Drug money and bank lending: the unintended consequences of anti-money laundering policies

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Resumen:

We examine how anti-money laundering (AML) policies affect banks and credit provision. Exploiting a Colombian regulation aimed at controlling the flow of drug trafficking proceeds into the financial system, we find that bank deposits decline in high drug-trafficking municipalities. This liquidity shock affects credit availability in other municipalities: banks sourcing deposits from high drug-trafficking areas reduce lending compared to other banks. Leveraging a proprietary database on bank-firm relationships, we also show that small firms relying on credit from these affected banks experience reduced sales, investment, and profitability. Finally, using night lights data, we find that these results do not reflect a shift in activity across firms or between the formal and informal sectors. Our findings reveal a hidden cost to be considered when implementing AML policies.

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1. INTRODUCTION

Money laundering is often a key element in organized crime operations. Despite global efforts to deter it, financial globalization and technological advances facilitate money flows, enabling the laundering cycle. Estimates suggest that an amount equivalent to 2–5% of GDP is laundered annually, making this issue a global economic phenomenon and prompting the United Nations Office on Drugs and Crime (UNODC) to declare the fight against money laundering “more urgent than ever” in 2019...