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# Impact of money laundering on the Indian economy and appropriateness of Indian penal provisions



S.M.Vipul<sup>1</sup>



Pooja Shukla<sup>2</sup>



Dr. Rakesh Kumar<sup>3</sup>

Money laundering is an economic menace causing damage to the economic, political and social fabric of the economy. It is a process by which illegal origin of the criminal proceeds is disguised. The present era of globalization has made the world economy, global village by making it more interactive, intertwined, interrelated and interconnected but at the same time has unleashed the flood gates of opportunities for the criminals to expand, grow and prosper. Least developed economies and developing economies like Indian economy are more vulnerable of being getting into the clutches of money launderers. As developed economies have stronger financial controls and effective laws to check the activities that leads to the menace. Weak financial system and control existing in least developed and developing countries provide entry and helps the money launder in establishing their foothold in said countries. This paper deals with impact of money laundering on the Indian economy and assessment of the appropriateness of a penal provision present in India for dealing with menace. The conclusion section of this paper throws light upon the penal system prevailing in India and its worthiness and will help the policy makers and legislators to take decision about having a thought upon making more stringent penal provision using which the menace can be checked.

**Key Words:** globalization, entrepreneurs, resources, sustainability, technology.

## Introduction

Money is and has been the prime reason for which people get indulged in any criminal activity and money laundering provides them the mechanism using which they can legitimize the ill gotten gains by disguising the source of origin of the crime generated money.

The European Communities Directive of March 1990 says that whenever any transaction takes place for conversion or transfer of property, knowing that such property is derived from serious crime and the purpose is to conceal or disguise the illicit origin of the property or to assist any person who is involved in committing such an offence or offences to evade the legal consequences of his action, and the concealment or disguise of the true nature. Financial Action Task Force was formed in G7 summit in Paris in 1989 for taking steps for developing recommendations containing measures for fighting with the menace.

Interpol's definition of money laundering is: "any act or attempted act to conceal or disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources."

Money laundering is a mechanism using which launderer disguises the criminal and illegal source from which the money originated. It the process by which crime generated money is given legal color. Money laundering is a cultured, planned, well executed and heinous crime effecting social, political, legal and economic condition of the country. Actually it is not a crime against any

particular individual but against nations, economy, rule of law and world economy at large. It is the process that is being used by the money launderer to legitimize the ill gotten gains. Huge amount of money is generated by activities like terrorism, illegal sales of arms and ammunitions, insider trading, speculation, prostitution, embezzlement etc money is routed to the safe heaven i.e. the countries specially least developed and developing countries having weaker financial control. In country like India where every year deficit financing is resorted to, funds introduced by the money launders that remain unaccounted may make things rosy for the time being but ultimately it causes adverse effect upon the various sectors of the country. Money laundering involves three phases or stages.

### Placement >> Layering >> Integration

**First stage is placement:** This stage is also known as initial or entry stage. In this stage big chunk of money is broken into smaller sum of money that is deposited into bank, invested into financial instruments etc. This step is resorted to because smaller amount of money is less likely to attract notice of authorities. In countries having strong and stringent financial control placing money is really a difficult job for the money launderer but in a developing country like India lot needs to be done for making the system more strong and efficient.

**Second Stage is known as layering:** As the name suggest in this process the launderer engages in series of conversions or movements of funds by transferring it from

<sup>1</sup> Assistant Professor, Centre for Business Administration, School of Management sciences, Central University of Jharkhand, Brambe, Ranchi. smvipul.2012@gmail.com

<sup>2</sup> Assistant Professor, Centre for Business Administration, School of Management sciences, Central University of Jharkhand, Brambe, Ranchi. cs.poojashukla@gmail.com

<sup>3</sup> Assistant Professor, KCB College, Bero, Ranchi University, Ranchi

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one account to another account, from one bank to another bank to distance it from its source. Alternatively they may draw the money from bank and invest it in monetary and financial instrument and afterwards may sale it and deposit the sum in bank again or may wire the funds globally using online banking system or other facilities available.

**The third and last stage is integration:** In this stage launderer re-enters the fund in legitimate economy. The proceeds that launderer gets after completing the layering stage is used for investing in real estate, luxury assets etc. Once the laundered money enters the last stage and after completion of the last stage it becomes very difficult or we can say next to impossible to trace back the origin of the money. It is very necessary to detect, adjudicate the matter and punish the offender before he enters the stage of integration.

In developing economies like India, financial control regime is not stringent as compared to developed countries and this makes the India venerable destination for the laundering of money. In India several steps have been taken including enactment of the Prevention of Money Laundering Act, 2002 but still certain loopholes are present in the system which provides space to money launderers. Some of the loopholes are lack of proper KYC norms compliances while opening bank accounts and having transaction through banks, information technology led banking operations such as e- banking transactions are also used for disguising criminal origin of money by cyber finance techniques, lack of awareness amongst the common masses also makes them participant of the system unwillingly. Professionals, politicians, etc. in order to earn more money many times resort to activities that come under definition of money laundering. Absence of proper and efficient enforcement agencies and stringent penal provisions instead of deterring the offenders encourage them. Money laundering if unchecked leads to increased criminality, damages, financial institutions, increases the volatility of exchange rates, promotes insider trading and embezzlement etc, deters foreign investment, and takes the economy out of control of government. In India there is need of having stringent penal provision as present in USA and UK to curb the financial menace of money laundering.

