HIDING FILTHY LUCRE IN PLAIN SIGHT: THEOREY AND IDENTIFICATION OF BUSINESS-BASED MONEY LAUNDERING

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SUMMARY

MONEY LAUNDERING is the process of moving proceeds from illicit activities into the legal economy.

FACTS: 2.3–5.5% of global GDP is laundered every year.

WE STUDY TWO MONEY LAUNDERING CHANNELS:

- BUSINESS-BASED (BBML) Illicit funds placed by investing in a legitimate business.
- FINANCIAL-BASED (FBML) Illicit funds channelled through financial institutions using hidden bank accounts, anonymous trusts, and intermediaries located in different countries.

CONTRIBUTION: We propose a theory-based approach that uses publicly available data to estimate changes in BBML due to regulatory changes affecting the marginal cost of BBML. We provide the first evidence that stronger international regulations designed to reduce FBML abroad causally increase BBML in U.S. counties.

THEORETICAL FRAMEWORK

GENERAL EQUILIBRIUM MONOPOLISTIC-COMPETITION MODEL

EQUATION 1: General Equilibrium

\[ Q = \alpha \left( 1 - \beta \right) + \beta Q(x) \]

EQUATION 2: Monopolistic-Competition

\[ Q = \frac{1}{1 + \beta Q(x)} \]

EQUATION 3: Firm-Level Evidence

\[ Q = \frac{1}{1 + \beta Q(x)} \]

EQUATION 4: Firm-Level Evidence

\[ Q = \frac{1}{1 + \beta Q(x)} \]

HETEROGENEOUS EFFECTS

The effects of anti-money-laundering regulatory changes vary by production sector, as predicted in our extended model. The effect is strongest in retail trade and other services, but absent in manufacturing.

INTERTEMPORAL EFFECTS

The effects of anti-money-laundering regulatory changes gradually build over time, peaking to 2.6% after 6 years from the first switch.

Table 3: Effect of AML regulations on Business Activity.

<table>
<thead>
<tr>
<th></th>
<th>OLS Baseline</th>
<th>All Discreted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offshore-FRI</td>
<td>0.02301***</td>
<td>0.00039***</td>
</tr>
<tr>
<td>Log Income</td>
<td>0.20545***</td>
<td>0.19167***</td>
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<tr>
<td>Log Income x Exposed</td>
<td>0.05899**</td>
<td>0.00831</td>
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<tr>
<td>Constant</td>
<td>Yes</td>
<td>Yes</td>
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<tr>
<td>County F:</td>
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<td>Yes</td>
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<tr>
<td>State x Year F:</td>
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<tr>
<td>Income/Wealth Controls</td>
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<tr>
<td>Socio-Demographic Controls</td>
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<tr>
<td>Observations</td>
<td>24,648</td>
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| Regression coefficients, Standard error clustered at county level in parenthesis.