cooperative with law enforcement. This concern could be more widespread if compliance with the AML/CTF regime were voluntary. However, in most jurisdictions, including Australia, it is a legal requirement to report on certain transactions. Unless a financial institution intends to attract illicit funds, compliance with reporting obligations is likely to be less harmful to a financial institution's reputation than an association with money laundering. It is possible reputational harm could result from risk-based reporting where there is more discretion, such as suspicious matter reporting, particularly where a report is falsely flagged as suspicious. However, for this reason, among others, suspicious matter reporting is treated confidentially. This was not supported among Australian stakeholders. Given recent enforcement action, it is likely the broader reputational damage of non-compliance with the AML/CTF regime would outweigh the impact of any perceived breaches of confidentiality associated with the regime.

'Any publicity is good publicity'

The harm to the reputation of a financial institution associated with money laundering or terrorism financing has been widely speculated to be negative. However, a recent study has examined the impact of naming and shaming on a financial institution's profitability. As profit driven businesses, the motivation for building a positive reputation is future profitability. Ferwerda and Zweirs (2020) measured customer reaction to publicity around AML/CTF compliance failures through the proxy of annual deposit growth. The findings indicate public identification did not have the expected customer reaction. The media attention largely led to a growth in annual deposits, perhaps in keeping with the theory that 'any publicity is good publicity'. The research theorised the public identification resulted in two rounds of media attention for the financial institution. The first was negative, related to the compliance failings, but the second was positive, related to the financial institution addressing the issue (Ferwerda & Zweirs 2020). Ferwerda and Zweirs speculated the negative media attention may not have had the anticipated impact, for multiple reasons. Firstly, customers expect financial institutions to do anything to increase profits and are consequently not deterred when this involves illicit funds. Secondly, it is possible that the increased annual deposit growth was a result of the compliance failure attracting additional criminals and money launderers to the financial institution.

Stakeholders did not support the view that any publicity is good publicity in relation to money laundering and its impact on reputation. Rather, the more common view was that this publicity is negative and, because of this, the financial institution must invest additional resources to avoid enforcement action (a cost borne by the institution).

Availability of credit

The direct and indirect impacts of money laundering and the AML/CTF regime discussed have the potential to benefit financial institutions through increased deposits and increased profits. One of the impacts that follow logically from this is the increased availability of credit for the financial institution to loan. Financial institutions create money by accepting money from depositors and lending it to borrowers (Kent 2018). This credit becomes available for legitimate businesses to borrow (Ferwerda 2013; Unger 2007; Unger et al. 2006). The indirect flow-on impact of this is the ability for legitimate business to grow and increase working capital, positively contributing to broader economic growth. An extreme example of this impact was noted following the global financial crisis in 2007. The Executive Director of the United Nations Office on Drugs and Crime, Antonio Maria Costa, stated there was evidence the proceeds of organised crime were the only liquid investment capital available to some banks on the brink of collapse (Ferwerda 2010; Levi, Reuter & Halliday 2018; Syal 2009). During and following the global financial crisis, many banks held toxic assets and had no liquidity, at a time when financial institutions required loans and other financial intuitions were unable or unwilling to offer short-term loans for liquidity. Some financial institutions failed or were bailed out by the government and other jurisdictions responded with monetary policy. However, Costa alleges some financial institutions had liquidity from illicit funds that were able to be loaned to other institutions, preventing the banks collapsing, further stating that most of the US\$352 billion of drug profits had been absorbed into the economy as a result (Syal 2009). However, no evidence was provided to support these claims. Stakeholders also did not provide evidence to support these claims in the Australian context.

Liquidity

As noted, increased deposits increase available credit. However, if the deposits are coming from illegitimate sources there is the potential for the money to behave in a less predictable manner. If the financial institution loans the illicit funds under the assumption the funds will behave normally, and this occurs at scale, this may put the liquidity of the financial institutions at risk (Bartlett 2002; McDowell & Novis 2001; Reuter 2013). Liquidity is the ability to access cash when needed and a financial institution's liquidity must be managed as banks borrow funds from short-term depositors and lend to customers for long periods (Australian Prudential Regulation Authority 2020).

The liquidity risk of money laundering is largely speculation, relying on the theory that illicit funds behave differently to licit funds. This is alleged to result from criminals being less predictable than other investors. By way of example, an investor motivated by economic logic is unlikely to withdraw funds from a term deposit before it matures if it will result in significant early withdrawal fees. In comparison, a criminal will be less concerned by these fees if they become aware law enforcement are interested in an account. This may result in the funds being moved despite the fee to avoid the full value being restrained. If large amounts of money are arriving and disappearing suddenly and without notice in response to non-market forces, this would present a liquidity risk (McDowell & Novis 2001).

The event that is often used to illustrate the liquidity risk that money laundering presents is the insolvency of the Bank of Credit and Commerce International (BCCI; Alldridge 2008, 2002; Reuter 2013; Reuter & Truman 2004; Unger & Rawlings 2008). BCCI was found to be actively involved in laundering large amounts of money and collapsed in 1991. The link is regularly made between the money laundering and the insolvency of BCCI. However, BCCI was also found to be undertaking fraud against depositors on a huge scale and it was not determined whether the insolvency was a result of the money being stolen or money being laundered (Alldridge 2008, 2002). In support of this counterargument, Alldridge (2016) considers the significant amount of money laundering that is likely to have occurred in Swiss banks since Swiss neutrality was guaranteed. Despite this, there have been no insolvencies attributable to money laundering. In addition, no insolvencies arising from the global financial crises were found to be a direct result of money laundering (Alldridge 2016). In the Australian context, stakeholders did not support the notion that money laundering impacts on liquidity. Liquidity risk is regulated in Australia and stakeholders opposed the idea that this risk may exist due to illicit funds behaving differently. Stakeholders noted that money launderers' main focus is ensuring illicit funds are behaving in the same way as licit funds to avoid detection. While it is possible there is an element of funds being withdrawn to avoid the interest of law enforcement, this is unlikely to be taking place at a scale that could contribute to a liquidity risk in Australia.

Summary and measurement

Money laundering has a number of impacts on the financial sector, gambling sector, remittance sector and other AML/CTF regulated sectors. In the short term, reporting entities operating in these sectors, particularly financial institutions, have the potential to benefit as illicit funds lead to increased fees. Increased fees lead to increased profits, benefitting senior executives, the institution and shareholders. Investigative reporting of specific cases globally indicates these profits are potentially significant. Despite the cost of compliance with the AML/CTF regime and the cost of any enforcement action it is possible, in the short term at least, the economic benefits outweigh the economic harms. However, in the Australian context, financial institutions did not support the view that money laundering provided a net benefit for profitability. This is because suspicious funds usually moved quickly through an institution, rather than contributing to the institution's profits. In addition, capitalising on suspicious funds would require financial institutions to either heavily monitor the transactions of high-risk customers or intentionally act outside the AML/CTF regime. The cost of doing this was considered significant. There was support for the idea that money laundering affects profitability in the gambling sector, although these benefits are likely to be short term. This is because, when a lack of compliance with the AML/CTF regime is detected, any benefits to profitability would be outweighed by the costs of remediation action and reputational damage.

Profitability is also impacted by the AML/CTF regime and the trend of debanking. Debanking can contribute to another potential economic benefit to a financial institution. However, from the perspective of financial institutions in Australia, when debanking occurs it is a necessary risk management decision. Conversely, the remittance sector identifies debanking as a power held by financial institutions to decrease competition. This is an economic harm to the remittance services, a social harm to the individuals left without access to the financial system and a social harm to the developing economies that rely on these remittances.

In the longer term, reporting entities, particularly financial institutions, may suffer economic harm from reputational damage due to association with money laundering. This reputational damage may lead to a loss of social capital and lost customer and shareholder confidence. This may reduce profitability in the longer term and reduce shareholder value. Reputational damage may also impact senior executives' reputations individually. The impact on reputation is considered a significant concern in Australia. This is true not only domestically but also in terms of the impact on correspondent banking relationships, where increased scrutiny would increase the cost of doing business. The impact on reputation for the gambling sector was also a significant concern, particularly with respect to the flow-on effects of further regulatory action.

Money laundering may economically benefit financial institutions by increasing the availability of credit, which is connected to increased profitability from deposits. However, there is limited evidence to that this occurs globally or in Australia. Similarly, no support was provided for the idea that money laundering impacts on liquidity risk as a potential economic harm in the Australian context.

