

***A REPORT ON
MONEY LAUNDERING AND
PREDICATE CRIME IN SERBIA
2000-2005***

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APPENDIX I

APPENDIX II

ALL NUMBERS ARE EXPRESSED IN EUROPEAN CONTINENTAL DECIMAL NOTATION WITH THE DOT SEPARATING THOUSANDS AND COMMA REPRESENTING DECIMALS.

1. Introduction: crime-economy, obscurity and questions for clarity

At present most jurisdictions devote major law enforcement efforts on money-laundering and its predicate crimes and Serbia appears to be no exception. In order to direct those efforts efficiently and achieve commensurate effects it is important to know the targeted criminal and law enforcement landscape. This means gaining an insight on the dimensions of the threat, what are the most frequent and disturbing crimes-for-profits and which activities are deployed by the responsible law enforcement actors to counter these law-breakers. The purpose of this research is to address these questions for Serbia in the period 2000-2005.

When trying to give a quantitative description of these aspects, and considering that the focus is on crime for profit, the key indicator (moral values apart) must be of course financial. Thus, when trying to gauge the seriousness of ongoing crime for profit or money laundering, emphasis is placed on the size of crime proceeds and on the amount of money that is laundered. Similarly, the various types of crime or schemes for money laundering will be weighed primarily in monetary terms, and their importance ranked accordingly. In short, the financial calculator should be the key unit of measure. Other indicators, such as the number of offences or cases, are also taken in consideration, especially in those instances where information of financial nature is lacking.

Assessing the seriousness of the criminal threat vis-à-vis the efforts of law enforcement entails considering three conceptual categories of crime: crime actually occurring (irrespective of society/law enforcement awareness or action), reported crime and sanctioned crime (actually a process: cases solved by police, indictments by prosecution, conviction by courts). Only by comparing information on each of these categories is it possible to establish to what degree are prevention and enforcement effective in relation to the threat.

Measuring “actual crime” is a leap into the unknown and only broad estimations of the kind no “more than” or “no less than” are usually possible. Such estimates rely on identifying relevant parameters that are then analysed and cross matched in order to identify inconsistencies (for example, between resources and expenses) and formulate hypothesis that can then be tested and narrowed down. As this method tends to move from the broader picture to the particular it shall be defined as the *top down approach*.

Assessments on “actual crime” may also be derived from careful analysis of available data on reported and sanctioned crime in order to deduce the broader picture. This approach will be defined as *bottom up* and is more likely to deliver insights on the relative weight of the

different crime typologies than on absolute dimensions. However, in principle it is also very relevant in the context of anti money laundering. Here specific institutions (Financial Intelligence Units) operate with the logic of fishing out the money and following its trail upstream, with the aim of uncovering the predicate crime. In principle, that is, assuming coordination and information sharing between institutions to be effective. This consideration brings to the critical aspect of the *bottom up* method: results will only be as good as the quality of data available. In this respect, crucial factors are size of the population that can be examined, and the possibility of organising it according to a range of meaningful parameters: the reliability of data and the use of consistent definitions across institutions and periods and the availability of time series.

A third, auxiliary approach relies on gathering perceptions through surveys. This approach is more likely to capture qualitative impressions. Although such opinions cannot replace analytical work, they do provide useful insights and help interpreting gathered facts. The possibility of obtaining information of some quantitative nature should also not be discounted. In short, surveys, constitute a valid “sanity check” tool to complement the other methods.

The methodology adopted in this research tried to take into account all three approaches, although researchers were aware from the start that their application would be severely limited by problems in gathering sufficient quality information. Indeed the information issue was the starting point of the whole research project: very little was known about money laundering and its predicate crime, other than there were very few reported cases of money laundering and very little information available. With these premises, the researchers’ endeavour appeared to be a veritable exploration on uncharted waters, with the plausible objective of getting as far as possible towards providing an answer to the questions initially posed and possibly shedding light on the distance still to be covered.

Initial impressions were to be substantially confirmed in the course of the work. Although capacity and information management of Serbian institutions in the field have considerably improved, the researchers still encountered issues of transparency and few tokens of a proper information management. Indeed, it proved to be extremely difficult to obtain data about the functioning of the authorities concerning law enforcement whether in economic, civil or penal law matters.

In the surveys of the social and economic situation of the region of South-east Europe, various authors of reports regularly indicate that the reliability of presented data of Serbia (and Montenegro) is very variable. More important, there is no key to determine the level of reliability of the various databases. In addition, focussing in this report on Serbia, many of the macro data do not (yet) differentiate between Serbia and Montenegro, though their economies are already separate for almost half a decade.

It should be acknowledged that the effort made by several institutions to fill this information gap and supply the researchers with available information was commendable. In some cases statistics were collected specifically for the purposes of the research, a circumstance that at the same time highlights the commitment of the institutions in question and the weakness of their information management system.

Because of this scarcity of empirical data, approaching the shady or criminal side of the Serbian economy to shed light on the issue of money-laundering by means of macro studies was somewhat speculative. However, going into more individual details would have made the study anecdotal on the other hand.

For this reason the researchers broadened their focus and exploited any opportunity to get data which could shed light on the non- or badly recorded economic criminal state of affairs and the exploits of the authorities. They were well aware that the present social, economic (and criminal) landscape of Serbia has been shaped in years of political turmoil and governmental neglect. When Milosevic was ousted from power in 2000, the economy in USD terms was about half the size it was ten years before.¹ The combination of the embargo during the wars in the Former Yugoslavia and mal governance brought the economy down. Though empirical data are lacking, the black or informal economy thrived, providing a means of survival to many and a lavish income to a smaller group of criminal and political entrepreneurs. The corruption index of TI was (and is) high², which naturally correlates highly with the above indicated lack of transparency in economic regulations, law enforcement and the records thereof.

This report should actually be read as a quest of the unrecorded wealth and incomes of Serbia. Not all these moneys stem necessarily from criminal activities and not all crime-money will be laundered. Because of the lack of data and because the authors wanted to avoid definitional debates, they have been very parsimonious with the qualification 'laundering'. Instead, in *chapter 2*, they first give an account of how they tried to penetrate the various information gaps to find out what is officially known about damage and income from crime. In addition in *chapter 3* a comparison was made between what is known about the household income and spending. If the household spends systematically beyond its means there are reasons to speculate about how they make up for the deficit when they are not depleting its savings.

¹ For example, GDP in USD terms decreased from 13.889 million in 1998 to 8.603 million in 2000. Similarly, Purchasing Parity (PPP) per capita GDP decreased from 4.365 USD in 1998 to 3.795 in 2000 (Source: IMF World Economic Outlook)

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

In *chapter 4* the researchers continued the reconnaissance by mapping the money flows into and out of Serbia to find out whether these flows balanced. The background philosophy is that large volumes of unrecorded financial assets must leave some trace and/or yield some imbalance. Being parsimonious with interpretations, the analysis brought some unanswerable questions to the surface, with Cyprus as the big financial question mark.

Chapter 5 elaborates what is known about economic and fiscal crime. The reader will again face many methodological annotations, due to the inconsistency of the database formats of the various law enforcement agencies that deal with economic, fiscal crime and corruption. According to the official figures, detection of economic and fiscal crime rates is improving but still pretty low, which reflects itself in the low number of prosecutions for such crimes. From the perspective of proceeds abusing the official position appears to be the most rewarding offence.

In *chapter 6* the reports sketches the institution and regulation which are put into place to counter money-laundering. Recently the anti-laundering legislation has been updated. Many enterprises have been included in the list of institutions obliged to report to the Administration for the Prevention of Money Laundering, with the exception of the Privatisation Agency. All this has resulted in an avalanche of reports of which less than 1 % is qualified as suspicious. The number of money laundering prosecutions is about ten, while there are no known convictions (yet).

Chapter 7 records the opinion of the focal groups from the authorities and private industry convened to capture qualitative impressions and opinions on the issues raised in the preceding chapters. The authorities' representatives and those of the private industry differ in the trust they have in the transparency and efficiency of the Serbian society.

The report concludes with recommendations to improve various aspects of the anti-laundering regime. The recommendations concern aspects of human skills and organisation as well as of necessary improvement in the data management in law enforcement matters in general and in the anti laundering system.

2. Material damage and the proceeds of crime in Serbia

Estimating the profits from crime or the even broader phenomenon of the informal economy is in all economies shrouded in clouds of uncertainty. The ranges within which the estimated illegal incomes are related to the GDP vary enormously, depending on the parameters selected.³ Such estimates usually cover the whole unregistered economy, of which crime-for-profit is just a subset.⁴ Apart from that, crime-for-profit itself is not a clearly delineated subset either, encompassing a wide variety of criminal conduct: ‘traditional’ property crime as well as all forms of economic crime, including tax evasion, which is the logical consequence of unregistered (criminal) economic activities. For this reason, a differentiation between forms of crime-for-profit and unregistered economic activities was made by the researchers only in cases in which the underlying evidence provided justifications to do so.

It is perhaps best to begin by trying to give a first general estimate of the dimensions of crime, or at least what is reported. The following step would then be to try and detail the overall figure according to the different types of crime and understand which are the most relevant in the Serbian context during the period under examination. According to the information provided by the Ministry of Interior (Table 2.1), material damage from reported crime in the period 2000 – 2005 amounted to a total of 86 billion DNS (corresponding approximately to a range of 1.200-1.400 million €). Material damage of crime reported in 2005 was 25,7 billion DNS. Close to 70 billion DNS (more than 80% of total) of all damage from crime reported between 2000 and 2005 is attributable to economic crime.

*Table 2.1. Ministry of Interior crime reports and material damage
2000- 2005*

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

YEAR	2000	2001	2002	2003	2004	2005	TOTAL	%
General crime	883	1.353	1.259	1.679	1.253	2.316	8.742	10,2%
Economic crime	17.800	9.992	6.736	7.197	6.724	21.272	69.720	81,2%
Against property	618	1.161	1.036	1.238	1.219	2.169	7.441	8,7%
Total	19.300	12.506	9.031	10.114	9.196	25.757	85.904	100,0%

Source: Ministry of Interior

³ Estimates cited for Serbia are in the range of 25% - 35% of GDP. However, to the researchers' knowledge, no in depth surveys/estimates on the Serbian grey economy have been carried out so far. The Statistical Office is currently refining a methodological approach to the issue.

⁴ See O. Lippert and M. Walker, “*The Underground Economy. Global Evidence of its Size and Impact.*” The Fraser Institute, Vancouver, 2005

2.1.b) Number of criminal offences reported 2000- 2005:

Crime Category	2000	2001	2002	2003	2004	2005	Total	%
Economic crime	12.792	12.916	13.889	12.017	12.069	13.143	76.826	13%
Life and body	3.692	4.011	4.156	4.417	4.976	5.164	26.416	4%
Property	70.278	83.247	55.545	45.374	50.703	54.274	359.421	59%
Safety of public transport	6.952	8.753	6.637	7.225	7.927	7.594	45.088	7%
Civil freedoms, reputation etc.	442	438	428	445	474	472	2.699	0%
Other	11.560	11.945	14.062	20.119	22.798	21.107	101.591	17%
Total	105.716	121.310	94.717	89.597	98.947	101.754	612.041	100%

Source: Ministry of Interior

The relevance of economic crime in Serbia is well portrayed in the following press article:

Blic Press, 2005 (08/10/2005): “Serbia loses 7.5 billion DNS per year because of economic crime”

“When one MD from Pancevo issued confirmation to a patient that he needed exceptionally expensive medical drug for treatment of a serious disease, that the patient in question actually did not suffer from, the MD in question had not thought at all that their deceit would be uncovered. Department for fight against the economic crime found out that the false patient managed to get 3,5 million DNS as a refund from social health. This is only one of about 9.459 criminal acts uncovered in the first nine months that cost Serbia about 200 million euros yearly.”

It must be said that a commonly accepted definition of economic crime as a part of the organised crime phenomenon is still lacking. Council of Europe Recommendation n.12/81 on economic crime may be considered a general guideline as it lists several offences including several kinds of fraud, collusive behaviour and cartel building, tax and currency regulation evasion, bogus firms, stock exchange offences and banking offences. According to the Council of Europe⁵, economic crime “has an adverse impact beyond individual victims and the material damage in that it affects a large number of persons, society and the state in general; it damages the functioning of the national or international economy and it causes a loss of trust and confidence in the economic system.” Taking this as a conceptual framework the researchers did not differentiate between economic or organised crime as the focus is crime-for-profit as such.

In the Serbian penal system, economic crime typologies are included in the categories of “crime against the economy” and “crimes against official duty” of the criminal code as well

⁵ Cited CoE report “Organised Crime Situation Report 2005”

as in a set of special laws.⁶ For 2005 the economic crime frequencies, the estimated damages and proceeds were brought together.

As detailed in table 2.2, in 2005, proceeds of economic crime were in the region of € 230 million, whereas damage to Serbian Society was above € 250 million.⁷ It is interesting to note that the most common crime category – both in terms of number of cases and financial volume – appears to be *Abuse of Official Position*.⁸ While this offence accounts for 39 % of all economic crimes, its share of the total estimated proceeds is 94 %. There is a serious caveat: there are no figures about the proceeds of business fraud, while for some crime categories the proceeds are higher than the financial damage.

Table 2.2. Economic crime in 2005

Economic Crime 2005	number of cases	%	Damage		%	Crime Proceeds		%
			DNS MM	EUR MM		DNS MM	EUR	
Negligence in business activity	200	2,7%	799,0	9,6	3,8%	0,0	0,0	0,0%
Abuse in business authority	272	3,7%	373,0	4,5	1,8%	298,0	3,6	1,6%
Illegal acquisition & use of loan	204	2,8%	52,0	0,6	0,2%	75,0	0,9	0,4%
Illegal trade	1.076	14,6%		0,0	0,0%	84,0	1,0	0,4%
Tax evasion	156	2,1%	481,0	5,8	2,3%	461,0	5,5	2,4%
Fraud	511	7,0%	128,0	1,5	0,6%	138,0	1,7	0,7%
<u>Abuse of official position</u>	<u>2.851</u>	<u>38,8%</u>	<u>18.000,0</u>	<u>216,4</u>	<u>86,3%</u>	<u>17.950,0</u>	<u>215,8</u>	<u>94,4%</u>
Business fraud	1.881	25,6%	1.020,0	12,3	4,9%		0,0	0,0%
Accepting bribe	159	2,2%		0,0	0,0%	4,0	0,0	0,0%
Offering Bribe	38	0,5%		0,0	0,0%	0,7	0,0	0,0%
Total	7.348	100,0%	20.853,0	250,7	100,0%	19.010,7	228,5	100,0%

Exchange rate: 83,19 DNS per 1 EUR

Source: Ministry of Interior

⁶ Up to the end of 2005 the criminal code was based on the old Yugoslav Federal Criminal Code and the Serbian Republic Criminal Code. The framework was overhauled at the beginning of 2006 with the introduction of the new Criminal Code. Penal provisions are included in many other acts, including the Law on Business Companies, the Law on Foreign Exchange Operations, the Accounting and Auditing Law, the old (Federal) Money Laundering Law, etc.

⁷ Council of Europe Report “*Organised Crime Situation Report 2005*” estimates material damage from economic crime in Serbia in 2003 in a range between 300 million and 500 million euros (p. 80 of cited Report).

⁸ Art. 242 of the Serbian Republic Criminal Code in force until 2006.

3. Assessing Through Gaps

What do the figures in the previous chapters mean –assuming they approach reality– and to what should they be related? Represent all these figures ‘launderable’ income of wrongdoers? No, because ‘damage to the public fund’ should not be equated to income to the wrongdoers. Fiscal damage as calculated by the Inland Revenue is usually larger than the illegal income of the fraudsters. In addition, laundering in the sense of *legitimizing* illegal income is rather a necessary *consequential* activity for the middle and upper echelon criminal earners. The common man’s economic crime may be substantial in accumulative terms but per earner-unit (person or household) it is too little for money laundering activities.⁹ By means of daily household expenses the illegal profits simply trickle back unseen into the licit economy. Hence, without a proper frequency distribution broken down by unlawful income and earners, a total figure of illicit money says little about money laundering in the meaning of explicit laundering activities.

