

The usage of corruption and money laundering in formal economy in Western Balkan countries

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Abstract: Fighting against money laundering and corruption is being a continuous problem for keeping the integrity of the socio-economic system of a country. Usage of the money generated from criminal activity in legal and formal economy seriously harms the stability and solidity of subjects/actors operating in a certain market and also the entire financial market of a country. Meanwhile, in developed countries, many researchers have been dealing with criminality and economic analysis from a financial perspective, laundering illegal capital and its operation informal economy; in Western Balkan countries, economic literature is mainly focused on organized crime and its activity, paying no specific attention to the usage of this money and where the money is really addressed. We have to underline that in the last two decades, the phenomenon of crime infiltration in the economic and social areas throughout networking with policymakers, is becoming more and more present in Western Balkan countries. Based on the facts mentioned above, the scope of this study is to give a general view and discuss different aspects of money laundering in Western Balkan countries, the costs of money laundering, forms of laundering, and also its infiltration into the legal, formal economy. This study is based on an existing literature review on money laundering and consisting later of a qualitative and quantitative analysis of some cases and schemes that have been published in the respective media of these countries. Empirical findings suggest that the construction sector, farming, and tourism, are the three main sectors money laundry is applied mostly. Empirical results show also that existence of a strong criminal economy leads to an increase in the corruption level, decreases the efficiency of public administration, and also, affects negatively economic growth.

Key words: Money laundering; Cash; Criminal economy; Western Balkan countries.

1. Introduction (Times New Roman 10 Bold)

The debate on crime and its costs for the economic development of a country as well as the impact that money laundering has on the real economy in a given territorial social or cultural context is as early as they are current (Alasmari, 2012; Gayraud, 2014; Gratteri and Nicasio, 2011). Over the last decades, crime has shown a high ability to infiltrate the economic and social environment of a

country and manages to establish relations with civil society, being "fed" by corruption and secret accords (Tarantola, 2012; Zabyelina, 2012; Masciandaro, 1995; Ehrenfeld, 1992). Although in Albania there are phenomena such as the strengthening of the Albanian lek to foreign currencies; a significant increase in the supply of construction activity in different areas of Tirana, not accompanied by an increase in credit; or a significant increase in the money supply during the election, there is still a lack of official data on the explanatory factors of these phenomena. So, the criminal economy is present in our country and those of the Western Balkans, what is not known yet is the entirety of the volume of the criminal economy in terms of GDP. We also don't know which sectors the criminal economy invests in and what percentage of the real economy does the criminal economy control (Stojarova, 2007; Dobovsek, 2006; Zhilla, 2011). Based on these facts in this study we have analysed the extent of money laundering in Albania and the Western Balkans and some of the methods of money laundering and the influence that the criminal economy has on the real economy with the primary objective being the highlighting of the level of criminal economy and money laundering in some of the countries of the western Balkans with Albania being our primary focus. To achieve this objective, we have performed an analysis of data published by INSTAT and various reports on money laundering and the impact of the criminal economy in Albania. The results of this paper suggest that Albania is the most problematic country regarding money laundering, while the construction industry is the preferred industry where money laundering is committed by the majority of the people who generate dirty money. This paper is organized as follows: firstly, a brief introduction, and after continues with an overview of the money laundering situation in Albania and the Western Balkans, money laundering methods and the influence of the criminal economy on the real economy and conclude with some conclusions and recommendations.

2. Significance of the Study

The risk a country faces is when a system of perverted links takes hold between civil society, politicians, and the mafia in which they hold each other and it is difficult to assess the real impact. This risk has already become a reality in the countries of the Western Balkans and it is significantly damaging the economic development of these countries and it is also hindering their integration. In all these countries a direct link between the state and persons with a shady past is seen by now. It is not uncommon for people with a criminal record to hold important positions in public administration. In addition, there is a significant increase in the influence of the criminal economy on the real economy. Money laundering has a destructive effect to financial sector institutions that are critical for economic growth, effecting money demand, growth rates, income distribution, tax revenues, promoting crime and corruption that slow economic growth, reducing efficiency in the real sector of the economy. It can create global and local impacts for businesses, economies, and societies. Albania is back again in the list of countries with a high level of money laundering risk. There are some reasons for this situation, but we can say that lack of preventive mechanisms, effectiveness, and inter-institutional cooperation are among the main reasons for the deterioration of the situation. Even Tirana is the capital of a small country, like Albania, it ranks among the capitals where this "activity" is most practiced. The significance of this research is to make ware the policymakers and all people related to the costs of money laundering, and also its infiltration into the legal and formal economy.