The stakeholders interviewed had few suggestions with respect to how money laundering affects profitability in the financial sector and other designated services. One factor influencing this, consistent with the measurement of money laundering more generally, is the challenge of measuring something that is hidden. Profitability is affected whether money laundering is or is not identified, whereas impacts on reputation, for example, only occur when money laundering is detected. A further challenge in measuring the potentially beneficial impact of money laundering on profitability is those best placed to identify data that could measure this impact are the stakeholders who suggest that the impact is insignificant or non-existent. Given the challenge of measuring any unknown benefits on profitability, the most effective way of measuring the impact of money laundering on profitability may be to consider both reputation and profitability together. It may be possible to replicate a study undertaken by researchers in the Netherlands (Ferwerda & Zweirs 2020), which considered a financial institution's annual deposit growth following enforcement action where money laundering was identified and publicised. The recent enforcement action in Australia against financial institutions presents an opportunity to measure this relationship with respect to Westpac and the Commonwealth Bank.

There were multiple suggestions for how to measure the impact of money laundering on reputational damage. One suggestion as a starting point to understand the reality of reputational damage generally was a public perception survey. The purpose of the survey would be to gain information on public attitudes, such as whether there is a desensitisation to money laundering. In addition, the survey could explore the reasons reputational damage was or was not observed. Reputational damage may have occurred that was not immediately observed due to factors such as shareholders or customers intending to leave the financial institutions but being unable to do so due to fixed terms, for example.

A number of stakeholders also raised the potential to analyse the impact on the share price of reporting entities at different stages of enforcement action. This would consider the impact on both profitability and reputation and would also be possible in Australia following the recent enforcement action. Analysing share price in isolation holds challenges. There are a number of external impacts unrelated and related to the enforcement action, including the impact of certainty following enforcement action. However, it is possible these factors could be controlled for. Independent review rankings could be considered in isolation to measure the impact on reputation at different stages of enforcement action. Independent review rankings could also be considered in combination with the share price to examine the relationship between profitability and reputation at different stages of enforcement action.

Another potential measure of the reputational damage following enforcement action would be to consider the resources redirected by the profit driven business of reporting entities to other regulatory compliance issues. Reporting entities may hold internal measures of the costs of remediation, but another factor noted by stakeholders following enforcement action was the ongoing increase in regulatory action. Examples provided included action at the Commonwealth and state/territory level, such as the action taken by the Australian Prudential Regulation Authority against financial institutions following enforcement action taken by AUSTRAC. Similarly, the cost of ongoing state/territory licensing processes for the gambling sector could be measured. Previous enforcement action by AUSTRAC against Tabcorp and the current investigation into Crown Resorts presents an opportunity for this harm to be measured.

Stakeholders in the financial sector identified internal data sources such as customer complaints and net promoter scores following enforcement action as another possible measure. Given one of the main concerns for financial institutions was the impact of reputational damage on their relationship with correspondent banks, the cost of delays due to increased scrutiny is another possible measure of interest. However, this would be difficult to capture based on data available.

Private sector

Key findings

- The involvement of professional facilitators in money laundering provides short-term benefits to revenue at the individual and firm level, but long-term harms to industries through reputational damage and increased regulation. There was agreement among interview participants regarding the involvement of professional facilitators in money laundering in Australia and the connected revenue for these services.
- The idea that money laundering undermines legitimate business in Australia also received support, including the effect of unfair competition causing economic harm. Also raised was the potential for a cultural change to occur among legitimate businesses who become aware of unfair competition due to illicit funds and who may be struggling and looking to increase their own profitability.
- Australian stakeholders did not support the notion that money laundering could be of economic benefit to the private sector due to the increased availability of credit.
- The long-term harm of an artificial demand for industries was also not considered significant in Australia. However, the idea that money laundering contributes to an artificial increase in prices in the Australian context was supported, specifically as it relates to the real estate market.
- The growth of the AML/CTF compliance industry was considered a benefit of the AML/CTF regime, particularly in relation to increased enforcement at the level of compliance services and the impact on the regulatory technology sector.

Unlike the financial sector, individuals and entities in the wider private sector are not necessarily directly regulated by the AML/CTF regime. However, the private sector comprises individuals and entities that can financially benefit from the flow of illicit funds. Many of the benefits received by the private sector will occur in the short term. The costs of money laundering to the private sector are associated with effects on the public sector and economy, are less likely to be direct and occur in the longer term.

Professional facilitators

As noted, money laundering—particularly when it entails emerging and more sophisticated methods—benefits from the involvement of professionals such as lawyers, accountants and real estate agents. These professionals act complicity or unknowingly to assist money launderers through each stage of the money laundering process. This may include moving illicit funds through complex transactions, providing financial or taxation advice or assisting with the purchase or sale of assets such as property (Unger & Ferwerda 2011). Professional facilitators also enable the creation of complex legal structures to obscure beneficial ownership, which is necessary in many different money laundering typologies (Van der Does de Willebois et al. 2011). Whether a professional is complicit or unaware of their role, they are financially benefiting from the work and the fees or commission they are earning. If a professional facilitator is complicit, they may be even further compensated for the risk involved in dealing with illicit funds. Profits may continue to increase through signals to other money launderers. Beyond individual gain, this can support an offshore industry of professional facilitators (Wilson-Chapman, Cucho & Fitzgibbon 2019). A large proportion of stakeholders noted the involvement of professional facilitators was a concern in Australia. There was a view that professional facilitators were often involved where the value of the funds was higher, whether the professionals were complicit and unaware. This was often discussed in the context of integrating funds into assets such as real estate in Australia.

Increased enforcement of the AML/CTF regime may have the unintended consequence of increasing demand for professional facilitators, who can employ more sophisticated methods to avoid detection. Increased enforcement in one jurisdiction may also lead to increased demand for professional facilitators in another jurisdiction with higher financial secrecy: a displacement effect.

While potentially lucrative in the immediate or short term, there may be significant costs to professionals, organisations and the wider industry from their involvement in money laundering. When they are detected as being involved in money laundering, professional facilitators—even those assisting unknowingly—face reputational damage similar to financial institutions. This damage may reduce profitability from the loss of legitimate clients and their business in the long term.

Further, repeated involvement of professional facilitators in money laundering or terrorism financing activity could ultimately lead to the expansion of the AML/CTF regime (in jurisdictions such as Australia where these professionals are not already included), which would have significant compliance costs. Stakeholders also discussed the impact of money laundering leading to an increase in other forms of professional regulation.

Conversely, in jurisdictions where designated non-financial businesses and professions are regulated, the AML/CTF regime could have a harmful impact on the reputation of the legal profession, due to the tension between reporting obligations and legal professional privilege (Stouten & Tilleman 2013). This harm could occur even with legitimate business as legal professional privilege is considered an important right that should be protected. However, reporting obligations under the AML/CTF regime would not be the first challenge to legal professional privilege and this tension could be balanced.

Availability of credit

As noted, one of the benefits of money laundering and illicit funds in financial institutions is the increased credit available to loan, including to legitimate business (Ferwerda 2013; Unger 2007; Unger et al. 2006). The increased availability of credit allows legitimate business to borrow and as a consequence to grow, invest, innovate and hire more people, contributing to economic growth. However, while the increased availability of credit is a benefit to some legitimate businesses, other businesses may be being used as a front for money laundering and will not need to go through a legitimate loan process as they will have access to illicit funds. If these businesses are operating in the same market, the cost of this unfair competition is likely to outweigh the benefits of the increased availability of loans. Stakeholders also reported that any increase in credit that may be available domestically due to money laundering was not significant as businesses often consider international options for loans. This impact may still be relevant to the potential global increase in available credit due to illicit funds. However, as discussed with respect to financial institutions, a number of factors affect the availability of credit. Attributing changes in credit availability and any resulting potential benefits to Australian business to money laundering is difficult.

Crowding out of legitimate business

Traditionally, and dating back to how the term money laundering originated, cash intensive businesses continue to be used as fronts to launder funds. The use of front businesses involves comingling illicit funds and licit funds to produce a purportedly legitimate income. Through this process the business is subsidised by criminal funds, providing an unfair advantage over legitimate businesses operating in the market (Ferwerda 2013; Unger et al. 2006). Cash is still an important enabler in this process, but the same effect can be achieved through false or fraudulent invoicing, as is the case with trade-based money laundering (Cassara 2016).

