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Since the mid-1980s, an increasingly global and intrusive Anti Money Laundering (AML) regime has developed in an era which otherwise has been characterized by deregulation of the international finance architecture and diminishing regulatory powers of states and international institutions over the financial system. While the AML regime has expanded over the years, tax havens and offshore financial centres (OFCs) that offer bank secrecy and high-level confidentiality trusts and corporations have increased as well. These act as conduits and shelters of capital, facilitate money laundering, capital flight, transfer pricing and tax evasion and harmful tax avoidance practices. Governments and international financial institutions tend to treat money laundering and tax evasion and capital flight as two different phenomena while the overlap in the use of mechanisms that smooth the progress of these contraventions is clear.¹ The AML regime was to roll back *deregulation* in the non-tax sphere. Only recently a certain convergence is taking place, usually in the form of proposals to use the AML instruments to also counter tax evasion and capital flight.²

While this development is a welcome step towards a more comprehensive approach to tackling financial crime, maybe it is also time to have a look at the effectiveness of the AML regime, and its intended and unintended consequences. Whereas governments and non-governmental, multi-

1. See for instance: Jack A. Blum, Michael Levi, R. Thomas Naylor and Phil Williams, *Financial Havens, Banking Secrecy and Money Laundering*, a study prepared on behalf of the United Nations under the auspices of the Global Programme against Money Laundering, Office for Drug Control and Crime Prevention; Vienna, Austria. Final report printed December 1998.

2. See for instance: *Summary of the Stop Tax Haven Abuse Act* in the US Congress

lateral, intergovernmental, and supranational organisations increasingly tend to look at the tax issue, they seem to uncritically adopt the AML regime as the example to follow – with some call for a tightening of AML regulations without reflecting on whether these really are effective or not. Recently, two retired Internal Revenue Service (IRS) investigators decided to put the AML system to the test in supposedly one of the most strictly regulated nations in the world – the United States, the nation that like no other has advocated the implementation of an AML regime internationally. In about one month and spending US\$ 4,000, the two retired IRS agents formed anonymously owned companies in Florida, New York and Panama, then wired money among the firms’ bank accounts, using their real name throughout the process and obeying all laws. The transactions would be almost impossible to trace, the agents said. Surprisingly, it was more difficult to form an account in Panama than it was in the US.³

The Anti Money Laundering regime and its effectiveness

Since 1989, when the Financial Action Task Force (FATF) introduced its 40 recommendations to standardise anti-money laundering regimes globally, an amalgam of national and international institutions has mushroomed to take on the task. Following the terrorist attacks of 11 September 2001, FATF issued a further nine recommendations focusing on the combating of terrorist financing. Supplemented in 2002, after the 9/11 terrorist attacks, with nine additional recommendations for Combating the Financing of Terrorism (CFT) into an AML/CFT regime. Its stated objectives were, or are now: (1) removing profit out of crime through confiscation, (2) detecting crime by following the money trail, (3) targeting third-party or professional launderers who through their services allow criminals to retain the proceeds of their crime, (4) targeting the upper echelons of the criminal organisation whose only connection to the crime is the money trail, and (5) protecting the integrity of the financial system against abuse by criminals.⁴ Replace the word crime with tax evasion and criminals with tax evaders and it would be a model for a future Anti Tax Evasion (ATE) regime. However, while the AML regime has been constantly updated since its initial conception and numerous mutual evaluations between countries have taken place, there is a growing awareness that the AML regime is not working as well as intended.⁵ In fact the core question remains *how to implement an AML/CFT system that works*.

3. *Project shows ease of money laundering in USA*, USA Today, March 19, 2007. A 2001 report by the Federal Bureau of Investigation claims that approximately fifty percent of total money laundered goes through the US financial system while the US Treasury estimates that 99.9 per cent of such funds are laundered successfully. (See: Daniel Mitchell, (2003) ‘US government agencies confirm that low-tax jurisdictions are not money laundering havens’ in *Journal of Financial Crime*, 11/2, 127-133).

4. Ian Carrington and Heba Shams, *Elements of an Effective AML/CFT Framework: Legal, Regulatory, and Best Institutional Practices to Prevent Threats to Financial Stability and Integrity*, paper presented at a seminar on Current Developments in Monetary and Financial Law, Washington DC, October 23-27, 2006.