3.1. Resources and expenses

Another question is to what extent this hypothetical economic crime figure is to be considered ‘bad’, in economic terms (apart from morals). To address this question it is necessary to relate it to an economic parameter like national income: either gross or net national income. For the year 2003 the Yearbook 2005 of the Serbian Statistics Bureau¹⁰ mentions a *gross* national income of approximately € 16.831,1 million and a *net* national income of approximately €14.323,1.¹¹ For illustrative reasons it is assumed that the economic crime damage was the same in 2003 as in 2005: € 230 million (table 2.2). The economic crime damage was then related to these income figures, arriving at a percentage of 1,5% and 1,8% respectively. However, as mentioned above, this inference would not be correct as the damage does not equal the illegal income. In addition, it is unknown whether and to what extent this illegal income is included in the national income. After all, illicit income is also income from services and goods. In addition, as soon as that income is spent

⁹ Technically, according to most legal money laundering definitions any handling of illegal income is laundering.

¹⁰ STAT.YEARB.SERB.2005

¹¹ In current 2003 dinars the figures are for gross national income DNS 1.095.029, 9 million, and for the net national income of DNS 931.859,8 million. GDP in 2003 was DNS 1.095.402,2 million (Chapter 6 of STAT.YEARB.SERB.2005) with an average exchange rate in 2003 of 65,06 dinars to the euro.

in the country's economy it adds again to other licit incomes in the form of profits and (indirect) taxes.

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

STAT.YEARB.SERB.2005, reports the data of income and spending obtained in 2004 by means of a Personal Consumption Survey among 4.328 households, selected representatively in rural and urban areas (table 8.1 of the Yearbook). The items of the questionnaire concerned the amount and nature of the average *monthly* income and monthly spending, including the objects of spending.

The figures for monthly spending per *household member* of 7.565 DNS and resources per *household member* of 7.135 DNS reveal a monthly average deficit of 430 DNS per *household member*. These figures translate to monthly resources per *household* of 21.833 DNS, monthly spending *per household* of 23.149 DNS and a *monthly deficit per household* of 1.316 DNS (about € 18/€20). Crudely translated in an annual figure, the average yearly deficit of households in the sample is still a modest 15.790 DNS (approx. € 250). However, one needs also to consider that:

- 1.the deficit represents a full 6% of available resources and, on an annual basis, it is greater than the average 2004 net monthly salary reported by the Statistics Bureau (14.108 DNS¹²);
- 2.as shown in table 3.1, considering an estimated number of 2.584.891 households¹³ if one projects the results of the interviewed sample to the whole of Serbia one may estimate an aggregate annual household deficit amounting to a respectable DNS 40.814 million (over. € 600 million), that is, 3,3% of GDP in 2003.

¹² table 5.17 of STAT.YEARB.SERB.2005

¹³ table 8.1 of STAT.YEARB.SERB.2005

Table 3.1. Household sector cumulated monthly deficit 2004

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

	DNS	EUR
<u>Household members:</u>		
Available resources per household member	7.135	98,32
Spent resources per household member	7.565	104,24
Surplus (deficit) per household member	- 430	-5,93
<u>Households</u>		
Available resources per household	21.833	300,86
Spent resources per household	23.149	318,99
Surplus (deficit) per household	- 1.316	-18,13
<i>% on available resources</i>	<i>-6,0%</i>	
<u>Aggregate (projection on whole) of Serbia</u>		
Monthly resources	56.436.183.692	777.679.257
Monthly expenses	59.837.383.270	824.547.103
Surplus (deficit)	- 3.401.199.578	- 46.867.846
<u>Annual estimate on whole of Serbia</u>		
Annual estimated resources	677.234.204.305	9.332.151.086
Annual estimated expenses	718.048.599.239	9.894.565.237
Surplus (deficit)	- 40.814.394.934	- 562.414.151

(average exchange rate 72,57 in 2004)

In trying to understand how this deficit is financed one should recall that income is not the only resource available for spending. One should also consider transfers (e.g. welfare benefits), the households' wealth (i.e. savings accumulated in the past), and other sources such as gifts and, if reasoning in terms of cash flows, one should also include borrowings, net of reimbursements of principal and of interest paid. As shown in table 3.2 all these sources of "spending power" appear to be considered by the surveyors:

Table 3.2. sample household member monthly resources:

Resources	DNS	% on total
Salaries and wages	3.902	54,7%
Transfers from Government organisations	1.997	28,0%
Transfers from non Government organisations	96	1,3%
Transfers from abroad	68	1,0%
Revenues from agriculture, fishing, etc.	715	10,0%
Salaries in kind	17	0,2%
Gifts in Kind	45	0,6%
Transfers in kind from abroad	17	0,2%
Other receipts (lease, interests, savings)	278	3,9%
Total	7.135	100%

Source: STAT.YEARB.SERB.2005

Unfortunately the categories used by the surveyor do not clearly distinguish between resources that are owned and resources that are borrowed and, with regards to the former, between flows currently received that can be correlated to GDP (income and transfers), and resort to the stock of wealth that was either accumulated in the past (e.g. savings or sale of assets) or whose current appreciation (capital gain effect) would not be recorded in GDP. Also, some of the definitions are not well crafted, so that it is quite unclear¹⁴ whether all potential sources are included. Thus, it is not certain whether the survey captured all sources nor is it known if it also contained a question about how the interviewed households bridged this deficit.

The distribution of the deficit among households is an important factor in trying to find an explanation for the deficit. One cannot deduce much from an 'egalitarian' distribution, whereas a highly concentrated distribution could mean that a few persons have the ability to draw on 'hidden' sources to finance their expenses. These could also include concealed proceeds of crime, although this is only speculation. The survey data presented by the Statistics Office does not include any information about distribution other than geographically. As shown in table 3.3, with the exception of Vojvodina (that actually shows a surplus) there does not seem a large variance between regions:

¹⁴ For example the Statistical Office defines savings as "covering receipts from selling securities (stocks and dividends), borrowing repayment and cash decrease (mutual subsidy funds, deposits withdrawn from banks and other)". Selling of stocks entails depleting the stock of wealth accumulated in the past (negative saving) whereas dividends are a source of income (flow). More important, the definition would seem to exclude the selling of other assets (vehicles, jewelry, other valuables, etc.)

Table 3.3. Sample breakdown by region:

	TOTAL SERBIA	CENTRAL SERBIA			VOJVODINA
		Total Central	Not Belgrade	Belgrade	
Number of households surveyed	4.328	3.198	2.218	980	1.130
total number of households estimated	2.584.891	1.868.815	1.279.846	588.969	716.076
% covered	0,17%	0,17%	0,17%	0,17%	0,16%
Average number of household members	3,06	3,09	3,17	2,93	2,99
<i>Household members (DNS):</i>					
Available resources per household member	7.135	6.887	6.027	8.878	7.782
Spent resources per household member	7.565	7.500	6.654	9.451	7.729
Surplus (deficit) per household member	- 430	- 613	- 627	- 573	53

Source: STAT.YEARB.SERB.2005

It is difficult to relate these outcomes to other figures in the STAT.YEARB.SERB.2005 or in other open sources due to the different meanings of 'households', which in some statistics seem to comprise (personal/family) enterprises as well. Though there is no certainty that other tables use the same definition of household, the NBS household saving statistics show that even with this spending deficit the saving deposit rate increases, though mainly in foreign currency. The total *DNS* saving at the banks increased from 714 million in 2000 to 4.233 million in 2003, while the *foreign* currency saving deposits increased from 3.008 million to 69.738 million *DNS*. Meanwhile the short term credits of financial institutions to households increased from 916 million *DNS* in 2000 to 11.264 million *DNS* in 2003; in the same period the long-term credits increased from 1.697 million to 17.274 million *DNS*. Putting these outcomes together, the plausible hypothesis is that the Serbian households saved more (in foreign currency) than it borrowed in *DNS*, while they spent more than they earned without (on average) eating into their savings. It is an interesting discrepancy for further research.¹⁵

It is clear that there is an interpretation problem in the search for the (im)balance between disposable resources and actual spending. In 2004 the Statistics Bureau carried out the same survey for the year 2003.¹⁶ The result was indeed a monthly surplus of resources over expenses, but only for the minuscule amount of *DNS* 204 (less than € 3,0). This is clearly at the margin and, as it seems that the Statistics Bureau has conducted the survey for a number of years, it would be interesting to complete the time series and assess:

- whether and to what extent is there a structural, on-going household spending deficit; and

¹⁵ Statistical Bulletin 2004; National Bank of Serbia.

¹⁶ (Refer to STAT.YEARB.SERB.2004)

- how this is being bridged in some way, if bankruptcy figures do not correlate with the rate of (hypothetical) indebtedness.

Of course, this does not allow a straight conclusion of ‘money laundering’, unless all hidden incomes and its spending are equated with crime-money and laundering, and such conclusion would unduly stretch the meaning of these notions. However, the outcomes of this approach will determine the perimeter within which one can search for the higher spending and (hidden) income echelons. A pertinent question is to see whether data will enable to assess the big financial ‘gaps’, with the assumption of approaching high-profit crime and related laundering.

In any case, the Wealth Effect of concealed (possibly illegally acquired) assets seems relevant for Serbia where the phenomenon of ‘capital resurfacing’ is notorious and the ‘previously held under the mattress’ explanation is often given when depositing large sums for the first time. Indeed, Serbia passed the law taxing ‘extra-profit’ precisely to deal with the problem, and it has been argued that the implementation of the first money laundering law was allegedly delayed to allow such resurfacing without too much fuss.

Explanations for so much ‘cash under the mattress’ commonly refer to the years of turmoil, lack of trust in the currency and in the banking system. Whilst there is truth in these explanations, the idea of a prospering society in need of finding a safe haven for its surplus does not sit well with Serbia’s recent past. If anything, the overreaching issue many Serbians faced was how to make ends meet in a plunging economy. It should be investigated how many succeeded in making ends meet splendidly, for example by studying the expenditure patterns after basic needs have been satisfied.

3.2. Valuables and income

Based on general police experience one can draft a (hypothetical) rank order of spending for those who experience a (criminal) windfall. Conventional wisdom has it that preference of criminals of luxury goods for themselves and for their families, followed by a better dwelling and travelling, perhaps to those sunny places where the unrecorded money can be deposited safely. For this reason it would be appropriate to look for luxury spending patterns: ‘rolling stock’, other valuables and real estate. Unfortunately the available data are meagre. As far as ‘rolling stock’ is concerned some data was gleaned together from various sources (Tables 3.4 and 3.5)

Table 3.4. Motors (parts) for motor vehicles and cars

	<i>Import in US \$</i>	<i>Export in US \$</i>	<i>Import in US \$</i>	<i>Export in US \$</i>
2000	13.671.460	14.593.770	70.769.500	4.520.487
2001	13.605.500	13.756.930	56.648.890	3.006.750
2002	20.170.130	14.199.560	72.856.940	2.056.852
2003	23.667.600	15.743.830	108.790.000	3.594.526

Coach works and parts

Trucks

	<i>Import in US \$</i>	<i>Export in US \$</i>	<i>Import in US \$</i>	<i>Export in US \$</i>
2000	31.864.800	32.039.600	149.745.500	9.078.938
2001	42.458.540	41.970.880	83.702.260	4.709.609
2002	56.859.490	25.181.529	168.916.800	8.129.179
2003	74.876.090	30.864.402	329.522.000	7.236.832

Source: Dutch Ministry of Economic Affairs, Economic Information office.
<http://www.evd.nl/info>. Consulted, April 2006

Table 3.5 Serbian Vehicle manufacturing industry

	2002 DNS MM	2003 DNS MM	2004 DNS MM
Imports	10.494	17.280	25.301
<i>annual growth</i>		65%	46%
<i>2002-2004 growth</i>			141%
Exports	192	262	395
<i>annual growth</i>		36%	51%
<i>2002-2004 growth</i>			106%
Domestic production*	4997	4767	5186
<i>annual growth</i>		-5%	9%
<i>2002-2004 growth</i>			4%

* determined by reinflating data in table 6.5 Statistical Yearbook 2005
 (expressed in 2002 constant prices) according to manufacturing price
 index in table 12.1 of Yearbook

Domestic production (units)	2003	2004	% change
Cars	11.370	14.549	28%
Buses	180	183	2%
Trucks	466	647	39%
Engines	15.296	15.827	3%

Source: STAT.YEARB.SERB. 2005

The trade figures for cars and related cars supports the suggestion that it is not inappropriate to take a further look at car trade: on the one hand, there is a stark increase of import of

passenger cars and a more than 100% increase of trucks import. On the other hand, the export in US dollars of the same vehicles is much smaller. However, there are differences with the official statistics. According to STAT.YEARB.SERB.2005, the import of passenger motor vehicles was \$ 432.000.000 plus \$ 19.000.000 'other transport means' for 2004 (table 17.6 of the Yearbook).

The next step to uncover discrepancies would be to single out the high price vehicles and relate them again to the available income. The same applies to other highly priced expenses, like real estate, as mentioned before. However, for this exercise there are no recent or valid data. Six years ago an analyst observed in the International Real Estate Digest 2000, that Serbian property prices and official purchasing power were moving in opposite directions, which again raises the need for addressing and updating the spending deficit question.¹⁷

¹⁷ The author, Simeon Mitropolitiski, indicates that this contrary movement of income versus real estate price is not unique for Serbia, but is also observed in FYR Macedonia and Montenegro.

4. The International money flow

Another approach is to survey the flow of money, also from the perspective of potential financial gaps, either of payment surpluses or deficits, which cannot be accounted for by other parameters. Again, it goes without saying that such gaps should not be equated directly to 'laundering'. If there are gaps, an economic explanation must be searched in the first place. To this end the researchers first looked for the foreign payments and receipts the information of which was provided by the National Bank of Serbia for the years 2003-2005. The outcome (in €s) is presented in Table 4.2.1.

Before entering into the description of the analysis conducted, it should be again stressed that without an in-depth study of all the economic variables, any conclusive statement would be a jumping to conclusions. Therefore, the researchers restricted themselves to raising questions and making observations by way of hypothesis.

4.1. Serbian Balance of Payments

An analysis of international monetary flows is essentially based on the observation of flows recorded in the *balance of payments*. Statistics on the Serbian Balance of payments for the years 2003, 2004 and 2005, a brief description of the structure of balance of payments accounts and key definitions are included in Appendix 1.

The National Bank of Serbia (NBS) prepares the balance of payment statistics¹⁸ from the information submitted for foreign currency transactions according to the rules set out by law. In the period under examination these were provided in the "Guidelines for the implementation of decision to the conditions for transfer and manner of arranging payments made, payments received and transfers under current and capital transactions in foreign currency and DNS" ("Foreign Exchange Law", FRY Official Gazette 25/2002 and 34/2002). The new Law on Foreign Exchange Operations introduced in 2006¹⁹ has confirmed the NBS supervisory role on foreign exchange operations.

¹⁸ According to the Foreign Exchange Law (Official Gazette of FRY n.23/2002) the National Bank is tasked with making projections of the Balance of Payments and the Statistics are published in the NBS annual report. Due to the time lags involved in obtaining final figures, the report of any given year only contains provisional data for that year. For this reason, figures for any given year were obtained from the following year's report, if available. The Latest provisional figures for 2005 have been considered.

¹⁹ Law on Foreign Exchange Operations (RS Official Gazette no. 62/2006).

According to art. 16 of the mentioned Guidance: “...for international payments to be made the ordering party shall submit a payment order containing the required items as provided by these guidelines to a bank. The ordering party shall attach a document on which such payment is based.” These instructions include specimen of forms to be filled for executing transactions. The form relating to payment orders requires the following information:

- transaction description;
- reference code for identifying the type of transaction according to the classification provided in the instructions themselves. For example:
 - code 112 – payments received or made for the import or export of goods after the goods have been imported or exported;
 - code 506 – advance payments received up to 90 days (prior) to export of goods;
 - code 106 – advance payments made up to 90 days (prior) to import of goods;
- for foreign trade transactions the form also requires the registered contract number and year.