#### **Comprehensive analysis of Money Laundering in the Indian Context**

Money Laundering refers to the conversion of money which has been illegally obtained, in such a way that it appears to have originated from a legitimate source. It is the process by which money earned from illegal activities is converted to legitimate money. Money Laundering is commonly referred to as the concept of concealing, relocating or seeking to retain the profits conducted from a crime. Laundered money is introduced into the financial system of the economy by the launderer following three step mechanism i.e. placement, layering and integration.

#### **Placement**

Huge sum of money generated by criminal activities and ill gotten gains if placed as such may attract attention of the authorities, launderers may get exposed and prosecution may be initiated against them. To avoid the attention of the authorities' huge sum of money is broken into small sums and afterwards they are deposited into large number of banks or are used for purchasing monetary instruments which are sold and money is deposited into banks. Following the process mentioned above the launderer succeeds in introducing the ill gotten gains and criminal proceeds into the financial system of the target economy. In countries having strong financial control placement is difficult, but in developing economy like India placement is relatively easy and this encourages launderer to use India as a money laundering destination.

#### **Layering**

As the intention of launderer is to disguise the criminal origin of money and ill gotten gains the step of layering acts as a boon for launderers. In layering i.e. steps following placement launderer engages in a number of transfers and movement of money by transferring it from one account to another account. The launderers' intention at this stage is to camouflage the illegal source. They keep changing destination of money by series of transaction which makes it difficult to ascertain the real origin of the money. For placement they choose countries having weak financial control and in course of layering using electronic banking facility they keep transferring money even from bank of one country to the bank of another country.

#### **Integration**

Integration stage is the last stage by which illegal funds are taken back into the financial system. After successfully completing the layering stage the next and the last stage is integration stage. It is the stage in which launderer withdraws the money from bank and invests it into real estate and luxury assets etc. It is noteworthy that even in the weak financial system authorities can detect the laundered money in the first two stages but once it enters the integration stage it becomes herculean task.

Before enactment of the Prevention of Money Laundering Act, 2002 following Acts were present in India which used to deal scantily with the issue of money laundering.

- a) The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.
- b) The Prevention of Illicit Traffic in Narcotic Drugs and Psychotropic Substances Act, 1988.
- c) The Narcotic Drugs and Psychotropic Substances Act, 1985.
- d) The Income Tax Act, 1961.
- e) The Benami Transactions (Prohibition) Act, 1988.
- f) The Indian Penal Code and Code of Criminal Procedure, 1973.

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In view of an urgent need for the enactment of a comprehensive legislation for preventing money laundering and connected activities, confiscation of proceeds of crime, setting up of agencies and mechanisms for coordinating measures for combating money laundering etc. Prevention of Money Laundering Act, 2002 was enacted and enforced. Prevention of Money Laundering Act, 2002 is an Act of the Parliament of India enacted to prevent money-laundering and to provide for confiscation of property derived from money-laundering. Prevention of Money Laundering Act, 2005 and the Rules came in to force with effect from 1<sup>st</sup> July 2005.

### **Salient Features of the Act**

#### **I. Offence of Money Laundering and its punishment**

An offence of money laundering is said to be committed when a person in any way deals with the proceeds of crime. The proceeds of the crime referred above include the normal crimes and the scheduled crimes. The prescribed punishment is 3-7 years rigorous imprisonment for an offence of money laundering with fine. In case of an offence mentioned under Part A, imprisonment would extend up to 10 years.

#### **II. Attachment, Adjudication and Confiscation**

The confiscation of the property under the Act is dealt with in accordance with the chapter III of the said Act. An official not below the rank of Deputy Director can order attachment of proceeds of crime for a period of 180 days, after informing the Magistrate. Thereafter he will send a report containing material information relating to such attachment to the Adjudicating Authority. Section 8 details the procedure of adjudication. After the official forwards the report to the Adjudication Authority, this Authority should send a show cause notice to concerned person(s) within 30 days. After considering the response and all related information, the Authority can give finality to the order of attachment and make a confiscation order, which will thereafter be confirmed or rejected by the Special Court.

#### **III. Obligations of Banking Companies, Financial Institutions and Intermediaries.**

The reporting entity is required to keep a record of all material information relating to money laundering and forward the same to the Director. Such information should be preserved for 5 years. The functioning of the reporting entity will be supervised by the Director who can impose any monetary penalty or issue warning or order audit of accounts, if the entity violates its obligations. The Central Government, after consulting the Reserve Bank of India is authorized to specify rules relating to managing information by the reporting entity.

#### **IV. Enforcement Paraphernalia**

*Adjudicating Authority* - The Act empowers the Central Government to constitute an Adjudicating Authority having a Chairman and 2 members and define their scope

of functioning and other terms of service. The Adjudicating Authority will operate through a Single or Division bench. The Authority has been given autonomous powers to regulate its adjudicating procedure.