Irrespective of the method, businesses that only have access to legal capital must compete with businesses that have access to illicit funds. These subsidised businesses are able to reduce prices and continue trading without making a profit (Jojarth 2013). This has a potential longer term impact on economic productivity due to the loss of legitimate businesses that are responsive to consumer demand and motivated by profit and increased efficiency (Bartlett 2002). Some international stakeholders were not supportive of this argument, noting that the obvious undercutting of prices would clearly be identifiable as suspicious activity to be avoided. In addition, these illegitimate businesses have the ability to make greater profits by directly competing with legitimate business, including setting prices at the same levels.

Other stakeholders perceived this impact to be more widespread. These stakeholders identified the impact of legitimate business recognising that competitors had access to illicit funds as something that could change the culture of the business environment, particularly among small business. For example, if a struggling small business was aware that competitors had an advantage, it could also look to become involved in illicit activity, such as by comingling funds to increase profitability. The impact of this may be particularly relevant in the current economic environment, where a large proportion of small businesses have been negatively impacted financially by the COVID-19 pandemic.

Artificial demand for industries

Conversely, a potential benefit of the increased flow of funds in the local economy is the increased funds available for local investment and the resulting increased demand for industry. In the short term this increased demand may create jobs and increase wages. Criminals looking to invest in business for the purpose of laundering funds often target specific sectors based on their characteristics. These characteristics may include regular cash transactions, high-value transactions, lack of transparency, under-regulation or a connection to entertainment. Sectors with some or all of these features that have been identified as higher risk over time include construction, import and export, hotels, restaurants and nightclubs (Masciandaro, Takáts & Unger 2007; McDowell & Novis 2001; Romero 2020).

In the longer term, however, this may create an artificial demand for particular industries, with negative effects. In some countries, certain industries in their entirety may be financed by criminal organisations (McDowell & Novis 2001). These industries often serve a short-term purpose for the criminal organisation and, when another money laundering method or location offers a lower transaction cost or another advantage to the criminal organisation, they will abandon the industry, causing it to collapse and causing significant damage to the economy (McDowell & Novis 2001). Romero (2020) cites anecdotal examples in regions such as Cancún, Mexico, where a mismatch between supply and demand in real estate can be observed and businesses such as restaurants and bars appear to operate without making any profit. However, despite the potential impact on the Australian real estate market (discussed below), this level of artificial demand for certain industries does not appear to be supported in the Australian context.

Artificial increase in prices

When a jurisdiction tolerates the flow of illicit funds, criminal organisations become comfortable with a location and eventually set up business there (Romero 2020; Unger & Rawlings 2008). Following the initial injection of money that can benefit professional facilitators, local business, local government revenue and economic outcomes in the short term, the longer term consequences include an artificial increase in prices.

The 'bad money driving out good money' phenomenon occurs when criminals are motivated to integrate their potentially incriminating funds into an asset that appears legitimate and, in deciding where to invest, they will not prioritise the price they pay (Walker 1995: 37).

Criminals investing illicit funds are likely to outbid legitimate buyers, who are more concerned with affordability or the value of the investment. This allows criminals to gain a greater share of a particular market or segment of the economy (Masciandaro, Takáts & Unger 2007). This phenomenon is often analysed in the context of the real estate market, as a high-value and non-transparent market, but also applies more broadly (Unger 2007; Unger et al. 2006; Unger & Ferwerda 2011; Walker 1995).

Interestingly, stakeholders did not identify the general increase in the price of goods and services due to money laundering as a phenomenon in Australia. However, a large proportion of stakeholders did focus on the Australian property market and, in particular, the integration of illicit funds from domestic and international sources leading to an increase in the value of property. The Australian property market was identified as one that is high value and stable and therefore attractive to criminal organisations seeking to integrate large volumes of funds. There was a general view that this was a feature of the Australian real estate market and likely to grow. Some research has explored suspicious property transactions and the indicators of these transactions in the real estate market (Canada Mortgage and Housing Corporation 2020; Unger & Ferwerda 2011). However, research extrapolating the impact of illicit funds on a potential increase in housing prices has not been conducted.

In the housing market, money laundering may artificially increase prices to the point where ordinary buyers cannot compete. This further increases the burden on public revenue as the government dedicates resources to support legitimate buyers attempting to enter the market. This leads to further indirect social and economic harms in the longer term. While acknowledging housing affordability is a much broader issue, money laundering can contribute to the problem, with buyers being priced out of the market. Stakeholders identified this as a distributional harm. It increases capital in the economy but disadvantages the law-abiding middle-income population.

The indirect social consequences of this may be heightened in the future, given the growing divide between home owners and renters. Ultimately, if a larger percentage of the population retire as renters, there is further income inequality in retirement and the possible subsequent social costs of those renting being more likely to experience poverty (Daley & Coates 2018).

Growth of the AML/CTF industry

There are also private impacts associated with the AML/CTF regime introduced to respond to money laundering and terrorism financing risks. The AML/CTF regime is one of many regulatory regimes that has directed private sector attention towards the need to invest in compliance services and consulting, benefiting those providing these services. Stakeholders identified this as an impact in Australia and suggested it was heightened by enforcement action that had raised the awareness among boards and senior executives of the need to carefully manage AML/CTF risks. Stakeholders noted there was a high demand for education and consulting services, and that businesses at risk were willing to invest in these services. Entities were likely to be proactive, and there was a need for more skilled persons and professional qualifications in compliance to meet this demand. This was not limited to local entities. International corporations that offer services in Australia had reportedly recognised the need to gain a greater understanding of the AML/CTF regime in Australia due to recent enforcement action.

However, the industry is not limited to services. Increased enforcement also increases the demand for technology-assisted solutions, which are more efficient and cost-effective. Simultaneous advances in technology have led to the emergence and rapid growth of the regulatory technology (RegTech) industry. International stakeholders considered Australia to be a global leader and a regional hub for the financial technology (FinTech) and RegTech industries, which could be further capitalised on.

Increased enforcement and increased sanctions or reform in the AML/CTF regime have obvious compliance costs for reporting entities. However, while acknowledging reporting entities cannot outsource their legal obligations, reform or increased enforcement may prompt entities to invest in solutions that reduce the administrative burden. In the context of the AML/CTF regime, RegTech solutions can be used to monitor suspicious activity, automate compliance and manage risk.

Increased investment and growth in the industry can have broader benefits for the economy. Approximately 13 percent of RegTech solutions are currently based in Australia and Australia is considered well placed for further development, with stable and sophisticated regulatory systems (Productivity Commission 2020). Regulators also benefit from advances in RegTech, including through widescale monitoring of activity that may have previously been impossible or too expensive to monitor (Productivity Commission 2020). In addition, the growth in the RegTech industry could ultimately reduce the impact of large entities having a competitive advantage as an economy of scale, with more cost-effective solutions allowing smaller entities to comply with regulation. One of the benefits of the AML/CTF regime and its increased enforcement is this prompt for investment in an industry that increases efficiency and hence productivity in the economy.

Informal remittance sector

One of the objectives of the AML/CTF regime is to increase the integrity of the international financial system (FATF 2019). However, advancing this objective requires a balance, because applying this strictly in financial institutions could reduce financial inclusion, a social cost. The remittance sector, including informal or unregistered remittance services, addresses this financial inclusion gap. It provides services to members of the community who otherwise would not be able to engage with financial services because, for example, the region they are sending funds to is unbanked, the transaction cost is too high, or identity documentation is difficult or impossible to obtain (Jojarth 2013; Stanley & Buckley 2016).

Further, increased enforcement in the regulated remittance sector could lead to higher administrative costs for transactions, which may be passed onto customers, in conflict with global financial inclusion goals (Global Partnership for Financial Inclusion 2020). In addition, financial institutions may reassess the risk of customers who previously had access to the formal banking sector, resulting in these customers losing access. A result of this may be that more customers will gravitate towards the informal or unregistered remittance sector. This is beneficial to the sector, which will experience increased profits due to increased customers and transactions. However, this benefit is limited to the sector as it operates entirely outside the broader economy. The benefits of increased taxation revenue, which would otherwise result from increased profits, will not be realised. In addition, despite the existence of the informal remittance sector, payments such as those made by migrants sending funds to their families in developing countries may still reduce. This would have a broader social impact on developing economies in the region (Jojarth 2013). Stakeholders also noted that the existence and ongoing functioning of an informal remittance sector can reinforce the legitimate remittance sector. In the event there is an issue with other methods of transferring funds, even for a short period of time, funds can still move through this sector, providing benefits to the individuals, communities and economies that would otherwise be impacted. In the Australian context, with advanced financial systems and a number of registered remittance options available, this may be less significant.