According to the statistics published by the NBS, the balance of payments for the years 2003-2005 presents a negative balance, largely due to a structural deficit in the balance of trade (See Appendix 1). The gap between the import and export of goods tends to widen with the growth of the Serbian economy (– 4.618 USD million in 2003 increasing to – 5.563 USD million in 2005) and is partly compensated by:

Current account

- Small and declining surplus of services exported over services imported (+289 USD million in 2003 falling to +17 USD million in 2005);
- A more substantial positive balance of current transfers, mainly remittances from abroad (+3.370 USD million in 2005).
- Serbia also benefits from grants received from other countries and multilateral organisations (476 USD million in 2003, 475 USD million in 2004, 330 USD million in 2005).

Capital account

- Robust flows of net FDI (+1.360 USD million in 2003 rising to +1.481 USD million in 2005) and loans received (+1.195 USD million in 2003 rising to +2.523 USD million in 2005). However, loan reimbursement is also increasing;
- On a much smaller scale, credit on the import of oil.

4.2. Description of collected data

The first step was to understand the pattern of currency flows between Serbia and other countries on a bilateral basis. This would enable to detect flows with specific countries that might be considered unusual and worthy of further analysis.

The NBS was therefore asked if they would provide for the years from 2000 to 2005 a quarterly or half –year break down of balance of payments statistics by country (bilateral balance of payments with all countries that trade or have financial relations with Serbia). The NBS was also asked to provide a breakdown by currency of each bilateral account and provide for each currency:

- 1) monetary amount of flows;
- 2) number of transactions.

For each country the NBS provided half-year data on total currency inflows and outflows for the period 2003/2005 (no figures were provided for the years 2000, 2001 and 2002). These figures were interpreted as representing the sum of the current account and capital account inflows/outflows²⁰.

²⁰ As described in Appendix 1, the following terminology is used in this chapter

- Overall inflows (exports): the sum of the inflows (exports) of the current account and of the inflows (exports) of the capital account.
- Overall outflows (imports): the sum of the outflows (imports) from the current account and of the outflows (imports) of the capital account.
- Overall flows: in general, the sum of current account flows and capital account flows.

Table 4.2.1. Example (Austria) of the information received from NBS for each country/time period

“Serbia:

Balance of Payments

For the period 01.01.03/30.06.03

Country	Currency	Receipts	Payments	Difference	No of receipt transactions	No of payment transactions
Austria	EUR	4.333.974.618,45	4.281.423.208,23	52.551.410,22	12.730	15.959
	USD	2.744.798.848,25	2.759.336.577,77	-14.537.729,52	1.523	1.003
	ATS	120	0	120	1	2
	AUD	9.676.397,95	9.626.343,75	50.054,20	97	180
	CAD	3.161,69	941,57	2.220,12	3	7
	CHF	34.416.419,37	27.844.220,92	6.572.198,45	132	88
	GBP	192.935,27	5.198,47	187.736,80	118	23
	JPY	0	235.415,00	-235.415,00	0	23
	SEK	912.270,99	25.810,00	886.460,99	9	1

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

1. size of flows in terms of monetary amounts and/or number of transactions;
2. geographic location;
3. unusual flows observed; and
4. countries that are considered “tax havens”

The cumulated 2003-2005 inflows and outflows for the selected countries in terms of €s are set out in the Table 4.2.2. Figures are to be considered an estimate as individual currencies had to be converted into €s and, for the purpose, the average rate (not weighted) for each 6 month period analysed was used.²¹ Nevertheless, converted figures are still quite indicative considering that 60% to 70% of all transactions in any given period were in euros (no need for conversion). Furthermore, approximately 95% of all transactions in any given period were in €s or USD. Maximum fluctuation of €/USD exchange for the 3 year period were within $\pm 20\%$ of the 3 year average.

²¹ An accurate conversion would have required calculating the average of the actual rate applicable to each and every transaction, weighted by the size of the transaction itself.

Table 4.2.2. Estimated EUR cumulated 2003-2005 overall inflows and outflows of countries in the sample

Rank	Receipts (EUR*)	2003-2005	Rank	Payments (EUR*)	2003-2005
1	Austria	20.685.410.753	1	Austria	20.439.346.730
2	Germany	14.946.667.970	2	Germany	13.547.675.521
3	USA	4.223.118.005	3	USA	3.587.730.458
4	Greece	3.149.131.311	4	Greece	3.268.741.613
5	CH	2.674.662.394	5	Cyprus	2.414.118.938
6	Russia	1.837.217.432	6	CH	2.327.715.871
7	UK	1.483.893.308	7	Russia	2.097.175.919
8	BiH	1.380.851.021	8	UK	1.737.525.538
9	Slovakia	1.109.036.342	9	Italy	1.673.914.278
10	Italy	1.084.622.589	10	Slovakia	1.463.075.213
11	Netherlands	1.073.277.191	11	Hungary	1.147.035.994
12	Cyprus	828.815.724	12	Croatia	716.213.298
13	Czeck Republic	720.868.244	13	Czeck Republic	604.106.445
14	Croatia	545.374.353	14	BiH	580.130.791
15	Luxemburg	481.716.541	15	Netherlands	562.893.391
16	Hungary	367.553.053	16	Liechtenstein	220.245.203
17	Liechtenstein	118.762.195	17	British Virgin Islands	195.206.313
18	British Virgin Islands	28.425.128	18	Gibraltar	165.884.130
19	Gibraltar	4.626.760	19	Luxemburg	47.994.965
	total	56.744.030.316		total	56.796.730.609

* converted at estimated rate - not weighted)

Before conducting any further analysis, the data from the sample was matched with official balance of payments statistics (included in Appendix 1). These figures are in USD, whereas the flows in Table 4.2.2 are in €. However it was immediately apparent that cumulated flows of the sample were substantially larger, as shown in Table 4.2.3. Any conversion of the official numbers into €s (or the reverse) would further highlight the gap.

Table 4.2.3: Comparison of sample and official balance of payments cumulated flows²²

Cumulate 2003-2005	Overall Inflows (Receipts)	Overall Outflows (Payments)
NBS Official balance of payments cumulated 2003/2005 overall flows (current + capital +/- errors and omissions):	40,1 USD billion	36,3 USD billion
Sample cumulated 2003/2005 overall flows	56,7 EUR billion	56,8 EUR billion

Clearly a sample extracted from a population cannot be larger than the population itself. When asked for clarifications, the NBS responded that the figures provided were not netted

²² "Errors and Omissions" are included in the official balance of payments figures considered for the comparison with the sample.

of *neutral transactions*²³. If the difference highlighted in Table 4.2.3 were indeed attributable to neutral transactions, then these would be at least equal to, respectively, 42% of Serbian Balance of payments current account + capital account inflows and 56% of outflows²⁴. Upon further reflection, these percentages appeared unusually high and, considering that some international money laundering triangulation schemes may manifest as transactions between residents or between non-residents, the NBS was asked if they could provide a list and description of transactions defined as neutral according to their methodology. Furthermore, a new set of data that did not include neutral transactions was requested²⁵. This time for a restricted group of countries:

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

Money flows with these countries expressed in the various currencies were converted into € according to the method use for the conversion of the first set of statistics received. The data provided by the NBS for these countries and subsequent analysis is included in Appendix 2.

4.3. Observations on the second set of data

a. Neutral Transactions

Information provided by the NBS on the typologies of neutral transactions did not go beyond a rather generic indication that these included “*exchange operations, depositing of foreign exchange currency of domestic banks to foreign accounts and portfolio operations of NBS*” and no further information was provided.

Furthermore, data received for the selected 6 countries included in the capital account the item “transactions between non-residents”. Whilst eliminating such transactions from the data received from the NBS was straightforward, their initial inclusion raised concerns that there might have been a misunderstanding on the kind of data to be provided (supposedly devoid of ANY neutral transactions) and that, perhaps additional neutral transactions might

²³ See Appendix 1 for definition

²⁴ The actual weight of neutral transactions must be even greater. 1) The sample does not include all countries and currencies 2) The percentages were calculated without prior conversion of the two sets of figures into a common currency (USD or €).

²⁵ It was specifically clarified that data for the countries listed had to be provided broken down by item of balance of payment (balance of trade, services, remittances, capital flows etc.) and currency.

be included in other items of the balance of payments as well (thus without separate evidence and no possibility of eliminating them).

While waiting for clarifications, it was assumed that all neutral transactions had indeed been highlighted or excluded. For the six selected countries the new data was compared with the first set received (see Table 4.2.2.). The difference between the two sets of data is equal to *transactions between residents* involving the countries. The total neutral transactions can then be obtained by adding the *transactions between residents* with the *transactions between non-residents* already highlighted in the capital account of the second set of data. As shown in Table 4.3.1, the ratio of neutral transactions (including both transactions between residents and between non residents) to non-neutral (balance of payments) transactions for the 6 countries in the sample is even greater than for the total Serbian balance of payments:

- **Overall inflows (exports):** neutral transactions are 145% larger than normal resident/non resident transactions. The US and Switzerland record the highest ratios of neutral to non-neutral transactions (448% and 212% respectively).
- **Overall outflows (imports):** neutral transactions are 69% larger than normal resident/non resident transactions. The US and Russia record the highest ratios of neutral to non-neutral transactions (again 448% and 98% respectively)

Table 4.3.1: Sample cumulate 2003-2005 overall (balance of payments) flows and neutral transactions

EUR million	Total neutral transactions INFLOWS	Non Neutral (BoP) transactions INFLOWS	Neutral / balance of payments INFLOWS
BiH (Federation + RS)	63,5	1.317,3	4,8%
Cyprus	185,7	643,1	28,9%
Hungary	34,9	332,7	10,5%
Russian Federation	1.137,3	699,9	162,5%
United States	3.452,5	770,6	448,0%
Switzerland	1.818,8	855,9	212,5%
TOTAL	6.692,7	4.619,5	145%

EUR million	Total neutral transactions OUTFLOWS	Non Neutral (BoP) transactions OUTFLOWS	Neutral / balance of payments OUTFLOWS
BiH (Federation + RS)	63,0	517,2	12,2%
Cyprus	225,9	2.188,2	10,3%
Hungary	31,0	1.116,0	2,8%
Russian Federation	1.040,6	1.056,6	98,5%
United States	2.933,6	654,2	448,4%
Switzerland	661,4	1.666,3	39,7%
TOTAL	4.955	7.198	69%

The breakdown of total neutral transactions in its two components - transactions between residents and transactions between non residents - is set out in Table 4.3.2 and deserves a further comment:

- i) *Transactions between residents*: they represent the greatest share of total neutral transaction. More interestingly they appear unusually large when compared to non - neutral transactions normally recorded in the bilateral balance of payments with the countries in the sample (164% of overall inflows and 64% of overall outflows). When analysing individual countries these ratios become even more remarkable. For example, for the US, transactions between residents are 418% greater than overall balance of payments inflows from non-residents and 437% greater than overall outflows.

Furthermore, inflows and outflows show persistent and substantial imbalances in each and every year and on a 3-year cumulate basis, whereas one would expect that neutral transactions would tend to balance statistically. Over the 2003-2005 period overall inflows relating to transactions between residents exceed outflows by almost 40%. Imbalances for some countries are even greater. For example, for Switzerland inflows exceed outflows by a ratio of 3 to 1, and for Cyprus the ratio is 2.6 to 1. On the other hand, inflows and outflows referred to Bosnia Herzegovina, Russia and to a lesser degree, the US, do show a tendency to balance out.

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

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

Table 4.3.2 Cumulate 2003-2005 neutral transactions for sample of countries

EUR million	Transactions between residents INFLOWS	Transactions between non residents INFLOWS	Total neutral transactions INFLOWS	Non Neutral (BoP) transactions INFLOWS
BiH (Federation + RS)	56,7	6,8	63,5	1.317,3
Cyprus	128,9	56,8	185,7	643,1
Hungary	21,0	13,9	34,9	332,7
Russian Federation	1.006,4	130,9	1.137,3	699,9
United States	3.218,2	234,3	3.452,5	770,6
Switzerland	1.740,1	78,7	1.818,8	855,9
TOTAL	6.171,4	521,3	6.692,7	4.619,5

EUR million	Transactions between residents OUTFLOWS	Transactions between non residents OUTFLOWS	Total neutral transactions OUTFLOWS	Non Neutral (BoP) transactions OUTFLOWS
BiH (Federation + RS)	57,1	5,9	63,0	517,2
Cyprus	49,8	176,1	225,9	2.188,2
Hungary	26,8	4,2	31,0	1.116,0
Russian Federation	1.030,3	10,3	1.040,6	1.056,6
United States	2.856,9	76,6	2.933,6	654,2
Switzerland	578,5	82,9	661,4	1.666,3
TOTAL	4.599	356	4.955	7.198

b. Cyprus

Cyprus is one of the top recipients of money flows from Serbia and the bilateral balance of payments with Cyprus consistently records major deficits. In these respects Cyprus is in league with far more important economies and financial centres (US, Germany, Switzerland and Russia) and part of the answer lies in the fact the island republic may be considered a “tax haven” that offers investors minimal requirements for incorporation, governance and disclosure of ownership, provided that at least one shareholder is non-resident. Cypriot International Holding Companies (IHC) or International Business Companies (IBC) may be incorporated with a minimum share capital of 1.000 CYP²⁶, only 20% of which needs to be paid up. Nominee shareholders are allowed, in which case disclosure of beneficiaries to the Company Registrar is not required.

A detail of Serbia’s balance of payments with Cyprus as provided by the NBS is enclosed in Appendix 2. The most notable observation is perhaps that consistently above 95% of outflows are represented by the acquisition of goods and services. With over € 600 million of goods sold to Serbia in 2003, rising to € 837 million in 2005 (+ 38%), Cyprus definitely appears to be one of the top exporters of goods to Serbia. This is, on the other hand, an unlikely circumstance considering that Cyprus is a small economy largely based on services. An additional remark is that over 80% of the said imports are paid in US dollars (an approximate € equivalent of 1.455 million over the 3 years under examination).

²⁶ Approximately € 550.

This fast growing flow of goods apparently imported from Cyprus is made up by a comparatively small and declining number of transactions (-14%). Consequently, as shown in Table 4.3.3, the average size of transactions is substantial and rising sharply from € 59.435 in 2003 to € 95.304 (the 2003/2005 average being € 71.417). The average size of transactions in US dollars is particularly high (€180.912 in 2003 and a record of €271.913 in 2005). When comparing with the other countries in the sample (Table 4.3.4), imports of goods from Cyprus appear to have the highest concentration on a small number of large transactions. The overall average size of transactions with Russia is higher, but it is uniform across currencies and much lower than Cyprus' average size of payments in US dollars.

Table 4.3.3. Bilateral trade balance with Cyprus 2003 –2005: number and average size of transactions (NBS data converted to €)

CYPRUS	2003	2004	2005	2003/2005 growth rate	2003/2005 Total
<u>Total value of transactions</u>					
Export (EUR)	77.891.926	93.067.693	158.325.047	103%	329.284.666
Import (EUR)	606.866.604	584.816.020	836.767.985	38%	2.028.450.609
<u>Number of transactions</u>					
Export	1.890	1.613	1.752	-7%	5.255
Import	10.226	9.397	8.780	-14%	28.403
<u>Average size of transaction</u>					
Export (EUR)	41.213	57.699	90.368	119%	62.661
Import (EUR)	59.345	62.234	95.304	61%	71.417

Table 4.3.4. Bilateral trade balances with sampled countries: number and average size of transactions (NBS data converted to €)

	CYPRUS	RUSSIA	USA	HUNGARY	CH	BiH (F+RS)
<u>Total value of transactions</u>						
Export (EUR)	329.284.666	297.209.459	246.676.559	195.312.206	400.577.700	1.086.904.140
Import (EUR)	2.028.450.609	818.574.982	441.752.374	942.328.719	1.468.482.997	421.666.371
<u>Number of transactions</u>						
Export	5.255	4.810	5.782	14.988	6.953	143.826
Import	28.403	5.378	31.109	85.905	43.037	65.675
<u>Average size of transaction</u>						
Export (EUR)	62.661	61.790	42.663	13.031	57.612	7.557
Import (EUR)	71.417	152.208	14.200	10.969	34.121	6.421

The size and pattern of import flows of goods from Cyprus derived by the figures provided by the NBS appears indeed unusual, especially when matched with:

A) Data on the Cypriot economy and balance of payments. Official 2004 Cypriot balance of trade statistics indicate an overall volume of exports to Serbia and Montenegro of € 1,4 millions only. Furthermore, Cypriot GDP amounted to about € 12,3 billion in 2004. Considering that services represent over 75% of the whole economy, the maximum value of goods that could be potentially exported was not more € 2,9 billion. This is a number that is clearly not compatible with € 585 million of goods exported to Serbia alone.