3. Review of Related Studies

The discussions about the effects the money laundering have on the real economy in a given territorial social or cultural context is still an actual problem in the Western Balkan Countries (Motta, 2017; Islam, 2014; Ering, 2011). During the economic transition of the Western Balkan countries, crime has shown a high ability to infiltrate the economic and social environment of a country and has managed to establish relations with civil society, being "fed" by corruption and secret accords (Muco and Balliu, 2018). According to the Basel index¹ regarding money laundering and terrorism risk, some of the Western Balkan countries rank among the first in Europe for money laundering risk. Albania dominates, which ranks second in Europe after Turkey², while globally, the Basel Institute ranks our 44th country among 141 countries in the world in relation to this phenomenon, receiving 5.69 points on a scale from 0 (low risk) to 10 (High risk), while Turkey is three positions above, ranking 41st with 5.76 points. In second place among the countries of the Western Balkans is Bosnia-Herzegovina, which is 47th, three places below Albania, followed by Serbia in 54th place. Macedonia is ranked among the countries with the lowest risk of money laundering and terrorism in 117th place with 3.98 points, Croatia in 119th place and Montenegro in 126th place followed by Greece in 127th place, and Slovenia in 133rd³. In relation to previous years Albania has regressed in terms of this index because in 2019, Albania received 6 points and ranked 10th in Europe, while in 2018 received 5.57 points. While Serbia and North Macedonia have made progress by significantly reducing this index during 2020. Apart from the deterioration in the Basel index will also remain on extended monitoring in terms of the risk of money laundering and terrorist financing. In response to the measures taken by the Albanian government according to the recommendations made earlier by MONEYVAL, the 2018 report⁴ states that our country will be on extended supervision for 2020 followed by an assessment of the report on the implementation of the recommendations made⁵. According to the report in question, "corruption poses great risks regarding money laundering in Albania. Often linked to organized crime activities, it generates significant amounts of criminal proceeds and seriously hinders the effective functioning of the criminal justice system. The authorities are aware of the dangers of corruption, but law enforcement has so far received limited attention to target corruption fed by money laundering. The report also notes that criminal proceeds are circulating and invested in some form, for example through investments in real estate and trading companies. The high level of the informal economy, combined with the high spreading of cash, poses a risk of money laundering. The economic literature confirms that cash

¹The Basel AML Index measures the risk of ML/TF in countries around the world. Risk is defined broadly as a country's vulnerability to ML/TF and its capacities to counter it. It does not measure the actual amount of ML/TF activity in a country. Risk scores are based on data from publicly available sources such as the Financial Action Task Force (FATF), Transparency International, the World Bank and the World Economic Forum. They cover 16 indicators in five domains relevant to assessing ML/TF risk at the country level: 1. Quality of AML/CFT Framework; 2. Bribery and Corruption; 3. Financial Transparency and Standards; 4. Public Transparency and Accountability; 5. Legal and Political Risks. The Basel AML Index ranks countries based on their overall scores, capturing the complex global nature of ML/TF risks and providing useful data for comparative purposes. However, the primary objective is not to rank countries superficially in comparison with each other, but to provide an overall picture of different countries and regions' risk levels and their progress in addressing vulnerabilities over time.

² https://baselgovernance.org/sites/default/files/2020-07/basel_aml_index_2020_web.pdf

³If we look at the countries with the highest risk then in the first place is Afghanistan as the country with the highest risk for money laundering and terrorism while Estonia ranks 141st as the country with the lowest risk.

⁴Based on the 2018 report, on the year 2019, need to take steps to change the legal framework by aligning it with the directives issued by MONEYVAL and anticipating the risk of money laundering through all the links. In this context, there was intervention in the regulatory framework of the Bank of Albania, the Financial Supervisory Authority, the General Directorate for the Prevention of Money Laundering. Aspects related to the shareholders of companies in tax havens, the activities of non-profit organizations or the ways of reporting were changed.

⁵ <https://rm.coe.int/anti-money-laundering-and-counter-terrorist-financing-measures-albania/16809988c0>