Summary and measurement

The impacts of money laundering in the private sector include the short-term economic benefits to the revenue of professional facilitators and longer term economic harms resulting from reputational damage and increased regulation. Compliance with the AML/CTF regime has financial implications in jurisdictions where it applies to professional facilitators. Measuring the extent to which the Australian professional services industry may be supported internationally by money laundering could include analysis of available data on the export of financial services and suspicious indicators.

Businesses in general in the private sector can benefit less directly from the increased availability of credit due to the illicit funds deposited in financial institutions. However, this economic benefit is outweighed by the economic harm of competing with businesses with direct access to illicit funds, eventually leading to the loss of legitimate business. Stakeholders did not believe money laundering affected the availability of credit in Australia.

The potential exists for money laundering to undermine legitimate business in other ways, and this idea received some support among stakeholders. This could be measured by analysing insolvencies. This would involve identifying specific business that may be attractive for use as front businesses and comparing their insolvency rates with those of other business types. If money laundering does occur more often in certain sectors, this may result in a greater insolvency rate for legitimate businesses in the same sectors. International stakeholders noted the industries and businesses targeted for involvement with money laundering were likely to differ in each jurisdiction, but could be identified from cases in which individuals have been prosecuted for money laundering or from suspicious matter reports. The impact of COVID-19 related insolvencies and other factors likely to affect insolvency rates in certain businesses would need to be taken into account.

On a larger scale, there was no support among stakeholders for the suggestion that money laundering contributed to a demand for industries (a short-term economic benefit) or the collapse of industries due to this demand being artificial (a long-term economic harm).

In the short term, illicit funds can also lead to an increase in prices, which can be beneficial to those who hold assets. In the longer term, this is economically harmful as the increase is artificial and legitimate buyers are prevented from entering the market. In markets such as real estate, this can lead to further social harms as it reduces housing affordability. There was considerable support for the idea that the real estate market could be impacted by money laundering in the Australian context. It would be possible to replicate in Australia research undertaken in the Netherlands to identify suspicious property transactions and to model the effect on housing prices and affordability (Unger & Ferwerda 2011).

Compliance industries in the private sector also benefit indirectly from money laundering and terrorism financing when increased enforcement or expansion of the AML/CTF regime leads to investment in the industry. This investment is a further economic benefit as it increases efficiency and productivity. Analysis of this impact in Australia at a micro level could consider changes in the remuneration offered to professionals in the compliance sector following events that heighten awareness of the AML/CTF regime, such as enforcement action. Assessing the impact of money laundering and the AML/CTF regime in Australia on the FinTech and RegTech industries would require measuring the investment and growth in these industries that is attributable to products related to AML/CTF compliance. For example, reviewing the analysis undertaken by the Productivity Commission (2020) on the RegTech sector, it could be possible to estimate the productivity improvements attributable to the AML/CTF regime and the benefits to the economy.

The informal remittance sector also benefits economically from increased enforcement or expansion of the AML/CTF regime; however, these economic benefits are limited to the sector and do not contribute to the economy more broadly. Any attempt to measure the informal remittance sector presents challenges. However, the impact of debanking on the registered remittance sector and the impact on developing economies of reduced remittances could be measured at a macro level. This would involve analysing international funds transfer instructions over time.

Public sector

Key findings

- The most significant impacts of money laundering in the public sector relevant to Australia are on public revenue and the national reputation.
- Despite the potential for money laundering to increase some forms of tax revenue at the local government and state and territory level, the connection between money laundering and tax evasion at the national level is likely to be a net harm to the economy. In addition, the costs of not having an effective AML/CTF regime are likely to outweigh the costs of public expenditure on the AML/CTF regime.
- The impact of money laundering on corruption, the undermining of the government, trust in public institutions and threatened privatisation are not viewed as significant in Australia, when compared with other jurisdictions.
- The impact of the AML/CTF regime on privacy is a social harm relevant to Australia, although one that is less tangible.

The public sector is impacted directly by money laundering, terrorism financing and the AML/CTF regime through prevention and enforcement costs. The public sector is also indirectly impacted by the costs and benefits of an injection of illicit funds into the financial sector and the private sector. The consequences of these costs are not only macroeconomic; when crime and corruption are rewarded, they can affect the whole of society by undermining democracy and the rule of law (Alldridge 2008; Bartlett 2002; McDowell & Novis 2001).

Public revenue and expenditure

Money laundering impacts on government revenue and expenditure in direct and indirect ways. Public revenue, which includes taxation revenue at local, state and national levels, is affected by the performance of the economy. Growth in the economy from money laundering will contribute to public revenue, whereas the opposite is true where money laundering has a negative effect on growth. These benefits may be experienced in the short term and harms may be experienced in the long term. Public sector expenditure includes the cost of government services such as law enforcement and the cost of implementing and monitoring regulation such as the AML/CTF regime.

National revenue

At the national level, the main component of Australian Government revenue is personal income tax, followed by company tax (Parliamentary Library 2020). Most research on national tax revenue focuses on either tax evasion as a predicate offence to money laundering or the similar techniques used in tax evasion and money laundering (Quirk 1996; Unger et al. 2006; Walker 1999).

The early focus on following the money and money laundering was also tax evasion related. Despite the existence of other offences, tax evasion was a point of weakness for criminal organisations where charges could be laid. In general, taxpayers will not declare income generated directly from unlawful sources such as drug trafficking, and tax is therefore not paid on this income. In addition, income that was generated from an otherwise lawful employment activity becomes the subject of tax evasion when the income is not reported or is under-reported, such as in the shadow economy. Whether the tax that should have been paid to the government on this otherwise legitimate income is proceeds of crime will depend on domestic legislation (Alldridge 2002). In Australia, the criminal offence of obtaining a financial advantage from the Commonwealth or fraud may apply and the unpaid tax on the income may be classified as proceeds of crime. Possession of the funds may therefore meet the Australian definition of money laundering, being dealing in the proceeds of crime. Regardless of the criminal offence, this is a loss of government revenue.

The related techniques involved in tax evasion and money laundering include the use of complex corporate structures and offshore financial centres to reduce the amount of tax to be paid or to disguise the beneficial ownership and control of funds. These strategies result in decreased tax revenue and this can be particularly harmful for developing economies, reducing their ability to effectively fund the government and public services. In the Australian context, tax evasion (especially through refund fraud) was also considered an issue with long-term consequences. In addition to reducing public revenue, it can involve illegal phoenix activity, which directly impacts on employees' missing wages, superannuation and entitlements. There was a view that this has the potential to increase in coming years. Stakeholders suggested the economic response to the COVID-19 pandemic could increase fraud against the Commonwealth, increasing the tax burden for future generations.

However, considering the purpose of money laundering is to conceal the sources of the illicit funds, the opposite can also be true, and money laundering may increase tax revenue. To distinguish between the predicate offence that generated funds and money laundering, the process of money laundering aims to integrate funds from an illicit market into the licit economy—funds that without money laundering would remain in the illicit economy. In this sense, the money laundering process is simply a means to pay tax by investing in a cover business to yield a lawful income (Alldridge 2016). While this is one method of money laundering, stakeholders suggested this was not capable of producing a net benefit.

State and local government revenue

Money laundering can also increase state and local government revenue (see the *Corruption* section, below), where the injection of illicit funds contributes to the local economy, including taxation (Romero 2020). However, this increase may only be short term and, as noted, may also contribute to an artificial demand for certain industries being supported by illicit funds, and these industries are later allowed to collapse when no longer required (Masciandaro, Takáts & Unger 2007; McDowell & Novis 2001; Romero 2020).

Some stakeholders also noted the contribution the gambling sector makes to state and territory tax revenue. This sector may account for approximately 10 percent of state and territory tax revenue, and the proportion has been trending upwards (Productivity Commission 2010). Money laundering in the gambling sector may contribute to an increase in revenue.

Further, in Australia, the sole source of local government taxation revenue is a tax on land value (Australian Bureau of Statistics 2020). Where the integration stage of money laundering involves the purchase of property, which is speculated to occur often, this may increase land tax and local government revenue (Unger & Ferwerda 2011). This effect can also be felt nationally where funds enter Australia such as in circumstances of 'capital flight' and foreign investors seeking approval.