B) Serbia's own balance of trade statistics. According to the figures published by Serbian Statistical Office²⁷ imports in goods from Cyprus were in the region of \$ 40 million (approximately € 33 million). Cyprus was not included among the top 10 exporters to Serbia, Germany being the leader (USD 1.446 million) followed by Russia (USD 1.396 million)²⁸. According to the data provided by the NBS, Cyprus would 4th, after Italy and before China.

Table 4.3.5 summarises the different figures for imports of goods from Cyprus according to the various sources described above. Discrepancies are indeed substantial, in the order of several hundred million euros, and definitely require an explanation.

Table 4.3.5. Comparison of imports of goods from Cyprus as reported by different sources

USD MM	2003	2004	2005
According to NBS data *	789,1	760,5	1088,1
<i>Would rank:</i>	3	4	3
According to Customs data**	13,0	40,0	n.d.
According to Cyprus data ***	nd	1,4	nd
Difference NBS - Customs	776,1	720,5	nd
Difference NBS - Cyprus data	nd	759,1	nd

* converted into USD at average (unweighted) exchange rate for the year

** Statistical Office of the Republic of Serbia - Yearbook 2005 (values reported in USD)

*** includes Montenegro

First of all, one must consider that the statistics summarised in Table 4.3.6 do not come from the same source. Also, the criteria and methodologies utilised by the institutions involved are not the same:

²⁷ STAT.YEARB.SERB.2005

²⁸ NBS Annual reports 2003 -2005

The NBS records foreign exchange payment declarations presented according to Law on Foreign Exchange (described in section 4.1). Such declarations can be divided in two categories: payments made into an account in the same country of the party that invoices the merchandise (country of invoicing and payment coincide); and payments made into an account in a different country than that of the person that invoices the merchandise (country of invoicing and country of payment do not coincide). Declarations falling in the first category are the most frequent. Transactions belonging to the second group are also common, although they do raise suspicions, especially if one (or both) of the countries involved qualifies as a tax haven. In either case the person invoicing might be different from the holder of the account. However, unless the beneficiary is a financial institution, this is would be quite an unusual scenario and even more so if the person receiving the payment is in a different country than the person issuing the invoice.

Balance of Trade statistics in STAT.YEARB.SERB.2005 (and in NBS annual reports) are compiled from Customs data. Customs officials record goods physically entering/exiting the country on the basis of the accompanying documentation (invoice, bill of lading, etc.). Classification by country is made according to the *Rules of Origin*²⁹, not on the basis of payments made or received. Comparison with statistics compiled by Cyprus introduces the additional issue that classification criteria utilised by different countries may not be the same.

One should not be surprised therefore to find differences between NBS balance of payments figures, Serbian balance of trade statistics and data coming from Cyprus. The key issue is how large would such discrepancies normally expected to be. In the case of Cyprus the discrepancy between Customs and NBS data is so substantial that it cannot be written off with a generic reference to “different classification methods” and a more specific explanation is needed. The NBS hinted that the main determinant of the discrepancy could be fuel from Russia, as part of these imports are invoiced from companies in Cyprus and/or paid for on Cypriot accounts. According to *Rules of Origin* these imports would still be considered as coming from Russia and, indeed, imports of goods from Russia recorded in the data supplied by the NBS are much lower than those recorded in official trade statistics³⁰ (that is, the opposite situation than that Cyprus).

The questions then are why would Serbia acquire or pay for fuel in Cyprus – definitely not a main market for fuel trading – and at what conditions. It should be added that trading in oil (like most other raw material and energy source) is highly exposed to the risk of transfer pricing and fraud. First, the sheer size of volumes intermediated ensure that even a very

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

³⁰ For example, in 2005 trade balance statistics indicate imports from Russia for USD 1.674 million whereas NBS records payments of only approximately USD 433 million.

small difference in price translates to a hefty sum of money. Second, there is a wide range of varieties of oil according to origin, grading, quality, place of trading, etc. Third, oil trading is in *real time*, therefore prices change every minute. Fourth, markets are sophisticated and offer a wide range of complex products/contracts. Finally, the volume of transactions executed by any individual operator is usually too high to allow for the possibility of checking each one of them. The morale is that an illegitimate surcharge of a few basis points on a transaction is very difficult to detect, almost impossible to prove and pays off handsomely.

Considerations on potential frauds may well offer another possible explanation to the observed discrepancies. Serbian institutions interviewed (Police, Customs, Tax Administration and Foreign Exchange Inspectorate) reported the practice of buying goods and services from Cypriot companies— usually IHCs or IBCs – that do not materially produce the goods or provide the service but buy it in turn from a third party (normally of a nationality other than Cyprus) who then delivers directly to the Serbian client. Thus, although the goods and/or services are invoiced from Cyprus (and payment made to Cyprus), such origin is not apparent when (and if) the goods materially reach Serbia or the services are rendered there.

These triangulations may contain the element of transfer pricing. According to the cited institutions, the price paid by the Serbian “importer is usually substantially higher than market value, whereas the price paid by the Cypriot supplier to the third party is usually in line with the market. Such gain is withheld by the Cypriot entity (whose beneficiary remains undisclosed) so that the operation may constitute a mechanism for money laundering and/or other illegal activities sanctioned by Serbian penal law. Examples of the latter would possibly range from tax evasion to the stripping of corporate assets, etc. (in such cases the crime proceeds would be automatically laundered by the operation itself). Likely, many of these dealings would be done through the infamous ‘phantom companies’ (see chapter 5).

The Foreign Currency Inspectorate of Serbia reported that a considerable amount of foreign currency was transferred abroad in 2005, “*most frequently, by importing and paying various services, the justifiability of which is difficult or almost impossible to establish*”.³¹ The report cites 3 notable cases in 2005 of dubious marketing and other business services rendered by foreign companies for a total amount of € 23 million. The inspectorate also reports for the period 1 May 2005 till 31 July 2005 other suspicious operations by 23 companies for a total of € 10,6 million. It appears that no further action was taken in these cases as, according to the inspectors’ report, “*whether paid services have in fact been delivered, imported, their*

³¹ *Foreign Currency Inspectorate “Information on payment of marketing services imported into Serbia” 2005/2006*

*value is represented realistically, or whether this is a transfer of capital abroad, is in fact very difficult to establish*³².

Reports by the Foreign Exchange Inspectorate deserve a few comments.

1. Transactions reported were related to the provision of services only. Not one report appeared to be filed on sales or purchases of goods. This would seem a surprising circumstance, especially considering the dubious situation described with regards to Cyprus;
2. The next step was thus to establish whether transactions involving goods had been examined - nothing worthy of reporting being detected - or whether the absence of any report meant that no transaction of this kind had actually been inspected. When asked what was the ratio of reports to total transactions investigated, the inspectorate responded that they do not follow a routine of planned inspections and but act on specific information/intelligence only. This statement seemed to confirm that, indeed, no sale or purchase of goods had been examined.

Foreign Inspectorate apart, it should be highlighted that one of the tasks of the NBS is to report international wire transfers to the Financial Intelligence Unit. The FIU was therefore asked if they could provide a breakdown by country of reports received from NBS and of suspicious transactions reported by all obligors. The latter information was particularly important, as it would possibly help to shed further light on unusual flows such as the one observed with regards to Cyprus. Furthermore, systematic monitoring of “Country Risk” would complement the activity of the Foreign Exchange Inspectorate (and other law enforcement institution) and provide useful input to the crafting of more effective, context specific suspicious transactions indicators.

The FIU delivered statistics on reports from NBS broken down by country³³ but did not provide the same breakdown of the suspicious transactions reports database (“STRDB”). The impression gathered in successive discussions is that the FIU data management system is unable to provide such breakdown (the query “Country of origin/destination” does not seem to be included in the list of key variables of the STRDB). Although, admittedly, few FIUs have a STRDB that can manage Country analysis, such capability would perhaps be desirable in the case of Serbia.

³² Ibidem

³³ The APML database records 47.055 payments made to Cyprus for a total amount of €2,7 billion and 33.756 payments received from Cyprus for a total amount of €1,0 billion. These records are for the period starting from the date the APML became operational up to the end of 2005.

c. Remittances from abroad

The largest flows of remittances to Serbia originate from Switzerland, the US and Cyprus (Table 4.3.6). However, Cyprus ranks first when one looks at the number and average size of remittances. Switzerland is traditionally a safe haven for capital; the US is the world economic powerhouse and host to a large community of Serbian expats. Flows from Cyprus do not seem to be justified by similar motivations. Large remittance flows are perhaps one of the ways in which assets exported to Cyprus are repatriated and, perhaps, laundered in the process. It would equally be interesting to analyse the frequency distribution of those remittances and to compare the data with information about size, composition and wealth of the Serbian community in Cyprus on the one hand, and with remittances from countries with a sizeable labour force originating from Serbia on the other hand.

Table 4.3.6. Remittances to and from Serbia 2003-2005:

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

Elaborations on data provided by NBS

d. Investments, loans and factor income

An in-depth analysis of investments (debt and equity), their dynamics and time series, as well as their returns (interest and dividends) is beyond the scope of this research. At a first glance one may observe that over the period 2003-2005 Cyprus ranked second in terms of investment (FDI and debt) and income received. In the course of the period examined net inflows from Cyprus (mainly in the form of FDI) have increased sharply and in 2005 Cyprus has become the largest investor in Serbia. One may observe that over the same period Russian net investments (mainly loans) have decreased by a corresponding amount (approximately € 60 million). It would be interesting to further analyse these trends and establish whether they are correlated.

Table 4.3.7. FDI and loans to Serbia

FDI + Loans received (EUR MM)	2003	2004	2005	cumulated
BiH (Fed + RS)	7,1	20,5	20,5	48,1
Cyprus	28	13,2	66,7	107,9
Hungary	5	14,2	21,3	40,5
Russia	121,7	62,1	60,6	244,4
USA	18,6	21,8	20,4	60,8
Switzerland	10,9	27	48,4	86,3
	191,3	158,8	237,9	588

Source: NBS data

Table 4.3.8. Factor income paid abroad by Serbia

Factor income (EUR MM)	2003	2004	2005	cumulated
BiH (Fed + RS)	0,2	0,3	0,6	1,1
Cyprus	19,6	6,1	10,8	36,5
Hungary	1,3	1,6	0,7	3,6
Russia	2,7	3	2,7	8,4
USA	9,1	9,7	51	69,8
Switzerland	7,1	8,3	8,7	24,1
	40	29	74,5	143,5

Source: NBS data

4.5. Final considerations

The analysis of international flows raises many interesting issues though few (if any) definite answers can be provided.

First, One wonders if the size, structure and imbalances of neutral transactions unusual and worthy of further investigation. Perhaps evasion of foreign exchange regulations and money laundering are concealed within these massive volumes.

Second, can the size of ‘goods and services’ imported from Cyprus as reported by the NBS be considered an indication of the size of ‘dirty’ or at least unrecorded money flowing out of Serbia? Assuming the ‘triangulation theory’ to be a (partly) valid explanation (a circumstance that has as yet not been proven), then one would need to estimate the size of the imports that are phoney or divertive. Also, one would need to assess the transfer pricing, that is, the difference between the prices mentioned in the invoices and the true market value of the goods and services (and the real beneficiary). On the other hand Cyprus is only one of the countries with which such transactions might be occurring.

As stated at the beginning of the chapter, it is impossible to draw firm conclusions as this would require a far more in-depth analysis. However, there are some clear discrepancies and

unanswered questions raised. Perhaps, the most disturbing finding of is the impression of a knowledge gap by the institutions that monitor international transactions and money flows. This impression was reinforced in the course of the focus groups illustrated chapter 7. When presented with data on such money flows, no institution or its representative was able (or willing) to provide any explanation or insight, regardless of the detailed information and documentation on foreign exchange transactions collected by the NBS (directly or indirectly through the banking system) and shared with the Financial Intelligence Unit. In short, the impression is that there is too little information on identifiable potential risks. Particularly, Cyprus has long been rumoured as a favourite destination for Serbian money launderers including, as often alleged in the press, former president Milosevic.³⁴

On a more positive note, it will be interesting to see the contribution of the new foreign exchange operations law to the effectiveness of institutions. In principle the new law should enhance cooperation between state bodies and provide more effective tools for action, including specific penal provisions.

³⁴ A few examples:

“Cyprus said Monday it had traced two instances where Yugoslav state assets were channelled through the island’s banking system and spirited elsewhere. . . Yugoslavia’s National Bank governor Mladjan Dinkic last month gave the Cypriots the names of at least 10 Cyprus-based offshore companies with links to the Milosevic regime, allegedly used to funnel billions of dollars out of Belgrade.” France Presse 9 April 2001

“For the first time, a Serbian official has acknowledged the claims that former Yugoslavian leader Slobodan Milosevic had laundered money in Greek Cyprus. “The Milosevic administration dispatched their money to Greek Cyprus in bags and suitcases,” said former Serbian Minister of Justice Vladan Batic, adding that eight off-shore companies founded with the support of Greek administration leader Tasos Papadopoulos were also made legal.” 7 July 2006

5. Economic/fiscal crime

5.1. Methodological notes

Economic crime, including fiscal offences and corruption, constitute traditionally and internationally a meagrely observed sector in the total field of penal law enforcement. This concerns the *intensity* of law enforcement as well as the *information management* of detected and reported offences and their subsequent processing in the chain of investigation, prosecution and trial. Because of their very nature, various law enforcement institutions are involved in the detection and subsequent handling of the case input and throughput: regulatory (administrative) agencies, usually at the detection phase, penal law agencies at the subsequent criminal investigation and prosecution phase, eventually followed by trial in court. Usually each institution has its own data recording and processing system. This does not add to transparency. Even if all agencies are performing to the letter of the rule, while no proper data management system is in place, the likelihood that the different data systems will match is very slim. Actually they must be treated as different databases describing different ‘statistical populations’. This implies that one and the same case and/or offender cannot be identified and followed automatically through the penal system from its detection till finalisation in court (or other competent institution).

Apart from this general characteristic, which Serbia shares with most western –supposedly more advanced– jurisdictions, the analysis conducted on the available data per institution (police, inland revenue service, prosecution) did not convince the researchers that the figures could be used at face value even within the same institution³⁵. Of course, much depends on the purpose for which the databases have been built and used. The impression that the databases are intended for rough workload measurement or case processing overviews. Organisationally this is useful, but it reveals only indirectly the underlying (criminal or fiscal/economic) reality. Apart from the well-known ‘dark number’ problem, the available figures of detected cases cannot be the building blocks for conclusive statements on economic/fiscal crime (let alone money laundering) without accompanying interpretation.

³⁵ One aspect that proved crucially weak was information relating to work flow passed along the law enforcement/judicial chain. Statistics on crime received from the various institutions proved very difficult to match (if such matching was at all possible) Data for the (supposedly) same phenomenon often diverged substantially because of the different definitions, criteria and methodologies utilised by the different state bodies. Figures on reports/cases sent, received and feedback from institution to institution (e.g. between police and prosecution) are often impossible to reconcile or simply missing. Thus, it is difficult to gather a general picture of the law enforcement/criminal procedural stages from detection to conviction.

For example, statistics can be aggregated on different counting unit levels: criminal offences or perpetrators. Unless the database allows offender-offences connected analyses, one cannot connect the offender frequency to the offence frequency tables: one offence can be related to more offenders and the other way round when offenders commit a series of crimes.

As far as the volume of economic crime and its impact is concerned, unless there are independent victim reports, the figures obviously reflect (as usual) the efforts, priorities and efficiency of the institutions. Concerning the (financial) impact of economic crime, additional comments about their use should be given. For example, as mentioned before, the reported damage in fiscal cases cannot be equated with the criminal income of the perpetrators. Apart from personal or corporate income tax evasion, the reported fiscal damage uses to be bigger than the potentially related criminal income. However, this presupposes that a case has been examined till the last (false) invoice, which is unlikely for every tax evasion case. This underlines the warning not to use financial figures composed for regulatory or police investigation tasks for concluding statements about a particular phenomenon like money laundering.