5. Compliance with AML/CFT assessments are conducted by the IMF and the World Bank in the context of the Financial Sector Assessment Program as well as by the FATF and the FATF-Style Regional Bodies (FSRBs) in a process of mutual evaluations amongst their members. All AML/CFT assessments are carried out in accordance with a commonly agreed assessment methodology. Currently, there are 8 FATF-Style Regional Bodies representing different regions of the world.

To date, according to officials of the IMF and the World Bank, there is no clear formula to assess whether the AML/CFT system has been effective in achieving its objectives.⁶ “Global rule making on money laundering issues has become something of a growth industry,” according to an AML consultant.⁷ A large number of nongovernmental, multilateral, intergovernmental, and supranational organisations are involved. “Their analyses, reports, and recommendations reveal a disturbing tendency to quote each other’s work; since they enjoy substantially the same membership, this practice amounts to self-corroboration. Moreover, at times they offer overlapping sets of rules and best practices to deal with money laundering. It is ironic that the international community would fail to produce a single, unified set of rules to take on a criminal activity that thrives precisely on exploiting differences in laws and regulations.”

Peter Reuter and Mike Levi attempted to measure the effectiveness of the AML regime.⁸ They concluded that, except at an anecdotal level, the effects of this system on laundering methods and prices, or on offenders’ willingness to engage in various crimes, are unknown. Available data weakly suggests that the AML regime has not had major effects in suppressing crimes. The regime does facilitate investigation and prosecution of some criminal participants who would otherwise evade justice, but fewer than expected by advocates of “follow the money” methods. It also facilitates the recovery of funds from core criminals and from financial intermediaries. However, the volume is very slight compared with income or even profits from crime. Though the regime also targets terrorist finances, modern terrorists need little money for their operations. AML controls are unlikely to cut off their funds but may yield useful intelligence. Money-laundering controls impose costly obligations on businesses and society: they merit better analysis of their effects, both good and bad.

At the core of the AML regime are the Suspicious Activity Reports (SARs) or Suspicious Transaction Reports (STRs) as the primary source of information from financial institutions and other reporting sources. Produced by the prevention pillar, they are principally used by enforcement agencies – as such SARs are the link between the two main pillars of the system (prevention and enforcement). The proportion of SARs in high-reporting jurisdictions that are actually seriously followed up is low, though the extent to which this is inherent or merely resource-constrained remains unclear.⁹ Defensive reporting to avoid potential penalties (and reduce internal review staff costs) seems to be commonplace, leading to a deluge of reports that are impossible to follow up. A study shows that excessive reporting fails to identify what is truly important by diluting the information value of reports.¹⁰

6. Ian Carrington and Heba Shams, op. cit.

7. Nigel Morris-Cotterill, *Think Again: Money Laundering*, Foreign Policy, May/June 2001. Nigel Morris-Cotterill is editor of *World Money Laundering Report* and author of *How Not to Be a Money Launderer* (Brentwood: Silkscreen Publications, 1999). He advises on how to set up AML systems.

8. Michael Levi & Peter Reuter, *Money Laundering*, Crime and Justice, Vol 34, 2006, pp. 289-375.

9. Michael Levi & Peter Reuter, op cit.

10. Előd Takáts, *A Theory of “Crying Wolf”: The Economics of Money Laundering Enforcement*, IMF Working Paper No 07/81, April 2007

There is also serious doubt about the fact that private-sector institutions take on (unpaid) an important and unconventional law enforcement role, for which their customers and shareholders pay, and has serious privacy implications. SARs result not from an objectively determined threshold but from something in the transaction or transactor, which raises suspicion in the minds of bank personnel. The system puts a premium on rumour, bias and stereotype, according to critics, since the information is strictly subjective and the client is uninformed.¹¹ An even more intrusive system was introduced with the Know-Your-Client (KYC) rules, which converted financial managers into private detectives. It seeks information about the client prior to any transaction actually occurring with, once again, the client remaining in the dark. Here the financial institution is no longer passive or even reactive as with the SARs, but proactive.