transactions are considered a very important source for criminal economic benefit, such as fraud or corruption (Alba, 2002), and cash also supports street crime (Wright et al., 2014). Firms that do business that pay mainly in cash are an important target of crime (Smith, 2005). Waldman (2012) and Lipow (2010) confirm that, if cash transactions would become illegal, the illegal economy and its infiltration into the formal economy would become more and more difficult. The construction industry was the most at-risk regarding money laundering, according to the report that was published in December 2018. For example, in Albania, in 2019 in Tirana alone, about 1.5 million square meters of construction permits were issued for 409 new buildings. Showing a significant increase compared to 940 thousand square meters issued in 2018 or 521 thousand square meters which were issued in 2017. In justification of the substantial increase in permits the then-current mayor of Tirana put forward the argument that there was a need to reduce apartment prices because if in a normal economy the price is determined by supply-demand, the increase in the supply of construction permits should reduce the price of apartments. But whereas INSTAT confirms a reduction in construction costs, apartment prices continue to rise. The Bank of Albania has reported an increase in house prices by almost 14 percent during the second half of 2019 and by almost 15 percent during 2019. But the biggest increase is reported on residential areas outside the city, where prices are estimated to have increased by 25% (Bank of Albania reports). The increase in prices has continued during the first 6 months of 2020. According to the Bank of Albania report, the Price Index for Tirana increased by 43.4% compared to the base period and by 6.5% compared to the previous period; Average prices in Tirana are reported to have increased significantly in areas outside the city (by over 50%) but have declined slightly in central and suburban areas⁶. Based on the Key data Albania Report (2020), from 2005 to 2019, the real selling price of apartments in Tirana has increased by 66%. While cumulative inflation for the period 2005-2019 is estimated at 34.6%⁷. So, this price increase is not justified either by raising inflation or by raising wages, or by a lack of supply. The price increases as a result of dirty money. If we consider the permits issued in the period 2017-2019, according to INSTAT (Albania Institute of Statistics), there were over 3 million square meters of construction permits for 1,028 new buildings issued by Tirana City Hall. According to a report by the Global Initiative against Cross-border Organized Crime, it points out that out of 141 companies that have obtained construction permits for over 6-story high buildings in the period 2017-2019, 59 percent of them did not have the financial capacity to finish construction of buildings. According to the balance sheets of these companies, they had a minimum income and had neither assets nor loans nor affiliated companies, which would enable them to make such an investment. According to the report in question, approximately 60 percent of this value came from dirty money, about euro 240 million, while it is estimated that for the 3 years in question about euro 1.6 billion⁸ have been laundered through the construction industry. This is probably the reason why the MONEYVAL Report for 2019 placed Albania back on the "grey list" of countries with a high level of money laundering risk. While the 2021 report states that Albania falls by 28 places, ranking the last in Europe, just ahead of Tajikistan⁹. Lack of preventive mechanisms, effectiveness, and inter-institutional cooperation are among the main reasons for the deterioration of the situation. According

⁶ Bank of Albania, Results of the survey "Real estate market" and the House Price Index, October 2020, p.7.

⁷ <https://www.monitor.al/lejet-e-ndertimit-tirane-t-i-2019-2/>

⁸ <https://globalinitiative.net/wp-content/uploads/2020/08/Prurje-Financiare-Te-CC%88-Paligjshme-Ne-CC%88-Shqipe-CC%88ri-Kosove-CC%88-Dhe-Maqedonine-CC%88-E-Verit-Faktore-CC%88t-Kryesore-CC%88-Dhe-Prirjet-Aktuale.pdf>

⁹ MONEYVAL Annual report for 2020 p.29

to international reports from agencies that monitor money laundering, Tirana ranks among the capitals where this "activity" is most practiced.

4. Objectives of the Study

- To make an overview of the money laundering situation in Albania and the Western Balkans.
- To make ware the policymakers and all people related to the costs of money laundering, and also its infiltration into the legal and formal economy.
- To tell about money laundering methods and the influence of the criminal economy on the real one.
- To underline that in the last two decades, the phenomenon of crime infiltration in the economic and social areas throughout networking with policymakers, is becoming more and more present in Western Balkan countries.
- To emphasize that one of the main problems, why there is a criminal economy in Albania, is the informal economy and high corruption.

6. Population and Sample

The population includes Albania and Balkan Countries. This study is based on an existing literature review on money laundering, and also on the qualitative and quantitative analysis of some cases and schemes that are published in the respective media of these countries.

6.1. Statistical Techniques Used in the Present Study

To achieve our objectives, we referred to the method followed by Schneider et al. (2010) to calculate informality [(difference between GDP by expenditure approach-GDP by production)/GDP by Expenditure approach]. The data used in this study are taken from the INSTSAT (Institute of Statistics of Albania, reports, and statistics) and National Statistics of the analysed countries. The period of the data is from 2008 to 2018 (annual data).

6.2. Data Analysis and Interpretation

Table 1. Size of the informal economy for the 2008-2018 period, in Albania

Year	GDP by expenditure approach	GDP by production approach	Difference	Difference/GDP by Expenditure
2008	1088132.10	832219.90	255912.20	23.5%
2009	1150155.70	877134.60	273021.10	23.7%
2010	1236417.40	964522.60	271894.80	22.0%
2011	1317891.20	1012340.10	305551.10	23.2%
2012	1364017.40	1012981.30	351036.10	25.7%
2013	1581376.82	2246280.01	664903.19	42.0%
2014	1624105.66	2252544.52	628438.85	38.7%
2015	1666935.61	2334761.74	667826.13	40.1%
2016	1716885.60	2401483.65	684598.05	39.9%
2017	1793832.17	2506027.71	712195.55	39.7%
2018	1865838.86	2600853.65	735014.78	39.4%

Source: INSTAT data, our calculations, 2021

Interpretation of table-1

The countries of the Western Balkans, and more specifically Albania, are countries with high informal economies, where if we refer to the method followed by Schneider et al. (2010) to calculate informality [(difference between GDP by expenditure approach-GDP by production)/GDP by Expenditure approach], we can say that over the years in Albania informality has fluctuated a lot, but beyond the fluctuations, we can say that informality over the recent years has seen an upward trend.