Expenditure

Any increases in national, state or local government revenue as a result of money laundering must be balanced with an increase in government expenditure. If revenue increases in the short term as a result of the injection of illicit funds into the economy, the long-term impact may be an increase in crime levels. Increases in crime levels increase government expenditure directly through an increased need for services such as law enforcement. Increased crime levels also increase government expenditure indirectly through consequential costs. For example, illicit drug trafficking—the financing of which is enabled by money laundering—affects the health of users, which increases the need for health services and related expenditure in the longer term (McDowell & Novis 2001). There is some overlap with the impacts considered in the section *Crime and criminal justice*.

Administering the AML/CTF regime is also a government cost, and this cost can be disproportionality high for developing countries. Expenditure on the AML/CTF regime is not limited to the cost of implementing regulation; rather, it also includes the cost of monitoring obligations, education and enforcement action. Some of these costs may be recoverable from the private sector in some jurisdictions, while other costs will be indirect. In Australia, the cost of running AUSTRAC is recovered through an industry contribution levy. However, indirect costs may include contributing to the global AML/CTF regime with assistance to identify, freeze and confiscate assets on behalf of other jurisdictions undertaken by other government agencies.

The cost of the AML/CTF regime and associated expenditure is often cited by critics in connection with its lack of evidence base and the lack of evidence supporting the identified harms of money laundering (Alldridge 2002). However, the costs are rarely considered by FATF or other regional bodies as it is taken for granted that the positive welfare impact of taking action against money laundering and terrorism financing will have a net benefit (Levi, Reuter & Halliday 2018).

Despite the high costs of the AML/CTF regime, the costs of non-compliance with international standards could be higher, potentially including damage to the national reputation. Comparisons between Australia and countries that have been blacklisted may be problematic. Countries that have been blacklisted have different economic characteristics to Australia, making a direct comparison difficult. In addition, a complete disregard for international standards could be viewed as competing for criminal money and may result in the ‘Seychelles effect’ of reduced foreign investment (Unger & Rawlings 2008).

Corruption

There is a close and interconnected relationship between money laundering and corruption. Money laundering and corruption feed into each other. Money laundering often requires the involvement of corrupt officials to succeed and, where corrupt officials receive substantial payments, they may need to legitimise the payments to prevent confiscation (Jojarth 2013; Levi, Dakolias & Greenberg 2007; Romero 2020). Money laundering can also dissociate funds or hide beneficial ownership to evade targeted sanctions against corrupt regimes (Jojarth 2013).

Corruption is a significant social cost that can undermine democracy and the rule of law, erode economic development and increase the cost of legitimate business (Albanese 2011; Bartlett 2002; Levi, Dakolias & Greenberg 2007). On a global scale, illicit funds and money laundering can connect corrupt authorities through the international economy supporting kleptocratic regimes (Burgis 2020).

Corruption incorporates a broad range of often connected behaviours and criminal acts such as embezzlement, fraud, bribery and extortion, and aiming to bypass lawful process using public office for private gain (Albanese 2011; Levi, Dakolias & Greenberg 2007). The AML/CTF regime considers the issue of abuse of public office, with FATF recommendations around ‘politically exposed persons’ which aim to identify potentially corruptible officials (FATF 2020c; Levi 2002).

Globally, law enforcement is perceived to be the most corrupt institution and corruption in law enforcement directly enables crime, including money laundering (Pring 2017). Corruption and bribery are not evenly distributed and studies from the Netherlands indicate there is very little corruption and bribery in law enforcement (Unger et al. 2006). Australia sits at a comparable level (11) to the Netherlands (8) on the global Corruption Perceptions Index, which ranks perceived levels of corruption in the whole public sector, inclusive of law enforcement (Transparency International 2020).

Influences on corruption levels

The impact of money laundering on corruption levels within a jurisdiction is complex. The common assertion is that higher levels of corruption are associated with higher levels of crime and money laundering (Bartlett 2002; Levi, Dakolias & Greenberg 2007). This is unsurprising as corruption is a crime and corrupt officials can lower penalties for criminals, including money launderers, which has the effect of adjusting the risk analysis for the potential criminal (Ferwerda 2009). However, Walker (1999) considers that higher levels of corruption may also deter money laundering as the corrupt official's money will be at risk due to the corruption. In this sense, the corruption may extend to easily corruptible officials at institutions entrusted with the funds, or instability in the region could lead to a change in government, putting the funds at risk of confiscation. Of course, this may only deter money laundering within the same jurisdiction. As a transnational crime, it is likely corrupt officials will launder the money offshore, in jurisdictions where the rule of law is stronger and the financial system is more advanced (Bartlett 2002). Smaller economies are less desirable for laundering funds than larger, more advanced economies, where large amounts of money can be more easily hidden (Walker 1999).

The direction of these financial flows contributes to capital flight, further harming the economic development of smaller developing economies. The Corruption Perceptions Index indicates financial hubs such as Singapore or Hong Kong and jurisdictions considered to have high financial secrecy such as Switzerland—'an iconic laundering nation'—rank very low on the Corruption Perceptions Index (Levi & Reuter 2006: 291; Transparency International 2020). Therefore, the relationship between potentially illicit fund flows and corruption may also depend on the direction of funds and the stage of the money laundering process.

Corruption is by no means exclusive to developing economies; however, like money laundering, it can have the greatest impact on developing and smaller economies. The speculated scale of money laundering can produce an economic power that corrupts all elements of society, and corrupted officials have the economic power to gain control of large sectors of the economy (Levi & Reuter 2006; McDowell & Novis 2001; Unger et al. 2006). Capital flight from developing nations also reduces the tax revenue available to fund government services, further contributing to inefficiencies and underfunding that can normalise the payment of bribes for services. In the Australian context, corruption was not perceived to be as big a problem as it was in other jurisdictions. However, Australia could be at risk of reputational damage if there is a perception the Australian economy is financially benefiting from the proceeds of corruption flowing from other jurisdictions.

Due to the interconnected nature of money laundering and corruption, the AML/CTF regime may address corruption by detecting illicit financial flows and eventually confiscating assets. However, Walker and Unger (2009) also consider that a more effective AML/CTF regime may result in corrupt officials needing to involve a greater number of other officials in the corrupt conduct, to gain greater control and reduce the possibility of prosecution.

Local public officials are likely to directly and more immediately experience the benefits of money laundering through the injection of illicit funds resulting in economic improvements, job creation and development in their communities (Romero 2020). These short-term economic benefits reflect positively on local officials and have the potential to increase their popularity and local tax revenue, disincentivising the local officials from reporting suspicious activity such as the unclear source of funds. Romero (2020) found the long-term impact of corrupt officials allowing money laundering at a local level to be an increase in crime and violence that outweighs the short-term benefits when more criminal organisations enter the region. However, this lag between the short-term benefits and long-term harms that may occur years later is likely a sufficient disconnect for the official considering their personal interests.

Trust in public institutions

The impact of corruption and bribery is very closely linked to trust in public institutions. Democracy is undermined when officials misuse their public position for personal gain and the public loses trust in the government's ability to act in the community's best interest (Albanese 2011). High levels of crime or terrorist activity also undermine the legitimacy of government and its ability to provide security and conditions favourable to economic growth (Jojarth 2013). In some jurisdictions, public officials may become indistinguishable from organised crime groups attempting to increase their control through politics. Corruption and bribery can also be used to interfere in the political process or laundered funds can be used to finance political campaigns (Jojarth 2013; Unger et al. 2006). The takeover of legitimate government could occur in extreme cases (McDowell & Novis 2001).

Research in the Netherlands, a jurisdiction which may be comparable to Australia, suggests it is unlikely money laundering could lead to the establishment of a criminal organisation infiltrating public institutions and undermining the political process (Unger et al. 2006). However, any emergence of criminal organisations has the potential to eventually erode social and political values and norms (Unger et al. 2006).

Stakeholders viewed undermining of the government and political stability as one of the greatest potential harms of money laundering. However, as with corruption, stakeholders indicated the risk of this in the Australian context, relative to other countries, was low.

Threatened privatisation

Money laundering and corruption have the potential to reduce or delay efficiency improvements and the resulting economic growth by threatening privatisation. Evidence gathered on privatisation outcomes in both developed and developing economies has found privatisation has generally had a positive impact overall and, following a drop during the global financial crisis, privatisation is again trending upwards (OECD 2019).

One of the economic harms explored in the literature of money laundering is how it threatens privatisation and the associated economic benefits. Firstly, with access to illicit funds, criminal organisations have the ability to outbid other purchasers for assets that were previously publicly owned (McDowell & Novis 2001). If successful, criminal organisations are not motivated by economic logic or the need to profit and the transition to increased efficiency expected of a privatised economy may be delayed or may not materialise at all (Unger 2007).