According to Mike Levi, in a paper delivered at a previous TNI seminar,¹² every international body with finance and/or crime within its mandate has become drawn into the AML arena because it wishes to make a contribution and/or because, politically and bureaucratically, it cannot afford to neglect this source of funds, influence and prestige by failing to be a 'player'. This has led to a plethora of regulation and, because money laundering actually is a common feature of all crimes for significant gain, AML has come to be written into the 'effectiveness' of all of these regulatory efforts including, with some conceptual and terminological strain, the financing of terrorism from the proceeds of otherwise lawful activity, including charitable donations. The regime has been successful in transferring control policies. This process adopted as a core tool an international 'soft law' peer group methodology, 'mutual evaluation'. It seems to be more concerned, however, in evaluating the *outputs* instead of looking at the *outcomes*. According to Levi: (a) the goal of affecting the organisation and levels of serious crimes has been displaced in practice by the more readily observable goal of enhancing and standardising rules and systems; (b) the critical evaluation of what countries actually do with their expensively acquired suspicious transaction report data remains in its infancy.

The conclusion seems to be that the AML regime is not very effective. When interviewed, officials at the US General Accounting Office had the following assessment of the AML regime: "no one would actually design it as it is; but it would be counterproductive to introduce something new."¹³ However, some critics challenge that position. Thomas Naylor has stated that the 'collateral damages' of the AML regime¹⁴ outweigh the positive aspects. In his opinion the

11. Thomas Naylor, *Criminal Profits, Terror Dollars and Nonsense*, paper prepared for the seminar Money Laundering, Tax Evasion and Financial Regulation, Transnational Institute, June 12-13, 2007.

12. Mike Levi, *Controlling the International Money Trail. What Lessons Have Been Learned?*, paper presented at the seminar Global Enforcement Regimes: Transnational Organized Crime, International Terrorism and Money Laundering, at the Transnational Institute (TNI), 28-29 April 2005

13. Eleni Tsingou (2005), *Global governance and transnational financial crime: Opportunities and tensions in the global anti-money laundering regime*, CSGR Working Paper No. 161/05.

14. In particular the intrusive regulatory apparatus that has turned the domestic, and increasingly the international, financial system into a global espionage apparatus. It puts financial institutions in a position of conflict of interest between their responsibilities to clients and shareholders and their duties to the police and national security agencies. He also points to emerging tendency of civil forfeiture in which assets can be seized on increasingly loose criteria, without the safeguards of the criminal justice system. (Naylor, op. cit.)

offence of money laundering is unnecessary. Existing legal concepts of aiding and abetting or accessory-after-the-fact or even criminal conspiracy could work just as well. Alternatively underlying offences could be rewritten to make handling the money part of the primary crime. Furthermore, Naylor states that ordinary fiscal procedures are and historically have been the most effective way to handle illicit financial flows: “Using tax law to seize unreported income produces the desired result with few if any of the undesirable side-effects. There is no need in fiscal procedures to suggest that unreported or misreported income is criminal in origin to justify taking it away – it suffices that it exists. Thus there is no need to tar someone with the brush of criminality without the right to a criminal trial to determine truth or falsehood.”

Tax Evasion and Tax Havens

International attempts to curb tax evasion and avoidance, capital flight and transfer pricing have a much more recent history. Although the overlap in the mechanisms for money laundering and tax and other financial crimes is clear, initial agreement on the establishment of FATF was reached on the basis that it would not address tax issues. Taxation does not have the same cultural resonance as ‘crime’ and certainly not as ‘terrorism’, making it easier to oppose, whether it comes in the form of lobbies such as the Tax Justice Network (TJN) or from otherwise powerful individual governments. At the same time tax evasion, tax avoidance, harmful tax practices, flight capital and transfer pricing have been recognised as having an even greater damaging impact on the stability of the global financial system and as a major impediment for countries to sustain their tax base, and in particular for developing countries to sustain their own development.

There was not then and is not now any international consensus even within the richer Organisation for Economic Co-operation and Development (OECD) members, who did set up the FATF, on the inclusion of tax offences as a ‘predicate crime’ for money laundering, i.e. as a crime that makes it obligatory for financial services and professional staff to report suspicions to the authorities.¹⁵ The lines between money laundering and tax havens or banking secrecy are often blurred even though publicly they are separate and distinct concerns because money laundering is illegal. Tax crimes are not a predicate under US money laundering or racketeering legislation (though once the tax form for that year is completed, production of false financial records may constitute the crime of false accounting in several countries). A common policy to address tax issues at an international level proved to be even more difficult than a common policy against money laundering.