*Administrator* - The property laundered will be taken care of i.e. managed after confiscation by an Administrator who will act in accordance with the instructions of the Central Government.

*Appellate Tribunal* - All appeals from an order made by the Adjudicating Authority will lie to an Appellate Tribunal constituted by the Central Government. It will consist of 2 members headed by a Chairman. An official can resign by sending his resignation to the Central Government thereby giving a 3 months' notice. He can also be removed by an order made by the Central Government on the grounds of misbehavior or incapacity.

*Special Courts* - The Central Government, after consulting the High Court is empowered to designate Court of Sessions as Special Courts. The Special courts can try all scheduled offences and that under section 4 and also offence under section 3, but after the authority requests in this behalf.

*Authorities under the Act:-*

- (a) Director or Additional Director or Joint Director
- (b) Deputy Director
- (c) Assistant Director and
- (d) Such other class of officers as may be appointed for the purposes of this Act.

#### **V. Summons, Searches and Seizures etc.**

The power of surveying and scrutinizing records kept at any place is conferred on the Adjudicating Authority. The Authority may ask any of its officials to carry on the search, collect all relevant information, place identification marks and thereafter send a report to it. The search of a person to be conducted is allowed if it is ordered by the Central Government. The authority authorized in this behalf cannot detain a person beyond 24 hours, must ensure the presence of 2 witnesses, prepare a list of things seized signed by the witnesses and forward the same to the Adjudicating Authority.

A property confiscated or frozen under this Act can be retained for 180 days. This period can be extended by the Adjudicating Authority after being satisfied of the merits of the case. The offences under the Act are to be cognizable and non-bailable.

#### **The Financial Intelligence Unit - India (Fiu-Ind)**

The Financial Intelligence Unit - India (FIUIND) is the nodal agency in India, which manages the AML ecosystem and has been helping, coordinating, strengthening and managing the AML ecosystem. It has significantly helped in coordinating and strengthening efforts of national and international intelligence, investigation and enforcement

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agencies in pursuing the global efforts against money laundering and related crimes.

#### **Myth**

The common myth related to the concept of money laundering is that black money and laundered money are same but it is not correct. Black money means money which has not been disclosed to income tax authorities for the purpose of tax evasion, it may be earned through legal business but laundered money is always crime generated proceed.

#### **Impact of Money Laundering:-**

- Increases criminal activities in the economy
- Damages social fabric of the economy
- It leads to volatility in exchange rate
- It weakens financial predictability of the economy
- It nourishes terrorism
- It deters foreign direct investment
- It leads to economic distortion and insatiability
- Undermines the legitimate private sector
- Weakens democratic institution
- Causes financial crisis
- Encourages tax evasion culture

#### **Comparative analysis of penal provision of money laundering in India and the United States of America:-**

##### **India**

##### *Prevention of Money Laundering Act, 2002*

Section 4 of the Act says that any person who commits the offence of money laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and also liable to fine. However, where the proceeds of crime involved in money laundering relates to any offence specified in under the narcotics drugs and psychotropic substances Act, the punishment may extend to rigorous imprisonment for ten years.

##### **The United States of America**

##### *Money Laundering Control Act, 1986.*

Money laundering charges can be levied in the 4<sup>th</sup>, 3<sup>rd</sup>, 2<sup>nd</sup> and 1<sup>st</sup> degree with the most serious offences being in first degree. 4<sup>th</sup> degree i.e.class E Felony with prison and sentence up to 4 years. 1<sup>st</sup> degree up to 25 years.

It is clearly evident from the above mentioned provisions that weak financial control along with the lenient legal system present in India acts as motivating factor and stimulator for launderers. In order to eradicate this menace we need strong financial system that is least or not susceptible to be used by the laundered along with stringent legal provision regarding punishment as present in the USA. As money laundering is an offence that causes damage to the various spheres of economy and nation, therefore more stringent, able, efficient, efficacious legal

and financial regime is required in the India context. The present legal and financial system is not up to the mark when compared with the realities of the present time. India will have to upgrade its financial and legal system and one of the solutions lies in making more stringent provisions regarding penalty and punishment.

#### **Conclusion**

Money laundering is not a problem specific to one country rather it is a menace existing globally. Countries having inadequate financial controls, especially developing and underdeveloped countries are targeted by money launderers. For fighting against the menace strong financial control and uniform legal provisions must be present across the globe. Difference in legal provisions and the absence of strong financial control acts as a motivating factor for the money launderers. Money laundering is an International phenomenon and can be checked and eradicated by having uniform financial control, legal practices and international cooperation. Difference in the laws relating to money laundering provides opportunity acts as motivating factor for the money launderers. Deterrent penal provisions along with imprisonment for a longer period of time are the need of the day. Thus, in the Indian context we need to have stringent legal provision and this can be done by enhancing the imprisonment provision and making it compatible with the developed nations. Here in India also as in the case of the USA we need to have a classification of offences related to money laundering based on the degree of severity and dampening impact on the social, economic, legal spheres of the country and the punishment and fines should be ranked accordingly instead of having one common parameter of punishment for all offences.

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