5.2. Facets and figures of economic crime and law enforcement

As in many other countries in South and Eastern Europe, the phenomenon of economic crime in Serbia is directly related to a decade of internal upheaval, wars and mal-governance after 1990/1991. In Serbia, in ten years the economy shrank to half its size of 1990, while during the UN sanctions 'blockade running' became a criminal economy of itself. To the common Serbian inhabitants who could not take part in this criminal industry, this period was a matter of making ends meet by all means, preferably in the cash based grey economy. The expanding underground economy justifies the expectation that economic crime as a subset would increase too. And so the number of reports on detected economic crime cases. The following Table falsifies that expectation:

Table 5.2.1. Economic crime reports 1991-2004

Year	Number of reports	% change in relation to previous year	Growth rate to real monthly earning
1991	30.579	-	-
1992	37.710	+23,3	-
1993	41.008	+ 8,7	-
1994	29.279	-28,6	-
1995	23.476	-19,8	16,1
1996	24.956	+ 6,3	-0,3
1997	21.881	-12,3	-0,2
1998	18.784	-14,2	1,5
1999	15.387	-18,1	-16,5
2000	14.614	- 5,0	5,5
2001	17.409	+16,1	16,4
2002	17.333	- 1,0	47,2
2003	18.464	+ 6,5	13,6
2004	14.700	- 20,3	10,6

Source: Customs Administration³⁶

While the economy shrank to the half of its size, so did the number of economic crime reports, particularly in the years 1994-2000. Naturally, one cannot conclude that this reflects the social and economic reality of economic crime. It may just as well reflect a lowering of law enforcement attention, less staff or even an increase of corruption, like officers taking a cut out of the cases they detected. Of course, these are speculations, even if they are not entirely implausible. But the short time span 2000-2004 does not show much correlation between the development of real income and increase / decrease of economic crime either. This lends support to the interpretation that the number of economic crime reports rather reflects law enforcement efforts than the prevalence of economic offending related to real income.

It is also possible to look at the recorded damage inflicted by economic crime, which can be found in the police statistics from 2000 onwards. In the next Table the recorded damage and the value of the illegally possessed property of economic crime are presented. It is not stated whether and to what extent the second category is a subset of the first one.

³⁶ Different data of economic crime are to be found in the police statistics on economic crime, averaging around 102.548 for the last five years and showing a U curved line between the highest frequencies in 2001 and 2005. See Table 5.2.2.

Table 5.2.2. Value of damage and illegally possessed property 2000-2005 in euros

	Number of offences	Material damage in € (average yearly exchange rate)	Value illegally possessed property: in €
2000	106.197	1.183.490.640	841.842.067
2001	121.847	168.070.106	153.894.626
2002	95.493	111.003.202	59.659.721
2003	90.409	110.620.051	83.598.241
2004	99.290	92.655.563	68.634.655
2005	102.056	265.904.141 ³⁷	248.715.677

Source: Ministry of Interior

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

Given the unclear status of the meaning of damage from economic crime as well as the reliability of the police statistics³⁸, the above figures should rather be interpreted as a hypothesis. It is also uncertain whether these damage and illegal possession figures include fiscal damage or which part is to be considered the illegal advantage of the perpetrators. Given the figures of the tax police over 2005 this seems highly unlikely: the recorded fiscal damage in that year amounts to € 104.9 mil (see Table 5.3.1). If the damage recorded by the police does not include the fiscal damage, the total damage would be € 371,8 millions. Related to the total public revenue of € 8.448.192.771 this amounts to 4,4 % (see Table 5.3.2). This is only indicative, as part of the fiscal damage concerns previous fiscal years.

There are some additional problems that relate directly to the problems of data consistency previously discussed. One may note for a start that the figures in Table 5.2.2 are slightly different than the ones reported in Table 2.2. Whilst one might attribute such differences to

³⁷ For 2005 the estimated average exchange rate of € 80 has been used.

³⁸ The police statistics need some clarification, indeed, in order to attribute them with a proper meaning and assess their reliability. For example, compared to the usual police statistics its crime solution percentage is extremely high. For example, 59% for burglary, 62 % of theft which would rank Serbia as the most risky country for property criminals. This is not the case: the reported and solved offences are not from the same (sub) database of the same year.

currency approximation, it should also be noted that in the same Table 2.2 the Ministry of the Interior (MoI) reports damages in 2005 from tax evasion for € 5,8 million. This is a stark contrast with the € 104, 9 million reported by the Tax Police. One may ponder the plausible explanations: damage as considered by the MoI may not equate directly to the amount evaded. However, it is unlikely that it would differ so substantially and definitely it would not be smaller. More likely the MoI is not informed of all instances of tax evasion discovered by the Tax Police. The further suspicion is that the MoI and the Tax Police might be reporting different cases altogether, so that the two sets of numbers should actually be added.

Given the uncertainty of the reliability status of the underlying police and tax statistics and the reasonable assumption that the informal, untaxed, economy in Serbia is sizeable, this may be a gross underestimation, certainly in the light of the informal economy estimated in Western European countries.

5.3. Tax Evasion

The figures provided by the fiscal police on Tax evasion detected for the years 2004 –2005 are illustrated in Table 5.3.1. Before analysing the figures in detail one should note that in its present form, the Tax Police was set up in 2003. The growing capacity of the institution is reflected by the marked increase in the detection rate of tax over the period examined.

Table 5.3.1. Tax evasion detected in 2004 and 2005 in €

5.3.1.a) Detected in 2004

Tax Evasion detected in 2004 EUR	Total Tax evaded	Estimated Average nominal Tax rate	Related undeclared tax base (based on nominal tax rate)
Excise	816.975	fixed monetary per unit of measurement (eg. Litre)	
VAT	0	18,0%	0
Sales tax goods	26.448.397	20,0%	132.241.985
Sales tax services	937.604	20,0%	4.688.021
Tax on property transfer	0	5,0%	0
Corporate profit tax	304.292	10,0%	3.042.924
Tax on financial transactions	0	0,3%	0
Tax on personal income - salaries	4.556.113	14,0%	32.543.667
Tax on personal income - other	0	10,0%	0
Tax on games and betting wins	0	na	na
Pension contributions	7.067.075	11,0%	64.246.140
Health insurance contributions	3.897.311	6,2%	63.370.904
Contribution for unemployment benefits	377.519	0,8%	50.335.822
Contribution for salary fund	766.482	na	na
Contributions for local revenues	16.756	na	na
Other Taxes	629.823	na	na
Total	49.017.250		350.469.463
Of which:			
Taxes	36.892.108	75,3%	
Contributions	12.125.142	24,7%	

b) Detected in 2005

Tax Evasion detected in 2005 EUR	Total Tax evaded	Estimated Average nominal Tax rate	Related undeclared tax base (based on nominal tax rate)
Excise	409.697	fixed amount per unit of measurement (eg. Litre)	
VAT	5.301.278	18,0%	29.451.545
Sales tax goods	49.406.807	20,0%	247.034.033
Sales tax services	1.858.924	20,0%	9.294.621
Tax on property transfer	56.027	5,0%	1.120.548
Corporate profit tax	732.684	10,0%	7.326.841
Tax on financial transactions	5.412	0,3%	1.804.039
Tax on personal income - salaries	8.337.402	14,0%	59.552.873
Pension contributions	11.605.773	11,0%	105.507.028
Health insurance contributions	6.598.292	6,2%	107.289.294
Contribution for unemployment benefits	755.748	0,8%	100.766.385
Contribution for salary fund	740.348	na	na
Other	27.872	na	na
Contributions for local revenues	17.530.488	na	na
Tax on personal income - other	1.438.364	10,0%	14.383.636
Tax on games and betting wins	1.706	na	na
Other	85.082	na	na
Total	104.891.904		683.530.844
of which			
Taxes	67.633.383	64,5%	
Contributions	37.258.521	55,1%	

Source: Tax Police reports

NB: Conversion of DNS into € was made at the average rate for each year as published by NBS (68.31 DNS/€ for 2003, 78.88 DNS for 2004 and 83.19 DNS/€ for 2005)

Of the estimated non-declared tax base of € 683.530.844 the pension, health and unemployment contributions represent the lion's share: € 313.562.707 or 46 %. It would be interesting to breakdown this figure by the perpetrators involved: the workers and/or the employers. Usually they are both knowingly involved: the employer doctoring his books (because of uncovered salary expenses) and the employee returning satisfied home with more to spend than his official salary.

It would not be too imaginary to speculate how much of the spending deficit of € 183.795.474 of the household survey (see chapter 2.2) is paid out of these illegal 'income supplements'. From the angle of money laundering these income supplements are of less importance than the illegal savings of the employees: these illegal savings have to be laundered or covered by means of documentary fraud.

Tax 5.3.2. Detected tax evasion versus State Budget and GDP

Estimated Government budget revenues (EUR MM)					
Revenue			2003	2004	2005*
Personal and corporate income tax revenues			1.203,3	1.063,6	1.257,4
VAT and retail sales tax (gross of liabilities to enterprises)			1.844,5	2.017,0	2.595,3
Excises Tax			850,5	876,0	857,1
Custom duties			433,3	434,8	468,8
Social contributions (gross of liabilities to enterprises)			1.699,6	2.015,7	2.219,0
Other taxes			368,9	450,1	289,7
Non tax revenues			449,4	540,1	646,7
Capital revenues			64,4	77,3	95,0
Total Public revenues			6.914,1	7.474,6	8.428,9
<i>Of which: taxation</i>			<i>4.700,6</i>	<i>4.841,5</i>	<i>5.468,2</i>

Source: Table P-5 Quarterly Monitor of economic trends and policies in Serbia October December 2005 - Foundation For Economic

Advancement Belgrade

* IVQ estimated

Tax evaded as % of tax collected	2003	2004	2005*
Taxes	n-a	0,71%	1,24%
Contributions	n-a	0,74%	1,68%
Overall	0,14%	0,71%	1,36%
GDP	13.784,2	12.966,5	13.070,1
Taxes as % of GDP	34,1%	37,3%	41,8%
Contributions as %	12,3%	15,5%	17,0%
Total %	46,4%	52,9%	58,8%
Tax evasion as % of GDP	n-a	0,263%	0,517%
Contribution evasion as % of GDP	n-a	0,115%	0,285%
Total evasion as % of GDP	0,064%	0,378%	0,803%

*estimate at 6.3% growth rate

NB: Conversion of DNS into EUR was made at the average rate for each year as published by NBS (68.31 DNS/EUR for 2003, 78.88 DNS for 2004 and 83.19 DNS/EUR for 2005)

Taken at face value, the findings in the Table above do not convey a really threatening fiscal doom: an evasion/income proportion of slightly less than 1 % is almost too good to be true.³⁹ One must keep well in mind, however, that this percentage is calculated on the basis of evasion detected, not of evasion actually occurring. The key question then is how large is the gap between the two. The idea that such gap is small or negligible should be dismissed off hand as it would turn Serbia into the most tax complying country in the European continent, and this is not the most plausible hypothesis. One has to consider that estimates for tax

³⁹ Percentages are indicative. Evasions detected in a given year usually refer in part to taxes due in previous years. Similarly, it is expected that a portion of taxes evaded in the current year will be discovered in future years.

evasion in Switzerland –a country with a reputation for strict fiscal obedience– are around 2% of GDP⁴⁰, and evasion estimates in Italy are around 12% - 18% of GDP.⁴¹

Back to the cases reported by the Tax Police is unclear whether and to what extent these statistics concern cases and suspects handed over to the Public Prosecution Office for further procedural processing. Table 5.3.3 illustrates the reports by the Tax Police:

Table 5.3.3. Activity of the Tax Police (Source Tax Police Reports)

	2003	2004	2005	2006
	partial	full year	full year	jan/feb
Number of reports filed	45	876	1365	217
Number of violations	63	1118	1804	273
Number of persons involved	49	987	1534	255
of which: <i>company owners or associates</i>	46	738	1449	216
<i>entrepreneurs/self employed</i>	1	181	23	26

Article Tax law	Description	2003*	2004	2005	TOTAL
172	Tax evasion	37	587	1.155	1.779
173	Non payment of Withholding tax	14	106	238	358
173a				3	3
174	Production or Submission of Counterfeit Documents of significance to taxation .	11	77		88
175	Endangering tax collection	1			1
176	Illicit trade in excise goods	0	176	21	197
176a			41	85	126
	TOTAL	63	987	1.502	2.552

* partial starting from April 2003

If (according to the law) all these cases would have been transferred to the Public Prosecution Office (PPO), this would imply workload input of 1.534 persons (1.363 reports) in 2005, suspected of tax fraud (and subsidiary, technically money-laundering). Indeed, the Tax Administration reports a feed back from Prosecution and Judiciary for the period

⁴⁰ “Tax evasion in Switzerland. The Role and Deterrence of Tax Morale” – Lars Field & Bruno Frey 2006.

⁴¹ UIL Servizio Politiche Fiscali “*Evasione Fiscale ed evoluzione strumenti di controllo*” 2005.

October 2003–March 2005 (thus not exactly matching the calendar years) as detailed in Table 5.3.5 below.

Tab 5.3.4 Feed back to Tax Police from Prosecution

Number of report sent to prosecution by tax police:		1.221
Corresponding number of violations		1.671
Corresponding Tax evaded	DNS	6.516.930.930
	Approx EUR	76.669.776

Status of reports as at reporting date		
Rejected by prosecution	51	4,2%
Ongoing investigation by prosecution	127	10,4%
Ongoing trial	891	73,0%
Court verdict	152	12,4%
Total	1221	100,0%

Breakdown of court verdicts		
Rejected for lack of evidence	15	9,9%
Not guilty	2	1,3%
Rejected for other reasons	2	1,3%
Convicted	133	87,5%
	152	100,0%

What is to be found in the subsequent case processing chain of law enforcement?

In 2005 the PPO received 249 charges of tax evasion, while it had still 66 cases in store of the previous year. It is not known whether these numbers concern suspected persons or cases, which can contain more suspects. As 89 % of the tax reports concern only one suspect, the line of argument does not differ much if one assumes that the number of charges can be roughly equated to the number of offenders. Of this total set of 306 cases 41 were refused or returned for further consideration. Of the remaining 265 cases 62 were rated ‘low priority’, leaving 203 for further processing. If a three years average is taken, there is a workload of 122 tax cases (38 in 2003; 126 in 2004 and 203 in 2005: a steep increase).

The two databases mismatch: for the period of 31-10-2003 till 31-3-2005 the tax police reported 1.221 cases to the PPO (Table 5.3.4). According to the prosecution statistics the PPO received only an input of 840 cases, though from the MoI it received another 379 cases, now summing up to 1.219. This might account for the gap, though it would be a satisfactory explanation only on condition that the tax police had indeed sent these 379 reports (out of the 1.221) to the Ministry of Interior rather than straight to the PPO. Tax police reports do not warrant such explanation as they provide no information on the matter.

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

Whatever interpretation or meaning one wants to attach to this statistical exercise, preliminary conclusions are that:

- the rate of *established* tax evasion as a general tax fraud category is low;
- there is a clear output-input difference between the case processing institutions, with a ratio of tax police detection versus court handling of around 5 %;
- the figures of other economic offences are difficult to interpret, because the underlying case processing mechanisms and reasons for handling or dismissing are unknown. Of the case/report input much is refused or sent back. Of two frequently occurring input categories (non-conscientious business management and abuse of authorisation in the economy: total 4.627) only 26 % were investigated (or directly processed because no investigation was required (e.g., 'caught red handed'?)).

Given the otherwise indeterminable reliability status of the data input and related database, the impossibility of further (cross)-breakdown according to penal law and perpetrator variables, in-depth analysis must be postponed. As the relation to economic/financial damage or criminal income per case is unknown, the seriousness of the cases cannot be rated or projected in a frequency distribution. Consequently little can be said about crime money or money laundering.

5.4. Corruption

A category of offences particularly relevant for the survey consists of public office related abuses: embezzlement, taking and giving bribes. Without speculating about the real size of corruption in the country the figure from the PPO may be illustrative of the limited priority given to this issue. Compare, for example, with the 6.541 cases of abuse in office and 481 cases of unconscientious performance of duty processed in 2005.