A further risk in connection with privatisation relates to the nature of assets previously owned by the state, such as ports supporting imports and exports or banks. If purchased by criminals, their ownership could be used to further criminal activity or enable further money laundering (McDowell & Novis 2001). However, for developed countries such as Australia, where state assets are largely already privatised, this type of strategic purchase by criminal organisations is less of a threat (Unger 2007).

National reputation

Association with money laundering or terrorism financing could damage a nation's reputation beyond the reputation of the nation's financial sector. However, this impact is amplified by the function of FATF.

The FATF recommendations could not be considered a source of international law; rather, the recommendations are standards that provide a framework for jurisdictions to implement domestic legislation. The FATF encourages jurisdictions to implement domestic legislation without creating any legal obligation to do so. However, the FATF holds influence because of its membership and the interconnected nature of global financial markets and trade. As noted, a connected function of FATF is to monitor the implementation of the recommendations—jurisdictions that receive a negative evaluation are publicly identified (Ferwerda, Deleanu & Unger 2019). In the past, FATF more directly identified jurisdictions, including non-members, as 'non-cooperative countries and territories' and blacklisted them for a lack of compliance. This practice ended as the term 'non-cooperative' may not have been accurate for jurisdictions that did not have a regulatory framework for structural reasons, rather than resistance. The interference in the internal affairs of jurisdictions was also viewed as a threat to FATF's legitimacy as an exclusive membership organisation (Alldridge 2008). Despite this, public identification continues, with different terminology. Public identification occurs at two levels. Being subject to a requirement for increased monitoring is still informally referred to as being on the FATF grey list. Public identification as a high-risk jurisdiction, and being subject to a Call for Action, is still referred to as being on the FATF black list.

While this strategy is contested, the logic is clear: reputational damage from public identification on the global scale will be felt in the domestic economy through signalling to international actors the jurisdiction is non-compliant. The seven largest economies in the world (G7) formed FATF and the organisation has substantial reach, with 37 jurisdiction members, two regional organisation members and over 200 jurisdictions committed to implementing the standards through regional bodies (FATF 2020f). FATF encourages jurisdictions to consider transactions with those publicly identified with increased scrutiny and, in serious cases, to apply counter measures (FATF 2020e; Nance 2018). In theory this could result in lost investor confidence, divesting currently held assets, avoiding new transactions and restricted access to international financial markets (Nance 2018; Unger et al. 2006). These consequences mean the economic costs for jurisdictions who do not implement the recommendations could be greater than the costs of doing so. This economic harm is distinct from the economic harm of money laundering itself.

Alldrige (2008) considers the AML/CTF regime to be an example of globalisation intruding on sovereignty and the sovereign power to write and enforce distinct criminal laws. Further criticism of this system relates to not only the lack of consent but the lack of an evidence base that the recommendations have an impact on money laundering levels (Pol 2018a).

Ferwerda, Deleanu and Unger (2019) detail how the evaluation processes used to publicly identify jurisdictions suffer a disconnect by relying on the private sector and applying the consequences to the public sector or national economy. They note also that this is only effective in motivating jurisdictions to remain just above the minimum standard required to avoid being publicly identified. Furthermore, and despite the logic of blacklisting, Nance (2018) reviews the evidence and finds there is no evidence that blacklisting causes reputational damage, with neither FATF nor regional bodies able to provide an example of blacklisting harming the economy. However, it is relevant that the jurisdictions that have been the subject of blacklisting, such the Democratic People's Republic of Korea, have very different economic and political characteristics to Australia, making it difficult to make direct comparisons.

There was little evidence from stakeholders regarding the impact of damage to the national reputation on the economy. However, stakeholders did consider the risk to the national reputation in connection with money laundering and the AML/CTF regime from the perspective of the damage to international relationships. Some stakeholders noted Australia was a good example of a developed country encouraging neighbouring countries to address the issue of illicit financial flows. Specifically, the work of engaging with the region, providing assistance and deploying analysts and specialists to other countries was recognised as a significant financial investment that had developed Australia's reputation as a leader. This outreach is particularly important given money laundering is a transnational issue and threats may emerge from outside of Australia.

However, other stakeholders noted that, despite this long-term outreach and investment, addressing domestic issues was necessary to maintain Australia's status as a leader. Stakeholders raised the diplomatic ramifications of a perception that Australia seeks to lead, particularly in the Asia-Pacific region, on issues of democracy and development, while potentially simultaneously benefiting economically from the proceeds of corruption in developing nations through identified gaps in the AML/CTF regime. Stakeholders also commented Australia would be disadvantaged by being seen to be slow in complying with FATF recommendations related to the regulation of professional facilitators. The impact of this could be felt in negotiations if Australia were reduced to being a 'soft power', with geopolitical implications. Conversely, maintaining a leadership position would allow Australia to speak with greater authority and influence.

Privacy

The loss of privacy is a less tangible cost of a constantly increasing AML/CTF regime (Alldrige 2002). The right to privacy is a human right under the International Covenant on Civil and Political Rights and in Australia the right to information privacy is incorporated in the *Privacy Act 1988* (Cth). However, the right to privacy is not absolute and is balanced against the rights of others and society as a whole.

The AML/CTF regime already involves a loss of information privacy to the individual, as information is shared under reporting obligations. Research on the effectiveness of the AML/CTF regime suggests the need for increased information sharing between private institutions, as well as between private institutions and law enforcement (Redhead 2019). Stakeholders also identified the connection between privacy and trust in public institutions. While the need for increased information sharing has been recognised in research, the ability to extend information gathering and sharing powers could be impeded if there is a loss of trust in public institutions. This is particularly relevant in relation to identity theft. Knowing the identity of the individual is one of the foundations of the AML/CTF regime. Identity data being stolen through hacks or scams was recognised as an increasingly common occurrence, weakening identity confirmation. Employing technology-enhanced identity confirmation such as facial recognition and biometrics may be a solution to this. However, stakeholders highlighted the public scepticism that already exists around these methods, and reduced trust in public institutions could contribute to an even lower tolerance.

Further, the global AML/CTF regime has been criticised as impinging on sovereignty, and banking secrecy—once a legislated selling point for financial institutions in certain jurisdictions—is now considered unacceptable (Levi 2002). Despite the required balance between individual privacy and the rights of others and society, some critics have claimed the AML/CTF regime’s impact on privacy is difficult to justify given the lack of demonstrated impact on organised crime, suggesting the political motivations for transparency and surveillance may be broader (Levi & Reuter 2006). The impact on privacy is particularly relevant for those who may have been falsely identified as engaging in suspicious activity, especially where that information has ultimately been leaked (Levi & Reuter 2006). Privacy is also an issue in the context of terrorism financing, since the need to prevent terrorism is an argument often used to increase surveillance (Alldridge 2008).

Overall, while the loss of privacy is a social harm, there is a necessary trade-off required to address money laundering and terrorism financing. Balance the potential loss of privacy with the potential widespread harm to the community from money laundering represents a significant challenge. Any effects on privacy, and associated consequences, are likely to be intangible and almost impossible to measure.

Summary and measurement

The public sector is likely to be impacted in multiple ways by money laundering and the AML/CTF regime. Despite the potential for money laundering to contribute to state, territory and local government revenue, money laundering’s relationship with tax evasion means it is likely to have the net effect of reducing public revenue at the national level—an economic harm. While not addressing precisely the same issue, existing measures of the size of the black economy consider proceeds of crime and are relevant to estimating the net effect of money laundering on public revenue (Black Economy Taskforce 2017). Measurement of international funds transfers to low or no tax liability jurisdictions would also contribute to estimates of the magnitude of the loss of public revenue attributable to money laundering.

The relationship between money laundering and corruption means money laundering is likely to lead to an increase in corruption levels, in both the short and long terms. The corruption of law enforcement and other public officials enables further crime and, in turn, further money laundering. There is some empirical evidence of this impact; however, the level of corruption will depend the characteristics of the jurisdiction in question. A further impact of increased corruption will be a decrease in trust in public institutions, also a social harm. Stakeholders did not perceive corruption and lost trust in public institutions associated with money laundering as a significant concern in the Australian context.

There is a potential for loss of trust in public institutions to affect community acceptance of further expansion of the AML/CTF regime in ways that reduce privacy. The measurement of this impact would need to consider the reduced effectiveness of the AML/CTF regime, relative to a regime with stronger information collection and sharing powers. However, as money laundering was not considered a significant contributor to the loss of trust in public institutions, which may be affected by many other factors, it would be nearly impossible to directly attribute this to money laundering.