While the average level of informal economy in the Western Balkans is respectively: 33.6 in Bosnia & Herzegovina; 37.6 in Northern Macedonia; 27.5 in Greece; and 33.3 and 35.4 in Montenegro and Serbia (**Schneider et al., 2010**). The increase in the level of informality makes it easier to move cash, transfer dirty money from abroad, or evade taxes (**Shurkov et al., 2017; Zeka et al., 2013**). It also makes it easier for people to accumulate, transfer, and absorb large sums of money without leaving a trace in the official financial system, making it easier to launder money through investing in real estate and selling later at a profit.

Money is also laundered through the construction of new offices or housing complexes, continues with the financing of construction contracts and reporting of lower figures for labour costs in construction, and then continues with the sale of the completed building. Another method is laundering through gambling. Gambling, both in physical casinos and online, with electronic machines or sports betting, has long been identified as one of the money laundering channels in the Western Balkans countries. Large amounts of daily turnover and cash payments make it very easy to mix dirty money with clean money and laundering dirty money. There are a number of methods for laundering money through gambling. The simplest way is when an individual enters the casino, buys gaming credits with dirty money, and then plays for a while, usually in high-stakes games. They place bets on each possible result; therefore, this will lead to one or more positive results. When they redeem the credits for money, they ask the cashier to write them a check for the amount of money won, or at least a receipt, in order to claim that the money was earned in gambling. Organized crime groups, or their accomplices, own casinos, specifically for money laundering. Online gambling accounts, which do not verify the identity of their customers in detail, offer other possibilities. Online gambling is especially valuable for moving money abroad, as funds can be deposited into betting accounts anywhere in the world. It was estimated that Albanians spent about euro 700 million a year on sports betting, and the only euro 150 million on bets were placed with legitimate companies.

Another problem is the transfer of dirty money from abroad and bringing it into the country by various means¹⁰. More specifically, a citizen X living abroad as an emigrant has continuously sent money to an Albanian citizen Y but also to other citizens in different countries. Citizen X doesn't undertake any commercial activities and is a person who does not justify remittances but the Albanian state does not check, Y is an entrepreneur in the real estate sector and invests the dirty money in construction and launders it for him, turning him into an investor in Albania.

Another scheme is when an individual X at a very young age owning a construction firm in the construction sector Albania benefits remittances from an individual Y living abroad as financing for a certain construction project, the cost of construction on the paper is declared at a low price and the

¹⁰ https://www.europarl.europa.eu/meetdocs/2009_2014/

final sale at a very high price. Businessman X is simply a name that enables transactions and runs the scheme.

Last but not least are fictitious activities such as issuing fake receipts in 5-star hotels, removing the corporate tax for these types of hotels makes money laundering much less difficult.

8. Conclusion and Recommendations

This study analyses the dynamics and the situation of money laundering and criminal economy in the Western Balkans, focusing primarily on Albania, how illegal money is been transferred, how it enters the real economy, and how it is recycled. From the analysis performed in this study, we conclude that one of the main problems, why there is a criminal economy in Albania, is the informal economy and high corruption. The study shows that the high level of the informal economy and the possibility of cash payments in large quantities enable criminal money to enter the real economy. In this paper, it is clearly highlighted that the most preferred sector for money laundering in the Western Balkan countries, and more specifically in Albania, is the construction sector, the hospitality industry, and more specifically the 5-star hotels, due to their low taxation. Gambling is also another widely used method of money laundering. Another specific problem to these countries is their geographical position which means they are part of trafficking corridors. Goods, people, and financial inflows can easily cross the border, and illegal money oftentimes enters these countries by freight trucks. Criminals and corrupt officials use these advantages to expand their activities across the region, investing and buying property where it is easier for them to make transactions without reporting for the source of income. Specifically, in Albania, the idea of digital immovable property registration offices has been discussed for years, but these are to become a reality yet, not because of their costs of about euro 1 million, but probably because of the lack of will to make them functional. To conclude, we can say that this study has a double contribution. On the one hand, it is a welcome addition to the relatively scant literature on the topic of money laundering in the Western Balkans countries, and on the other hand, it offers some suggestions on the ways of transferring and money laundering that can be taken into consideration by policymakers to reduce this phenomenon in the future.

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