Table 5.4.1. Corruption case input and actively processed by PPO

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

Source: Republic Prosecutors Office

Granted, because of lack of backgrounds, one can do little more than merely presenting these figures without additional interpretation: a proper content analysis of the criminal corruption files actually handled should shed light on aspects like (lack of) evidence, on-going (or halted) investigations etc. The researchers do not know the outcome of the prosecution phase: the number of final decisions. They can only compare the case workload of the PPO with that of the courts of first instance and compare the differences.

Table 5.4.2. Corruption case processing by the courts of first instance: total cases and % of guilty verdict

year	2003		2004		2005	
	N	% guilty	N	% guilty	N	% Guilty
Embezzlement	393	87	464	87	445	89
Bribe taking	66	77	48	90	55	84
Bribe giving	46	83	34	71	46	80
Total	505	85	546	86	546	88

Source: Republic Prosecutors Office

There is a gap between the PPO figures and the court figures, though a direct year to year comparison is not really allowed: part of the court decisions concern cases processed by the PPO in the previous year or one of the years before. However, a steady PPO-Court ratio of around 40 % raises the question concerning the PPO decisions in the other roughly 60 % of its corruption workload. Again, one must be parsimonious with interpretations, but these figures cannot convey a high-intensity anti-corruption policy.

5.5. Privatisations

Like all countries in transition from a centrally planned to a market oriented economy, Serbia has been massively engaged in privatising its state owned and socially owned enterprises.

In the past Serbia has attempted several privatisation efforts, but the results were at best mixed. Opaque sale procedures often led to accusations of collusive behaviour and the whole process was overhauled in 2001, with the introduction of a new Privatisation Law.⁴² The latter places an emphasis on open, competitive procedures. Specifically, larger enterprises are to be disposed through a ‘tender procedure’ whereas an ‘auction procedure’ is envisaged for smaller companies. Disposals are managed by the Privatisation Agency⁴³ under the supervision of the competent Ministry.

The following tables illustrate the sheer size of the ongoing programme and speed with which it is being implemented. Between 2002 and 2005 over 2.000 companies have been put on the market and over 1.700 of these have been sold. Proceeds amount so far to € 1,7 billion and if one includes also investment commitments by buyers, the turnover of the ‘privatisation industry’ approaches 30% of the Serbian GDP (and not counting advisory fees for advisory services paid to investment banks, legal advisors, auditors, etc.).

Table 5.5.1 Privatisations 2002-2005

Companies privatized 2002 - 2005	number of companies offered	number of companies sold	Sale price (EUR '000)	Investment commitment (EUR '000)	Social Program (EUR '000)
Tenders	93	51	888.286	720.415	271.995
Auctions	1.542	1.206	563.566	153.692	
Capital market	738	483	313.036	5.902	
Total	2.373	1.740	1.764.888	880.009	271.995

Sale price + agreed investments	2.916.892
--	------------------

Source: Privatisation Agency

With much of Serbian economy at stake it would be surprising if privatisations did not attract the interest of the criminal world. Opportunities for corporate sharks and money launderers are simply too great to be ignored. Indeed, as previously mentioned, previous efforts at selling state companies collapsed amidst accusations. In this sense it is significant that 2 of the 10 money laundering cases investigated by the police and described in chapter 6 directly involved privatisation procedures:

- In October 2005, 30 million DNS (about € 350.000) of illegal proceeds from a business fraud were paid to the Privatisation Agency for the acquisition of a socially owned firm in Pozarevac.

⁴² RS Official Gazette N. 38/2001

⁴³ Introduced by the Privatization Agency Law (RS Official Gazette N. 38/2001)

- In December 2005 1.0 million DNS (€ 12.000) of illegal proceeds derived from abuse in office were paid to the Privatisation Agency as first instalment for the acquisition of a socially owned company.

Although there seems to be no additional hard facts (investigations and cases) of crime related to privatisations, rumours of conflict of interest, insider dealings, asset stripping, and occult leveraged buyouts abound. This would be hardly surprising in an environment that is still lacking consolidated ethics and standards of corporate governance, disclosure and accountability (see chapter 7) but, again, there is a lack of substantiated evidence.

It is nevertheless worth investigating whether privatisations procedures are adequately designed to deal with a potentially high risk of criminal infiltration. The current framework entails a plethora of actors, none of which appears to have a clear and strong mandate or responsibility. For example, the Privatisation Agency is only an *agent*, not the owner of the companies to be sold. It is not the only actor who can initiate a privatisation procedure nor is it the decision maker in selecting the winning bids. This is the task of a specially appointed commission that may include among its members a representative of the company to be sold. Possibly in an effort to establish a system of checks and balances, the legislator has veered away from common wisdom of well-defined principles of ownership, management and control. These are vulnerabilities that can be exploited by wrongdoers, particularly insiders.

In connection to the above, it appears that too much initiative and decision-making powers are left to the management of the company to be privatised.⁴⁴ Management is in principle situation of conflict of interest for it has to choose between serving the best interest of the owner and ensure that the new ownership is not hostile (or perhaps buy out the company himself). In the case of state and socially owned companies the “Agency Problem” is particularly critical.

On the issue of conflicts of interest and incompatibilities, the Law on Privatisation is strict when it rules the exclusion of any relative of persons that have failed to meet previous obligations with the Agency and of any debtor to the company to be privatised (including regular customers whose obligations fall within normal terms of trade). Yet the law is silent on the issue of potential conflict of interest of associates of the Agency, the Ministry and the companies to be privatised themselves, nor is there any provision on this issue in the

⁴⁴ A few examples:

- Art. 16 of Law on Privatizations: “The privatization procedure shall be instigated by a motion made by the competent body of the entity undergoing privatization . . .”
- Article 21 of Law on Privatizations: “the entity undergoing privatization by public tender shall prepare documents in compliance with the regulation referred in article 33 of this law. The entity undergoing privatization by public auction shall prepare documents in compliance with the regulation referred in article 40 of this law.”
- Managers of privatized companies are sometimes appointed to the Commission that decides the winning bid ex art.29 of the Law on Privatizations.

Privatisation Agency Law. Only in the “Guide Through Tender Privatisation” published by the Agency (but not in the “Guide Through Auction Procedure”) is it stated that “*members of the Agency staff or Tender Commission may not be involved in the organisation of a public tender if: (1) He/She has ownership rights to the company put up for sale (2) He/She is a bidder (3) His/Her direct relations up to third degree are bidding*”.⁴⁵ Also, it should be noted that nothing is said about Ministry officials and advisors (financial, legal, etc.) involved in privatisation procedures.

The Privatisation Law and subsequent instructions prepared by the Agency appear quite loose when it comes to determining who is entitled to participate in privatisations,⁴⁶ and this is a crucial aspect when looking at privatisation from the angle of money laundering. Procedures are open to physical persons and intermediaries and, with the exception of the largest operations information requested is minimal, particularly when it comes to establishing the identity of the ultimate beneficiary. One should hope that in practice the Agency is more stringent when establishing the identity of potential buyers (and their ultimate beneficiaries). However, judging also by the opinions expressed by participants to the focus groups it would appear that in depth due diligence on the identity of bidders is not a principal concern. In this context it is interesting as well as disturbing to note the following: as a public agency funded at least in part by the Budget of the Republic of

⁴⁵ Page 10 of the quoted publication.

⁴⁶ Requirements for participants to tender procedures are not defined beforehand. They are decided on case-by-case basis and set out in the Public Invitation to Tender. This is a sensible approach considering that tenders relate to larger enterprises and the goal is to select the most qualified potential buyers (industry relevant, strategic investors and qualified financial investors). Ten Public Invitations to Tender were examined. Only one (Beopetrol a.d.) did set out detailed requirements relating to business operations and corporate governance/structure as well as the appropriate supporting documentation (deed of incorporation, bylaws, ownership structure, audited IAS or US GAP financial statements, etc.). All other 9 documents set out loose business requirements (industry and size of operation). No information on corporate governance/structure or supporting documentation was requested. In the case of consortia, it was enough for one member to meet the requirements. Although this corresponds to standard practice, the fact that no corporate requirement is set or information is requested leaves room for ‘shady’ outfits who can participate to tenders with no question asked by teaming up with others. Information to be submitted by applicants to auction procedures (source: “A Guide Through Auction Procedure” Privatisation Agency):

1. Local individual: “*particulars about that individual, including his/her citizenship and a certificate showing that he has settled his commitments under the law on Non – recurrent Tax on Extra Income...*”
2. Local or foreign legal entity: “*all particulars about it, including an authenticated photocopy of the court registration certificate and authority for representation at the auction*” (same issues of interpretation, and)
3. Foreign Individuals: same as Serbian Nationals plus “*Citizenship and Identification number*”

The term “particulars” is quite obscure and it is not clear whether the bidder simply has to file a declaration or deposit appropriate certificates (if yes, which ones), and, with regards to legal entities, there is no explicit reference to disclosures on sector of activity, ownership, ultimate beneficiary.

Serbia⁴⁷, the Agency was included the list of Obligors as set out by the previous 2001 Money Laundering Law, art.5⁴⁸, though it would appear that the Agency never quite conformed to these obligations. At present, this provision on obliged public agencies and institutions was eliminated in the 2005 Law for the Prevention of Money Laundering. Likewise, the reference to “ownership transformation” was deleted from the definition of money laundering provided by the new Criminal Code of the Republic of Serbia. It seems quite odd that Serbia allows this major omission at a time when it appears to be keen in closing down on money launderers.

5.6. Damage and profits, enterprises and officials

In most jurisdictions there is no a formal or legal definition of entrepreneurial crime or of corporate crime. As a rule these concepts have in its core a set of economic regulations and legal interests which may be violated in the course of entrepreneurial activities. For phenomenological (and ideological) reasons it may be of interest to differentiate corporate crime (e.g. big or international firms as perpetrators) and crimes committed by other entrepreneurial entities. However, in legal practice such distinctions are usually only made in cases in which the criminal accountability of legal persons is at stake. When the focus is on separate acts of law breaking, particularly as ‘statistical counting units’, the difference between firms, corporations, one-man enterprises or personal economic violations is difficult to made, unless one can derive it from the nature of the offence. The concept ‘enterprise’ or ‘corporate crime’ has also its fuzzy edges in cases the enterprise or corporation is only a fictitious one, as is often observed in smuggling undertakings or VAT fraud. There is only the pretence of legality to lull the creditors.

a. General business climate

Serbia, like most countries in transition, has not yet fully met best standards when it comes to transparency and accountability of business operations and governance, including disclosure of ultimate beneficiaries of legal persons. In 2004 the World Bank assigned Serbia a score of 3 on the Business disclosure index (0 min – 7 max) against a world average of 3,27 and an average for OECD Countries of 5,67. Serbia’s score is not unusual for a country in transition. For example, Croatia scored 4, but Albania 3 and Bosnia Herzegovina and Romania were both assigned a score of 2. The opinions collected from professionals participating in the expert focus groups (see chapter 7) provide an illuminating qualitative “snapshot” of current standards:

⁴⁷ Art. 5 of Privatisation Agency Law.

⁴⁸ Art. 5 of 2001 Federal Money Laundering Law: “Pursuant to this Act, the obligors shall be . . . government agencies, organisations, funds, bureaux and institutions as well as other legal persons which are in whole or in part financed from public revenues”

**Table 5.6.1 Responses of Private sector focus group
(Grade range: from 1 “very poor” to 5 “Excellent”):**

1) Reliability of corporate financial reporting

Auditor	Notary	Broker	Financial Advisor	Legal Advisor	Retail Banker	Business Consultant
2	2-	1	2	2	X	2

2) Clear distinction between personal property and corporate assets

Auditor	Notary	Broker	Financial Advisor	Legal Advisor	Retail Bank	Business Consultant
1	1	1	1	1	1	1

3) Transparency of business operations and ultimate ownership

Auditor	Notary	Broker	Financial Advisor	Legal Advisor	Retail Bank	Business Consultant
1	1	3	2	3	5	2-3

In a climate lacking in transparency the first question is about corporate security: look (legal) persons what they really are and of what can one be assured. The point “seeming what one is not” is exemplified in the phenomenon of ‘phantom firms’; and the uncertainty of assurance/trust which is briefly elaborated in a section about insurance.

b. Phantom firms

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

Table 5.6.2. Phantom operators, damage and success rate

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

Source: Ministry of the Interior⁴⁹

One must assume that this table presents only a part of the phantom reality. A police report for 2002 mentions 619 identified phantom firms. These outfits skimmed taxes in an organized fashion and laundered money through the Novi Sad branch of a legally registered commercial bank from Belgrade. According to the 2002 police report, the activity of these phantom companies resulted in tax evasion in the amount of approximately 300 million DNS.⁵⁰

Thus, in 2003 a case was reported in which three owners of several companies from Valjevo had used phantom companies to present an alleged sale worth more than € 3,3 million, evading taxes in the total amount of € 638.000. There are also cases of phantom companies involved in illegal trade, such as the combine that sold imported oil derivatives worth € 128.000; a company from Bujanovac, that illegally imported goods worth € 168.000. Another from Čačak, which sold imported petroleum and xiol worth € 200.000; 'DOO Interprom' from Pančevo, whose owner acquired illegal profits by selling goods through phantom companies in the amount of € 184.000. Furthermore, the tax police reported for 2003 the uncovering of 357 phantom firms engaging in tax evasion for an amount of DNS 1.711 million (approx. € 21.7 million). 168 people were involved and 141 criminal offenses reported by the tax police.⁵¹

These are just illustrations, to which one should add the VAT fraud schemes, as this form of fraud requires such a phantom firm in the chain of buying and selling: the 'missing trader'. Naturally, money laundering is inherent to these scams, as the illegally obtained payments to the phantom firm have to be syphoned off as soon as possible, leaving only the empty shell for the creditors. As the word implies, the phantom firm has a respectable front with nothing behind it: a complicated ramification of legal entities surrounding it, but with only the proverbial drunken straw man as director, empty bank accounts and in the weeks preceding its bankruptcy frequently changing addresses.

It goes without saying that low standards in corporate governance and disclosure, as well as paucity of easily accessible, reliable company information (accessibility of corporate

⁴⁹ The MoI has no other data on these companies.

⁵⁰ The report on the work of the Ministry of the Interior for 2002. (www.mup.sr.gov.yu /pg. 4.)

⁵¹ Tax police report 2004

information through the companies registrar is still far from perfect) have contributed to the proliferation of phantom companies. These in turn probably provide further incentives for economic crime.

c. Regulated financial services

In the years 2000 – 2003 Serbia had to contend with serious problems in the banking sector that had been brewing in the previous decade. Several banks appeared on the verge of financial collapse, as a result of widespread corporate fraud of various nature. Banking Supervision Authorities were heavily engaged in the restructuring of the sector. Several banks were forcibly closed or merged and criminal reports filed.

Having more or less cleaned up the banks, Serbian authorities turned their attention to the other financial services. In 2004 The NBS took over from the Ministry of Finance the Supervision of the insurance sector. Between 2004 and 2005 all insurance companies were inspected. As a result of this activity 22 out of 40 licensed companies were forcibly shut down and 2 others were forced to merge. The NBS Insurance Supervision Department also revoked 125 Agent and Broker licences. As detailed in Table 5.5.1. the measures taken by NBS affected over 50% of the companies on the market, although in terms of market share (premiums collected) this represented a meagre 11% of the non life sector and 0% of life insurers.