Money laundering may threaten privatisation due to intervention by corrupt officials or criminal organisations with access to illicit funds. This may reduce or delay any efficiency improvements that could otherwise result from a privatised economy. Threatened privatisation is considered an economic harm, although there is limited support for this, particularly in economies such as Australia's, which are largely already privatised. This was therefore not identified as a significant impact of money laundering in the Australian context.

In connection with the impact of money laundering on foreign direct investment, the national reputation can also experience indirect economic harm due to association with money laundering or non-compliance with global AML/CTF standards. A failure to effectively implement the AML/CTF regime has consequences that can be felt domestically. Public identification can send a signal to international actors that the jurisdiction is non-compliant. While there is limited evidence to support this having actually affected an economy in practice, the economies that have been considered have different characteristics to Australia, making direct comparisons unreliable. In addition, the damage to the national reputation directly, as opposed to the effect on the economy by extension, was considered a concern. Reputational damage could have diplomatic ramifications such as reduced 'soft power' and influence, particularly in the Asia-Pacific region, where Australia has been considered a leader. Due to the nature of this impact, initial qualitative analysis such as reviewing resolutions and statements from international organisations and inter-governmental bodies for references to Australia in relation to money laundering may provide supporting evidence. Consultation with stakeholders directly involved in diplomatic engagement or the consequences of reduced regional influence and authority could then consider the impacts, which could include a weaker negotiating position internationally and longer term geopolitical implications. The net effect of this impact would take into consideration the significant investment Australia has made in the Asia-Pacific region. Measures of this impact at a macro level could be estimated based on expert opinion, but this would not include meaningful quantitative analysis.

A conceptual model of impacts

A review of current evidence of the harms and benefits of money laundering and terrorism financing identified three broad categories of impacts—economic, societal and sectoral. The societal impacts were further classified into crime and criminal justice related impacts and terrorism impacts. The sectoral impacts were further categorised into those affecting the financial sector and other designated services, the private sector (outside of designated services) and the public sector. It is possible to draw several conclusions regarding the nature of these impacts.

While some impacts presented clear harms or benefits, others could be both harmful and beneficial. In these cases the net effect often depended on when the impact was measured. In general, impacts recognised as short-term benefits may result in longer term harms. In many cases the initial injection of funds into different sectors was thought to stimulate the economy or provide revenue for individuals or firms. In the longer term, impacts such as a reallocation of resources or an artificial increase in prices may result in a harm that outweighs any initial benefit. In addition to this disconnect between the short-term benefits and long-term harms, the benefits are often felt by individuals or businesses, while the harms are felt collectively by the wider community.

Further, some of these impacts have the potential to be far more significant than others, largely depending on the characteristics of the jurisdiction. In addition, many impacts, including those identified commonly in the literature, appear largely speculative, with limited or no evidence provided to support them. Even the potentially more significant impacts could also be affected by other external confounding factors, making the degree to which they are attributable to money laundering or terrorism financing difficult to establish.

These issues aside, Table 2 presents an initial conceptual model of the impacts that may be associated with money laundering and terrorism financing, based on the outcomes of the literature review and interviews with a wide range of stakeholders. In addition to stipulating the nature and direction of the impact, and whether there is published evidence available, we assess the significance (or otherwise) of each component of the model and whether it is relevant to the Australian context.

Table 2: A conceptual model of the impacts of money laundering and terrorism financing

Impact	Harm or benefit	Evidence from the literature	Assessment and relevance to Australia
Economic impacts			
Distorted rates	Harm	Limited support	The potential to indirectly impact Australia but a challenge to attribute to money laundering.
Foreign direct investment	Harm	Supported	Supported in Australia as a potential longer term harm in connection with the national reputation.
Economic growth	Harm	Supported	Relevant to Australia but better supported in connection with crime levels rather than solely economic impacts.
Societal impacts			
Crime and criminal justice			
Crime levels and associated costs (predicate offences, financed crimes and crimes attracted by money laundering)	Harm	Supported	Potential to be a significant harm in the short and long term in Australia.
Recovery of proceeds of crime	Benefit	Supported	A relevant benefit of the AML/CTF regime in Australia, but a very low proportion of proceeds of crime are recovered.
Terrorism			
Terror attacks	Harm	Supported	A significant impact but unlikely to be prevented by restricting financing.
Financial intelligence	Benefit	Supported	A direct benefit of the AML/CTF regime that may contribute to preventing terror attacks.
Sectoral impacts			
Financial sector and other designated services			
Profitability	Benefit	Supported	This is relevant in Australia although is industry specific and likely only beneficial in the short term. The net benefit would be decreased by related costs to profitability of enforcement and remediation action and costs of the AML/CTF regime.
Reputation	Harm	Supported	The reputational harm is considered a significant concern for designated services, particularly the financial sector in Australia.
Availability of credit	Benefit	Limited support	Unlikely to have a significant impact compared with other external events affecting the availability of credit and not considered relevant in Australia.
Liquidity	Harm	Limited support	Unlikely to have significance in larger institutions, particularly in jurisdictions where liquidity risk is regulated, and not considered relevant to Australia.

Table 2: A conceptual model of the impacts of money laundering and terrorism financing (cont.)

Impact	Harm or benefit	Evidence from the literature	Assessment and relevance to Australia
Private sector			
Professional facilitators	Benefit	Supported	A direct impact relevant to Australia that has the potential to increase profitability of individual businesses in the short term. The long-term harms to professional facilitators individually include reputational harm and increased compliance costs. Increased regulatory costs affect the collective, which may ultimately outweigh the individual benefits.
Availability of credit	Benefit	Limited support	An indirect impact unlikely to hold significance, particularly compared with the harm of crowding out legitimate business, and not relevant to Australia.
Crowding out of legitimate business	Harm	Supported	The potential to have an impact, particularly for small business. There was support for this in the Australian context.
Artificial demand for industries	Harm	Supported	An indirect impact of money laundering with the potential to be significant in the long term but not considered relevant to Australia.
Artificial increase in prices	Harm	Supported	An indirect impact of money laundering with significance to the Australian property market.
AML/CTF industry	Benefit	Supported	An indirect impact of money laundering with potential to support an emerging sector, including in Australia.
Informal remittance sector	Benefit	Supported	An indirect impact of the AML/CTF regime that has the potential to benefit individual businesses in isolation. In Australia operating unlicensed businesses is not legal.
Public sector			
Public revenue	Harm	Supported	The net harm of the money laundering strategies also used to evade tax is relevant in Australia.
Corruption and bribery	Harm	Supported	The significance will depend on the characteristics and corruption level of the jurisdiction. In jurisdictions where this may be significant, consequences include reduced trust in public institutions. Not directly relevant in Australia.
Threatened privatisation	Harm	Limited support	Unlikely to have any significance in developed economies such as Australia's, which are largely already privatised.
National reputation	Harm	Limited support	In connection with foreign direct investment, the size and stability of the economy is likely to have a greater impact but damage to the national reputation in Australia is still relevant for the purpose of international relationships.
Privacy	Harm	Supported	A direct harm of the AML/CTF regime, including in Australia. However, limited significance or tangibility.

The next stage of this research will involve a series of pilot studies identifying discrete impacts from the conceptual model that were supported in the literature review and affirmed in the interviews with stakeholders and attempting to measure these impacts. These pilot studies will aim to determine the existence and magnitude of the impact, and the degree to which it can be attributed to money laundering or terrorism financing. This will be achieved through the replication of studies conducted internationally.

Broadly speaking, the pilot studies will explore:

- whether there is evidence to support the existence of the impact in Australia;
- how to identify and apply existing and available data to build a model to measure the impact;
- the degree to which the magnitude of the impact can be isolated from other factors to determine the proportion attributable to money laundering or terrorism financing; and
- how the measurement of this discrete impact can be incorporated into a conceptual framework for all impacts relevant to or significant in Australia.

Table 3 describes the six impacts identified as being relevant or significant to Australia based on the interviews with stakeholders that are currently considered measurable and therefore good candidates for pilot studies. In addition, Table 3 outlines the possible options for measuring these impacts and the extent to which they may be attributable to money laundering or terrorism financing. Several potential approaches were identified. Some of these measures already have clear and available data sources and established research design. Other methods of measurement are still evolving, where measurement is considered possible but the source and availability of the data are less clear. This will affect the research design and ability to attribute the impact to money laundering or terrorism financing.