Table 5.6.3. NBS intervention on insurance market

Insurance market data (CSD mln)	Including winded down companies	%	Excluding winded down companies	%	Delta (ie overall size of winded down companies)	Market share of winded down companies
Number of licenced insurance companies	40		22		22	55%
Aggregate Non Life premiums collected	23.414	93%	20.954	93%	2.460	11%
Aggregate Life premiums collected	1.689	7%	1.682	7%	7	0%
Aggregate total premiums (life + non life)	25.103	100%	22.636	100%	2.467	10%
Aggregate total assets under management	34.417		30.805		3.612	10%

Source: NBS Insurance Supervision Department

As a result of its activities the NBS also filed 22 reports to the competent authorities and, specifically, 12 relating to economic offences (misdemeanours) and 12 to criminal offences (reported to PPO) for abuse of official position, delinquency in duties in the field of economy, exceeding one's authorities in the field of economy, unauthorized representation or mediating illegal trade, and unauthorized insurance activities. According to the report of the Insurance Supervision Department, ". . . *companies and individuals under investigation engaged in operations contrary to basic business principles:*

- *unauthorised use of insurance funds: use of insurance funds for personal needs of the owner, for real estate, for vehicles, etc. although such funds ought to be invested in a secure manner so as to enable the company to regularly settle its liabilities undertaken at the time of issuing policies;*
- *insecure investment of insurance funds (in securities issued by the company of the owner or of persons connected to the owner without proper authorisation; lending to companies of the owner, or of persons connected to the owner, at non-market conditions);*
- *Incomplete and incorrect financial statements*⁵²

In other words, owners and managers of insurance companies were plundering for their own benefit the companies' assets and reserves set aside for potential future liabilities (claims), through related party transactions under unfavourable terms for the company itself. In order to conceal these activities they had to "cook the numbers". In two cases, NBS has found irregularities that have been reported to the Administration for the prevention of money laundering.

First case: Illegalities amounting to € 327.345.

Insurance company (owned by Mr. X., not resident of Serbia) sold (unfinished) real estate (about 1200 m²) to a natural person – Serbian resident (that is head of transport company 'X-trans' – owned by Mr. X). The money transfer is done through 'X-bank' (foreign bank owned by Mr. X). The origin of the money was suspicious.

Second case - Illegalities amounting to CSD 35 million

The insurance company sold real estate (about 300 m²) to the investor-partner Ltd. (X company) for the amount about CSD 6.5 mil), but the payment was made by the owner of X company, rather than by the company itself. It was also established that some natural person had increased its equity stake in company X through 2 successive rounds (respectively, CSD 19,0 million and CSD 8,0 million). In both cases the origin of the money was suspicious.

d. The evasive illegal earnings

From the perspective of laundering, the situations described render a precise attribution of criminal profits to categories of perpetrators difficult. There is a glimpse of the 'loot', but it is not known how it is being divided. This is important as a broad spreading of the criminal profits over many beneficiaries dilutes the loot such that a substantial part dissipates as daily household expenditure. However, lacking any database designed for cross-break analysis, the gross figures of illegal profits as provided by the Ministry of Interior are taken into consideration and the figure of the 'illegal income' considered as a hypothetical 'launderable

⁵² NBS annual reports

volume'. The methodological basis for determining these figures could not be determined either.

As can be deduced from table 5.6.4 the abuse of official position (art. 242/395 new Code) ranks highest in every year, followed by abuse of business authority. Fraud, quite a general category, ranks third. Looking at the time series, one can observe that in the year 2000 Serbia was not only in a political, but in (financial) law enforcement turmoil too: large amounts of money (€ 841 million) appear to have come into the wrong hands. A new rise of financial wrongdoing can again be observed in 2005, mainly attributable to the abuse of the official position (€ 224 million).

**Table 5.6.4. Illegal profits for various crime categories
2000-2005 in €**

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

Source: Ministry of Interior

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

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

Table 5.6.5. Illegal profits from tax evasion and smuggling 2000-2005 in euros

	Tax evasion ⁵³	Smuggling	Total
2000	2.791.153		2.791.153
2001	905.925		905.925
2002	2.607.718		2.607.718
2003	11.381.316		11.381.316
2004	6.350.973	27.127	6.378.100
2005	5.759.588	568.942	6.328.530
Total	29.796.673	696.069	30.492.742

Source: Ministry of Interior/Customs Administration

⁵³ Until 2002 under article 154 of the Serbian Criminal Code; from 2002 onwards under the article 172 of the Law on tax procedure and tax administration.

Again, comparison with Table 5.3.1. will raise some questions concerning the validity of the figures as they deviate substantially. This may partly be explained by the difference in reach of the applied articles, the difference between tax evasion and illegal profit or double counting. For example, corporate and personal income tax and social insurance contribution: the lower tax base of the manager and his employees is a consequence of tampering with the corporate books. All involved are liable to be imposed a *gross* correction, of their individual evasion. But even then, not only was it observed already that according to the detected tax evasion figures but also that the illegal profits are pitiful low. If (for the sake of argument) nevertheless all these illegal profits are added up with those of Table 5.6.4, the resulting five year illegal transfer of wealth is approximately € 1.432.000.00. Though this figure approximates suspiciously the Cyprus figure, it is pure coincidence: the researchers do not know anything of the illegal income distribution in Serbia. Other empirical research (Van Duyne and de Miranda, 1999; Van Duyne et al., in progress) supports the hypothesis that in general the criminal income distribution is as skewed as the licit one as can also be derived from the large sums of the abuse of the official position.

Having come at the bottom of the (database) barrel of what is known about the criminal income, attention shall be shifted to the anti money laundering instruments.

6. Anti-Laundering laws and institutions

When the figures of the Ministry of Interior concerning the illegal profits (irrespective of their validity) are compared with the reported suspicious transactions, some discrepancy is apparent. For example, the Ministry of Interior recorded in 2005 € 240.689.641 as illegal profits (mainly from abuse of official position) while in the same year the Administration for the Prevention of Money Laundering (APML)⁵⁴ recorded € 54.625.845 as suspicious transactions. Assuming a ‘chain system’ of detecting and reporting crime related financial transactions (per definition suspicious), a lot of detected criminal income reports failed to reach the APML. As the APML is one of the receiving, analysing *and* forwarding links in that chain of illegal transaction processing, it is justified to have closer look at the anti-laundering structure.

Money laundering has been criminalised since 2001⁵⁵, when the first anti-money laundering law came into force. As this was a federal law (for the Federal Republic of Yugoslavia, which ceased to exist in 2003), containing a number of flaws, a new law was drafted in 2005 and entered into force in January 2006 – the Law on the Prevention of Money Laundering – while a corresponding clause and definition was adopted in the Serbian Criminal Code. First, some brief comments about the 2005 law will be made.

a. *Legal instruments*

The legal description of money laundering in the new 2005 Law on the Prevention of Money Laundering is in its essence in agreement with the European Convention on Laundering etc. by containing the components of conversion, transfer, concealment, disguise, acquisition, possession or use of assets derived from crime.

One aspect is worth consideration: the origination of assets from a criminal offence. Is this origination a direct one or does it comprise also indirect forms? This is important for the construction of evidence in cases in which the line of origination has become a long and very indirect one. The proceeds of the first criminal act, if smartly laundered, can open the door to ‘white’ capital. For example, once real estate has been acquired, the property can be mortgaged and the borrowed capital can be used for the acquisition of new real estate and new mortgages. This is the problem of ‘crime-money inheritance’: at what point is the causal link between the crime-money inflow and enterprise/capital building considered to be severed? This is certainly relevant within the context of privatisation: how many deceptively acquired enterprises will not be split up, sold and resold (on paper) and/or grow into normal

⁵⁴ Officially the Serbian Financial Intelligence Unit (FIU) is the ‘Administration for the Prevention of Money Laundering’. For readability the shorthand the APML will be used.

⁵⁵ Although the more general crime of ‘concealment’ was already contemplated by Penal law

firms with a normal, licit management and a ‘white’ profit base, despite having a (partly) criminal origination?

Another aspect which is not clear is the recovery of the illegal profits. In the previous sections it was observed that substantial amounts of illegal profits were mentioned in the survey of the Ministry of Interior. However, what happened next? In many jurisdictions, like the Netherlands and the UK, recovery procedures are part of the legal system of fighting crime-for-profit. Serbia knows a general clause for confiscating illegal profits, but whether it is adequate in cases of organised (economic) crime with extensive money-laundering schemes remains to be seen.

b. The Administration for the Prevention of Money Laundering

The body to implement the fight against money laundering –an agency within the Ministry of Finance– is tasked with data collection, analysis, storage and detection and prevention of money laundering.

The agency receives reports about any cash transaction of € 15.000 or more (in DNS counter value) or of several inter-related cash transactions amounting to the same sum. In addition, the agency is assumed to receive reports of all the legal and natural persons obliged to submit reports. The obligation of reporting life insurance operations to the Administration is prescribed too. Also, customs authorities are obliged to submit to the APML the data on every transfer of cash, foreign currency, checks, securities, precious metals and precious stones across the state border the value of which exceeds the allowed amounts prescribed by the provisions on bringing in or out the state borders DNS, foreign currency, checks and securities, and not later than three days from the day of such transfer. In short, the agency is assumed to receive reports from:

- banks and other financial organizations (savings banks, savings and credit organizations and savings and credit cooperatives);
- bureaux de change;
- postal and telecommunication enterprises, as well as other enterprises and cooperatives;
- insurance companies;
- investment funds and other institutions operating in the financial market;
- stock exchanges, broker-dealer associations, custody banks, banks authorized to trade in securities and other entities engaged in transactions involving securities, precious metals and precious stones;
- organizers of classical and special games of chance (casinos, slot-machine clubs, betting places), as well as of other games of chance;

- pawnshops;
- also included in the 2005 law (but not in the 2001 law) are provisions imposing reporting requirements for attorneys, accountants and other professional categories.

This is a long list, which is extended by the way the law denotes the obligors: “*For the purpose of this Law, the obligors shall also be understood to mean other legal entities and individuals doing business related to:*

- *asset management for other persons;*
- *purchase and sale of debts and claims;*
- *leasing;*
- *issuing payment and credit cards and performing operations with the cards;*
- *real estate business;*
- *trade in artworks, antiques and other valuable objects;*
- *trade in automobiles, vessels and other valuable objects;*
- *treatment and trade in precious metals and jewels;*
- *organization of travels;*
- *mediation in negotiations related to granting credits;*
- *mediation and representation in insurance business;*
- *organising auctions”.*

This is an almost exhaustive list of enterprises and entrepreneurs, particularly the open category “telecommunication enterprises, as well as other enterprises and cooperatives”. One may wonder who is not included in the set of obligors. As a matter of fact, according to the 2005 law public administrations and other institutions funded (even partially) from the budget, are no longer included in the list of obligors as was the case according to the 2001 law (one wonders if such obligations were met in practice). This means that, as noted in chapter 5 the important Privatization Agency, which is handling so much of interest, for the society and potential criminals alike, is now missed out.

The large number of categories of obligors, some of which not quite well defined raises the question whether a precise differentiation between these input categories is possible, which was very much an issue under the old 2001 law as well. The forms to be filled by the obligors are less than clear in this regard.⁵⁶ The obligor must fill in his name and UCRN and giro account. Apparently the APML must subsequently sort out to which category the obligor must be assigned (e.g. bank, insurance company, etc.).

The forms used for registering the (suspicious) transactions may have to be tested for their user-friendliness, as they seem somewhat complicated. On the other hand they seem to lack

⁵⁶ Reporting forms are currently being updated as a result of the introduction of the new Law. For the time being old reporting formats are still in use.

information, such as the field of business of reported persons, that would be of great use in fishing out suspicious transactions patterns. This may have an impact on the reliability of the data input and the shape of the data base. It is very questionable whether and to what extent the present database and the programme for analysis are suitable for strategic in-depth analyses as can be deduced from the next section.

Let us first go back to the logic of the financial intelligence and prevention system. The first level of control is attributed to obligors. They have to report all transactions above the legal threshold and also the ones they deem suspicious even if lower. It is a cumbersome task considering the sheer numbers that are normally executed every day. However, there is a large number of obligors and, not surprisingly they need to devote to the task substantial resources and a complex organisation.

The Financial Intelligence Unit is responsible for second level control. This means the further analysis of transactions reported as suspicious by obligors, as well as managing reported transactions that are not suspicious but simply above the threshold. The scope of the latter is twofold:

- a) keep database of transactions which may be then retrieved for future use;
- b) double check those transactions that do raise suspicion and have slipped through the obligors' net.

When it comes to b) the APML is the collection point of about 1.000 transactions reported daily and, needless to say, its resources are far more limited than those of obligors, considered collectively. The APML cannot possibly re-examine all reports received. Therefore the forms should include immediately visible indicators (such as matching of type of business/type of transactions) enabling the APML a rapid and effective scan.

c. Some data from the APML

In the beginning of this chapter the discrepancy between the allegedly detected illegal profits and the amount of money in the suspicious transaction reports was pointed out.

The administration processes all currency transaction reports and determines which of those should qualify as suspicious. Looking at the obliged institutions and other obligors one gets the following frequency over the last four years.

**Table 6.1. Reported transactions and obligors
2002-2003**

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

*ZOP, the old, socialist era, financial clearing house, reported only in 2002;
Administration for Public Revenues (APR) reported till 2004.*

Source: the Administration for the Prevention of Money Laundering

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

When looking at the processing of the reports about cash transactions, one gets the following picture:

Table 6.2. Cash and suspicious transaction 2002-2005 in €s

	2002	2003	2004	2005	Total
No. trans. reports	17.779	65.255	96.066	165.318	344.418
€	502.084.098	2.028.432.355	2.637.671.836	4.126.669.063	9.294.857.352
No. suspicious	14	120	259	280	673
€	135.833	4.723.869	11.272.858	54.625.845	70.758.406
% suspicious: no	0,007 %	0,2 %	0,3 %	0,2 %	0,2 %
% of €	0,003 %	0,2 %	0,4 %	0,1 %	0,7 %

Source: APMML

It would be unfair to present these outcomes as a trend: four years (of which the first can be considered a ‘warming-up’) are too short for a trend analysis. Let it just be summed up that on average 0,2 % of the reported cash transactions were eventually considered suspicious. This is a small proportion indeed. It should be noted that most European FIUs report also small proportions of unusual/suspicious transactions.

When one relates the proportion of cash transactions to the volume of the suspicious transactions one finds that only the reports filed by the banks approach the 1 %.

Table 6.3. Cash transaction reports and suspicious transaction, 2003-2005

Obligor	No. of cash transaction reports	Total amount in €s (approximately)	Suspicious No. reports (cash and non-cash)⁵⁷	Amount in € cash and non cash	% Susp. Money
Banks	316.859	8.883.097.740	678	77.127.779	0,8
Bureaux de change	1.624	40.695.899	2	65.569	0,2
Other	8.708	230.925.302	17	191.115	0,0

As remarked above, given the large category of ‘other’, it would be interesting to differentiate somewhat more precisely according to the detailed categories of the obligors as presented in Table 6.1.

The question about the outflow (how many were reported to the police or prosecution) could not be answered. Though the APML stated during a presentation that it resolved 108 cases, it remained unclear what that means in terms of time (year), ‘outcome’ (suspicion of ‘laundering’ confirmed or rejected) or subsequent procedure (forwarding to the authorities or archived).

Several institutions reported to the researchers instances of money laundering. However, bearing in mind information management issues described in chapter 5, it is only possible to list the various sources, with no clue as to how the data is related and, indeed, in which instances it refers to the same cases.

- 1) The APML stated that in the period from 1 July 2002 to 30 June 2005 it notified 44 cases to the Ministry of Interior, 74 to the tax police and 2 to the PPO. As at end of 2005 the APML also reported 17 criminal charges filed for money laundering, 11 requests for conducting investigations, 5 indictments and no conviction.
- 2) The Tax Police reports analysed in the previous chapter do not mention cases money laundering.
- 3) The MoI (police) reported 10 cases: five of which from 2005; three from 2004 and one from each previous year. The predicate offences concerned illegal traffic, tax evasion,

⁵⁷ A breakdown of the volume of money in cash and bank transfers was requested. This proved to be impossible. The variable ‘nature of payment’ (if it is in the variable list) does not allow such a differentiation.

abuse of authority in the economy, kidnapping and fraud. According to the MoI Analytics Department, only one of these cases was reported to the police by the FIU. The other 9 cases were not reported by the MoI to the APML.

- 4) It was not possible to obtain a comprehensive set of data from PPO.⁵⁸ The only information received was from the Novi Sad district prosecutor reporting 44 cases from 2002-2004. At the time of reporting most of them are still pending. And, again, no information on reporting institutions or liaisons with APML/FIU could be obtained. Also, an additional case was mentioned during conversations with the Office of the Special Prosecutor for Organised Crime.
- 5) Commercial courts report 9 charges of misdemeanours against employees of obligatory entities failing to report appropriately cash transactions for values exceeding the legal threshold.