Of the 18 impacts identified as relevant to Australia, five were also considered significant. While the benefit of the AML/CTF regime in providing financial intelligence in the context of terrorism financing is recognised as very difficult to measure, the remaining four relevant and significant impacts are considered at least possible to measure. As expected, the more direct impacts of money laundering, particularly those related to crime, can be more clearly attributed to money laundering. The measurement of the impact on crime also benefits from readily available data.

Table 3: Measurement of the impacts of money laundering in Australia through pilot studies

Impact	Relevance and/or significance in Australia	Measurement
Societal impacts		
Crime and criminal justice		
Crime levels and associated costs (predicate offences, financed crimes and crimes attracted by money laundering)	Relevant and significant	<p>Measurable as a pilot study by linking law enforcement and financial intelligence to identify predicate offences associated with suspicious transactions and the costs of the associated crime.</p> <p>The relationship between money laundering and crime levels is also measurable as a pilot study examining the impact of the COVID-19 pandemic on the ability to launder money. A proportion of the change in crime levels, identified through law enforcement charges or conviction data, and analysed with respect to different offence types, could attribute a proportion of crime costs to money laundering.</p> <p>There are also opportunities to measure this impact at the macro level by considering the migration of crime and analysing suspicious international funds transfers and changing crime levels of identified offence types.</p>
Recovery of proceeds of crime	Relevant	<p>Measurable as a pilot study analysing law enforcement data on confiscated assets and the crime types connected to the confiscated assets. The connected crime types could be established using law enforcement charges or conviction data. The analysis would compare the costs of the crime types with the value returned to the community.</p>
Sectoral impacts		
Financial sector and other designated services		
Profitability	Relevant	<p>Measurable as a pilot study most effectively in connection with the impact on reputation. Recent and widely publicised Australian enforcement action provides the opportunity to measure the impact of association with money laundering on an entity's profitability. The impact on profitability could be measured with data that may be available on annual deposit growth or fluctuations in the share price of institutions.</p>
Reputation	Relevant and significant	<p>Measurable as a pilot study following recent Australian enforcement action. Data including independent review rankings with controls for external factors at different stages of the enforcement action could be examined.</p> <p>Another potential measure could consider the costs of additional regulatory action following enforcement action or investigation. Specifically, this study could measure the cost of internal resources redirected by organisations that have been subject to enforcement action by AUSTRAC (eg in the financial and gambling sector) into subsequent investigations by Commonwealth and state/territory departments.</p> <p>At the macro level the cost of reputational damage to the financial sector more broadly could be measured in delays caused by enhanced scrutiny in correspondent banks. This would compare the costs of the delay occurring or not. The data source needed to undertake this analysis is not clear at this stage.</p>

Table 3: Measurement of the impacts of money laundering in Australia through pilot studies (cont.)		
Impact	Relevance and/or significance in Australia	Measurement
Private sector		
Crowding out of legitimate business	Relevant	Measurable as a pilot study analysing insolvency rates. Data on insolvency are available at an aggregate level, and it may be possible to obtain these data at a level that enables comparison between industries identified as low or high risk for money laundering. The research design would need to determine how these industries could be identified. This may be possible using law enforcement charges or conviction data on offenders who laundered money in a specific business type. However, this information is unlikely to be readily available. If high-risk industries can be identified, the research design would depend on the nature of the insolvency data available. It may be possible to compare insolvency rates in higher risk industries, controlling for other factors, to attribute a proportion of insolvencies to money laundering.
Artificial increase in prices	Relevant and significant	Measurable as a pilot study in the context of the real estate market. Law enforcement data on confiscated real estate could validate indicators of suspicious transactions. Data available on property transactions more broadly, from a number of sources, would be analysed for suspicious indicators. The research design would control for other factors influencing inflation in prices and measure the impact of money laundering, identified through suspicious transactions, on housing affordability.

Simultaneously in stage two, AUSTRAC will undertake econometric domain analysis—a top-down approach to measuring the impacts of money laundering and terrorism financing that makes use of available data and studies. The outcomes of the AIC’s pilot studies will provide important evidence to help refine the work being undertaken by AUSTRAC. Additional pilot studies may be developed as new sources of data and methods for measuring identified impacts become known.

Table 4 details eight impacts that are considered relevant to Australia. This includes some of the less direct impacts, such as effects on the economy and the public sector. These are considered possible to measure but at the macro level rather than as good candidates for a pilot study.

Table 4: Measurement of remaining impacts of money laundering and terrorism financing in Australia

Impact	Relevance and/or significance in Australia	Measurement
Economic impacts		
Distorted rates	Relevant	Components of distorted rates, including the savings and consumption patterns among criminals could be measured. However, there is no clear data source for quantitative analysis of a savings and consumption pattern. Law enforcement data on confiscated assets could be analysed to measure investment and distortion. The types of assets confiscated could be analysed, noting the data may not be representative of investment of illicit funds that remain undetected. The research design must also develop a measure of how the investment affected the productivity of the economy at the macro level.
Foreign direct investment	Relevant	There is no clear research design or data source that could be used to measure this impact as a pilot study. It may be possible to measure changes in investment if there were also evidence of an impact on national reputation, but it would be difficult to attribute this to money laundering and establish evidence of a causal relationship.
Economic growth	Relevant	No clear measurement as a pilot study. Further research of other impacts could inform measurement of the cumulative impact on economic growth.
Societal impacts		
Terrorism		
Terror attacks	Relevant	It may be possible to measure the costs of terror attacks using data on previous attacks. However, the data source is not clear and it would be difficult to attribute the costs to terrorism financing.

Table 4: Measurement of remaining impacts of money laundering and terrorism financing in Australia (cont.)		
Impact	Relevance and/or significance in Australia	Measurement
Sectoral impacts		
Private sector		
Professional facilitators	Relevant	<p>The cost of AML/CTF regulation to professional services can be measured for regulated entities and estimated for currently unregulated entities.</p> <p>It may be possible to measure the benefit to professional facilitators exporting services that exhibit suspicious indicators. Data on the export of Australian services are available at an aggregate level, so it may be possible to obtain data at a level useful for analysis. The nature of the data would determine the design of the research and whether it is possible to identify suspicious indicators.</p>
AML/CTF industry	Relevant	<p>It may be possible to measure the impact of compliance services as a pilot study using changes in remuneration of professionals following enforcement action as an indicator. There is no clear data source for this information.</p> <p>It could potentially be possible to measure investment and increases in the RegTech industry, including as an export, and productivity improvements at the macro level. Data are available at an aggregate level for RegTech products and services, so it may be possible to obtain data at a level useful for analysis. The design of the research would depend upon the ability to obtain data that identify a product as a response to the AML/CTF regime to enable any impact to be attributable.</p>
Informal remittance sector	Relevant	<p>It is not possible to measure the informal remittance sector. It may be possible to analyse trends in financial intelligence data (ie international funds transfer instructions) to developing countries in the registered remittance sector, but the impact measured would be on developing economies rather than directly on Australia.</p>
Public sector		
Public revenue	Relevant and significant	<p>The black economy is one measure of lost public revenue. Estimates of the black economy and resulting lost tax revenue exist (Black Economy Taskforce 2017).</p> <p>Financial intelligence data could also be analysed for transactions from Australia to low or no tax liability jurisdictions. The research design would require these jurisdictions to be defined and challenges would exist with funds evading taxes moving through multiple jurisdictions prior to reaching a low or no tax liability jurisdiction. A measurement of how much tax may have been applicable to the funds would also need to be considered.</p>

Table 5 details the remaining four impacts, including those relating to the national reputation in the context of both money laundering and terrorism financing and less tangible impacts such as privacy. These impacts could be supported with evidence but are not considered measurable through meaningful quantitative analysis.

Table 5: Impacts of money laundering and terrorism financing in Australia not considered measurable		
Impact	Relevance and/or significance in Australia	Measurement
Societal impacts		
Terrorism		
Financial intelligence (AML/CTF regime)	Relevant and significant	Measurement of this impact would relate to the cost of attacks prevented. However, financial intelligence is only one factor in terrorism investigations and attributing prevention to the AML/CTF regime may be difficult.
National reputation (humanitarian work)	Relevant	There is no clear research design or data source that could be used to measure this impact.
Sectoral impacts		
Public sector		
National reputation (AML/CTF regime)	Relevant	There is no clear research design or data source that could be used to measure this impact.
Privacy	Relevant	There is no clear research design or data source that could be used to measure this impact.

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