From these figures it is not possible to come to an evaluative conclusion about the functioning of the anti-money laundering instruments and organisation. There is an overwhelming inflow of reports, transformed into a trickle of suspicious transaction output and a mere shadow in the subsequent law enforcement bodies of police and prosecution. In addition, respondents were not able to identify a conviction for money laundering. If there are any, they are very much unknown.

The law provides the possibility for law enforcement agencies to take the initiative to request the administration to execute examinations. The next table presents the use of this option for the first half year of 2006, which may also be considered a ‘warming-up’.

Table 6.4. Requested examinations of various law enforcement agencies.

Agencies	First half of 2006
Courts	-
Public Prosecutor	3
National Bank of Serbia	-
Ministry of Interior	15
Privatization Agency	-
Securities Commissions	2
Tax police	2
Customs Administration	1

Source: APML

Surveying the present state of affairs, a concluding comment like “the system works” is by no means supported by scarce facts and figures of unknown or at least undeterminable reliability. Unless the variables of the input (business sector, nature of the reported persons,

⁵⁸ Unfortunately neither the Statistics Office on justice data nor the data available from the Republic Prosecution give a separate highlight for money laundering crimes. They are lumped in the “other crimes/other laws” categories and it is impossible to identify them short of opening each and every case file.

country of origin or destination, reasons for suspicion, the nature of the transactions etc.) can be related in a breakdown analysis, these figures have very limited value, even if reliable.

d. Case descriptions

Irrespective of variation of numbers, some more specific details on the ten money laundering cases reported by the Ministry of Interior are available and, their description will close this chapter. For the reader it is important to know that none of these cases have resulted in a conviction (yet). Therefore, these descriptions, were handed out in a very summarized form, and have to be read with care. Set out below are some the key highlights of each case:

1. In 2002 a director of a bankrupt firm bought goods, but paid them with unsecured money orders, which subsequently bounced. In this way he illegally obtained 3.157.000 dinars. From this amount, he paid another company, of which he was director, 964,000 dinars under the pretence of a loan.
2. April 2003 the two co-owners abused their office facilities for the production of ecstasy that they sold for 272,5 million dinars. They used their companies to buy real estate (business and residential buildings) and equipment for their companies, as well as other assets. 62 million dinars was paid to bank accounts of their companies as loans.
3. Between 2002 and 2004, an owner of two private companies imported and sold goods worth approximately 600,000,000 dinars, falsifying business documents to the effect that the goods were sold wholesale, obtain using a major tax relief. He thus evaded taxes to the amount of 120.000.000 dinars. Of these proceeds he bought property for 800.000 euros. The remaining 700,000 euros were deposited in the bank accounts of his relatives.
4. In 2004, an entrepreneur imported 650 t of rice without proper licenses, resold it on the black market and made an illegal profit of 18,000,000 dinars. The money was deposited in the bank accounts of his companies in Serbia and abroad.
5. In 2004 a crime-entrepreneur, involved in illegal trade (gas, oil, cigarettes), burglaries, counterfeiting money, vehicle theft and documentary fraud, had to find a destination for the ill-gotten 10 million dinars. About 8,5 million dinars found their way to the banks for the purchase of real estate (business and dwellings) while 100.000 dinars were deposited as start capital for a firm.
6. In 2004 two businessmen committed tax fraud by falsely pretending to sell goods each other, while they actually sold goods to third persons. The evaded tax to the amount of 7.990.252 dinars was deposited in the bank accounts of one of companies as a daily profit, although this company does not have retail facilities.
7. A criminal group of 10 persons (two from Macedonia), kidnapped in 2003 a businessman from Macedonia. The victim was taken to Serbia. A ransom of € 700.000

was paid for him. Of that amount, € 80.350 was used to purchase an apartment in Kraljevo (€ 62.500) and a jeep (€ 17.850) in the name of another person. The remaining money was spent for other purposes and € 15.000 was found with a suspect.

8. In 2004 the director of a company sold land to another company director without the approval of the Executive Board of the company and without public tender or considering other bids (contrary to the Law on trade in immovable property + abuse of official position). The land owned by the company, worth 10 million dinars was sold for 45.500.000 dinars with an illegal profit of 35.500.000 dinars. This money was deposited in the account of his business bank. Part of the money (€ 350.000) was transferred to a company in Greece that allegedly mediated in this business transaction.
9. In 2005 a company director was accused of manipulating promissory notes to the amount of 28.000.000 dinars. The promissory notes were deposited as guarantees for the purchase of a consignment of bitumen. How the bank and the notes were abused or laundered is still under investigation.
10. In 2005, a company director abused his business authority by transferring 1.200.000 dinars covered by false invoices from the account of his company to the account of a private business. Part of the money, 1.000.000 dinars, was taken from the account of the private business and paid to the Privatization Agency, as an instalment for the purchase of a socially-owned company whose director he was.

Of course, these are no more than illustrations, containing various elements of (organised) business crime and laundering the profits, like the trusted loan-back construction. When in the coming time the number of cases increase, such descriptive 'narratives' must be conferred into a database in which the distinctive features are translated into unambiguous variables, suitable for in-depth statistical analysis.

7. Focus expert groups in discussion

The project management also held two round table discussions with experts from the public sector (ranging from ministry of Finance, National Bank of Serbia, FIU to courts) and private sector (consultants, banks, brokers, insurance firms). Some of the persons invited declined to participate or did not turn up. There were some cancellations and some of the invited persons did not turn up, without notice.

a. Public sector group

Among invited institutions, The MoI could not send a representative and the representatives of the Public Prosecution Office did not show up or send a notification. The Privatisation Agency representative cancelled on the day of the session.

Though the discussion in the public sector group was lively, the participants made the impression of demonstrating rather their own representation of the situation than the situation itself. To what extent do their statements match reality, if one can find only few 'measure for reality' in the first place? For example, the representative of the tax police stated that there is full exchange of information with the APML and that detected offences are forwarded to the police. The researchers do not doubt the sincerity of that statement, though searching all the available databases, the researchers did not find unambiguously corroborating evidence for this assertion. As far as the organised, economic crime is concerned, in addition to money-laundering, it became clear that a proper overview is lacking. One participant mentioned that in the whole of Serbia there was only one money-laundering case, while his colleague mentioned 5 indictments and 19 criminal charges. Naturally, not the reliability of these exact figures matters, but the lack of any strategic overview among these law enforcement representatives is worrying.

Two other money-laundering related aspects which were brought forward by the tax representatives concerned the harmful functioning of phantom companies and the increasing VAT fraud. Because of the invoicing requirement for VAT, phantom firms are sham invoice producers. Similarly (or at the same time) foreign phantom firms can invoice all sorts of phoney administrative and/or consultancy/advisory services for substantial amounts of money, reducing VAT, corporate tax as well as furthering the cross-border flow of money (laundering).

Similarly there is the problem of obtaining loans. Many people avoid regular banking and prefer to obtain loans from family and friends. It is difficult to find out whether there is some laundering going on, but the proverbial money-under-the-mattress is an inherent part of the informal economy.

The public focus group was not very specific about corruption. Confidence in the business and public sector even got a mark **5**, meaning very good. Other rankings of the Serbian business environment were very ambiguous: the reliability of reporting and the distinction between corporate assets and personal property. The focus group expressed little concern, even resignation about the remarkable payment deficit with Cyprus and other tax havens.

b. Private sector focus group

The private sector focus group consisted of representatives from a business consulting firm, a retail bank, a law firms specialised in business transactions, an auditing company, a corporate finance advisory house, a securities house, a notary. A representative from an insurance firm and a construction company were also invited but failed to show up at the last moment.

The opening statements reflected a shared opinion that financial and economic (organised) crime was a major problem in the country. According to the focus group this problem is furthered by inadequate or non-implemented laws, like the Law on Investment Funds, which has not been adopted thus far. This allows wealthy buyers to purchase firms below their value. The Law on Accounting and the Tax law are also considered inadequate.

Concerning the Privatization Agency most of the representatives favoured a more limited investigative role: the Agency has to privatize and should not waste its time on all sorts of investigations. One of the speakers remarked that the Agency notified in cases of doubt the Commission for the Prevention of Money Laundering to investigate. However, the Commission never responded (and no such cases are surfacing in the databases which the authors obtained).

About the institution to fight money laundering, the Administration for the Prevention of Money Laundering, the opinion was expressed that it should be an independent body, whereas at present it is tied to the Ministry of Finance.

Another issue put forward concerned the unorganized state of information management: the impossibility of establishing a proper database and information network between state bodies.

Corruption is another issue. The fact of a recent arrest of a member of the commercial court is a good example that something is done, however most of the old Milosevic network relationships are still on their place: just a handful has been prosecuted and none convicted. There is no institution building and the degree of trust of the citizens in the maintenance of

law is low: arrests are considered a political manoeuvre and the outcome of lacking proper political protection. Another field of assumed corruption and the organisation of crime is the manipulation of the VAT return.

The participants rated the Serbian business environment and practices with regards to reliability of corporate financial reporting very low: 1 – 2. The general reporting reliability of corporations was not rated very high either: 2. The distinction between personal property and corporate assets got a low valuation of 1. The transparency of business operations and ultimate ownership was rated slightly higher with an average of 2-3.

8. Concluding remarks and recommendations

It is difficult to deduce from the available data about the economy, economic crime and tax crimes a comprehensive picture, which could be considered the basis for an approximation of the 'real' damage of (economic) crime-for-profit. Granted, all countries face the problem of estimating the 'hidden economy' from uncertain parameters. As far as Serbia is concerned, this is aggravated by the circumstance of discrepancies in institutions' "bookkeeping". It is difficult to locate 'concentration areas' of economic and financial wrongdoing from the information system itself. While hints and hunches from the field of practitioners tasked with daily law enforcement are valuable, they should be underpinned by systematic information gathering and analysis. At the moment this is lacking. The Serbian phantom companies are matched by state phantom databases.

Therefore it is also difficult to approximate the financial volume of the underground economy, let alone to single out the subset of organised (economic) crime (net) earnings. Implicitly the researchers do not even come near any insight into the phenomenon of money-laundering. While the economic damage of reported crimes may be around € 374.000.000 (or more) per year, the researchers do not know what part of it represents income to be spent or saved (and laundered later). Is it the estimated € 560.000.000 deficit of the household spending? Or the € 250.000.000 illegally possessed assets according to the police reports? Without taking resort to the 'tip of the iceberg' metaphor, it is better to leave the figures as they are. It is of little use to speculate about data of which the reliability is not only highly contestable, but of which the level of reliability cannot even be determined.

It is a plausible hypothesis that the underground economy is sizeable and largely foreign cash based. The added value or profits of the numerous daily hidden transactions by the 'common man' may find its outlet in spending on consumer goods, exceeding his official earning, while the economic criminal main players may find their financial outlets in one of the banks in Cyprus or other tax havens. In shadowy information system there is no easy way to test such hypotheses. This situation is aggravated by the disharmony between the databases of the various law enforcement bodies dealing with the same cases: (tax) police, customs, Public Prosecution Office. There is no output-input comparability and no yardstick to determine the reliability of the figures put forward by each organisation. This entails that coherent and target oriented policy making is well-nigh impossible: where to start from to set targets?

Recommendations

In circumstances as in Serbia it is customary to recommend ‘more staff, more cooperation, better legislation and particularly more computers’. The authors of this report do not follow this customary road. The experience of the authors was that they hit on a more fundamental void: lack of curiosity. The questions they raised were very fundamental and basic and concerned ‘if A then B questions’. For example: ‘if households spend more than they earn and save, then there are unaccounted funds’. Or: ‘if more financial offences are detected, the suspicious transaction reporting should go up commensurate, followed by a higher input at the PPO’. The authors met nobody in the public agencies neither in the academic community who was intrigued by such questions. This leads to the first recommendation.

1. Expertise improvement

The authors are of the opinion that more advanced equipment and/or staff will only bear fruit if this ‘soft’ human aspect will be addressed successfully. Concretely this implies:

- a. more staff training for financial and economic strategic crime analysis; in-depth studies and time series analysis interacting with short term law enforcement operations;
- b. interdisciplinary participation in such analysis: the APML, (tax) police, customs, Public Prosecution, Courts, NBS *and* academic researchers;
- c. a proper dissemination of the outcomes of strategic analyses, unless police investigations are at stake. At present the FIU does not publish an annual report, which precludes a public assessment;
- d. a competent body or agency responsible for monitoring the law enforcement data production and management (police, customs and tax police, prosecution and the courts). Even if each agency strives for a optimum data management, the lack of a common format and a responsible ‘watch dog’ will soon lead to inconsistencies. More realistically, if no one is accountable for a central task, nothing happens.

2. Database improvement

Most of the present databases are ill-designed and unsuitable for anything but basic frequencies or simple comparisons (if allowed because of differences of definitions). As a matter of fact, the databases were not designed to execute any analysis, being intended as a crude workload measurement in the first place. In addition, each organisation opted for a format of its own making the databases incomparable. It is needless to remark that this approach prevents any transparency of the penal law system.

From this observation it is recommended the implementation of a *law enforcement tracking and tracing database* set up according to the following principles:

- a suspect can be followed from its input until its finalisation;
- similarly, if more suspects in a case, the case can be traced;
- all agencies adopt the same set of case/suspect variables with exactly the same definitions;
- the information input and processing is the same for all agencies;
- the data input (or automated form) per counting unit (case/suspect) travels with the case/suspect like a ‘bill of lading’: this implies that information inserted at a previous stage can be used in all later stages instead of starting anew with data-input. This is the principle of “input once, multiple use later”.

3. Analysis improvement

A database designed according to these principles allows a precise and in-depth analysis, if the right programme is applied. Most databases can easily be converted into an SPSS database (or an equivalent analytical programme) for statistical analysis. This is not an innovation, but the application of a well-trusted analytical technique which is simply at hand.

4. Checking for ergonomics

One of the aspects which may turn an expensive high-tech system into an underused tool is to neglect the human interaction with the system. In simple terms: user friendliness. The authors are not convinced on this aspect. It should be checked whether the input system is such that it reduces mistakes below an acceptable level to prevent a polluted database. If this principle is not heeded, investments for improvements are at risk to be nullified.

User friendliness does not only apply to the obligors at the basis of the system but also the processing links higher-up in the law enforcement chain: the police, prosecution and the courts.

The reverse side of the user friendliness is the discipline which should be demanded – and justifiably if the system is geared to the users’ needs. Moreover, part of the discipline can be imposed an automated data-entry system.

5. Reducing the volume

At present the volume of the input is staggeringly large, due to the cast transaction reports, which is predictable in a largely cash based economy. This leads to an enormous workload, which may affect the efficiency and efficacy of spotting suspicious transactions. A cost-

benefit evaluation should be performed on a regular basis to determine the added value of present system or the adequacy of the staffing in relation to input.

Will the implementation of these recommendations automatically lead to improvements in the fight against money-laundering? A confirmative answer would be unrealistic, given the widespread grey economy and the vast number of economic players who make their living by fishing in these troubled economic and financial waters. To act as a proper counterweight, the results of the implementation must remain visible and play a part in the public perception and thereby contribute to the political accountability of the public agencies involved. This is a basic social and political condition.

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PUBLIC INSTITUTIONS

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- Customs Administration*
- Foreign Exchange Inspectorate*

MINISTRY OF INTERIOR

MINISTRY OF JUSTICE

MINISTRY FOR CAPITAL INVESTMENTS

NATIONAL BANK OF SERBIA

REPUBLIC OF SERBIA STATISTICAL OFFICE

OFFICE OF THE REPUBLIC PROSECUTION RS

OFFICE OF THE SPECIAL PROSECUTION FOR ORGANISED CRIME

OFFICE OF THE DISTRICT PROSECUTOR, BELGRADE

OFFICE OF THE DISTRICT PROSECUTION, NOVI SAD

1ST MUNICIPAL COURT, BELGRADE

COMMERCIAL COURT, BELGRADE

PRIVATE AND NON PROFIT INSTITUTIONS

AC BROKER

BANCA INTESA

BEARINGPOINT

BOOZ, ALLEN & HAMILTON

ILS - CLYDE & CO

ECONOMIC INSTITUTE RS

FOREIGN INVESTORS COUNCIL

PRICEWATERHOUSE COOPERS

APPENDIX I

APPENDIX II