Globally, taxation has been the preserve of the nation-state, representative of national sovereignty.¹⁶ Yet multinational corporations and High Wealth Individuals (HWIs) are not constrained by nationality or sovereignty. Contrasts in national tax regimes, sustained by the intersection of state

15. Levi (2005), op. cit.

16. See for a description of the system and the failure to establish an effective control regime: Gregory Rawlings, ‘[Taxes and Transnational Treaties: Responsive Regulation and the Reassertion of Offshore Sovereignty](#)’, *Law & Policy*, Vol. 29, No. 1, January 2007, pp. 51-66

sovereignty, generate opportunities for tax minimisation on a massive scale. The international tax system differs fundamentally from the AML regime. While the AML regime has a UN convention (the 1988 UN Vienna Convention) as a basis for international regulation, tax regulation was never internationalised by way of a multilateral agreement, but rather dichotomised between states in an ever-increasing number of Double Taxation Agreements (DTAs).

DTAs were designed as a way of giving relief to companies for foreign-source income to ensure that they would not be taxed twice. While commendable in some respects, the bilateral system of DTAs is fraught with dilemmas for national authorities, and rich with opportunities for transnational corporations and citizens. Offshore financial centres (OFCs) take advantage of the bilateral system. Through an ever-increasing number of DTAs, transnational corporations and HWIs take advantage of diversity in types, rates, and definitions of tax. One consequence of this is that “Poorly designed and enforced double tax treaties often meant that tax was paid in neither state”. OECD states responded by introducing ever more complex legislation, such as Controlled Foreign Corporation (CFC) rules, which simply exacerbated the problem for them and created more opportunities for transnational corporations and HWIs to engage in arbitrage and reduce their tax liabilities. The national system of separate taxation systems has “cost states dearly.”

The focus of the efforts of curbing tax evasion and avoidance has been on the role of tax havens that facilitate the mobility of capital. The IMF views OFC states as potentially destabilising markets. Regulation must be strengthened in order to minimise this risk. Tax administrators in OECD countries and the EU perceive them as risks to the integrity of national revenue collection systems. However, the preservation of tax bilateralism has limited the capacity of multilateral organisations to deploy the full range of regulatory techniques, particularly those involving penalty and coercion. Instead all parties, tax haven states and multilateral institutions alike have been confined to the broadest base of the regulatory pyramid. Responsive regulation can end up having the opposite effect from what is intended where the enforcement peak of the regulatory pyramid is absent. This has resulted in strengthening the sovereignty of small OFC states and has increased international tax competition, rather than reduced it.¹⁷

Some have suggested that the United Nations might be the best organisation for convening an international tax body. In particular since the UN International Conference Financing for Development (also known as the Monterrey Consensus) identified the need to address capital flight and associated tax evasion to mobilise resources for development to meet the Millennium Development Goals. However, since its formation in 2004 the UN Committee of Experts on International Cooperation in Tax Matters (known as the UN Tax Committee) remains dominated by OECD member states. It has not shown to be very effective or proactive and lacks the resources that a nascent international tax organisation needs. In contrast to the OECD Department of Fiscal Affairs, which is globally renowned for its technical expertise, the UN Tax Committee functions on a minimal secretariat. The TJN is proposing to strengthen the UN Convention Against Corruption (UNCAC) which offers possible avenues for tackling the enablers of cor-

17. Rawlings, op. cit.

ruption (and therefore for combating capital flight and tax evasion), despite the issues not being explicitly identified in its wording.¹⁸

Recently, hedge funds have come under scrutiny as well. A report by the Senate Permanent Subcommittee on Investigations, *Tax Haven Abuses: The Enablers, The Tools & Secrecy*,¹⁹ exposed how US untaxed assets were transferred to offshore entities in tax havens and then relocated to hedge funds controlled by the same US persons, thereby regaining control of the assets. Concerns were raised that this conduit might enable money laundering as well. A bill called the *Stop Tax Haven Abuse Act* introduced to the US Congress recommends that the Treasury Secretary should finalise a proposed regulation requiring hedge funds to establish anti-money laundering programmes and report suspicious transactions to US law enforcement.²⁰ There is a growing discomfort with the role of hedge funds and private equity funds. The huge volume of private assets held offshore are seen as a potential source of global financial instability, and the German Finance minister has labelled their conduct as akin to that of ‘locusts’. Central bankers and regulators have expressed concern about the risks to the world’s financial system from the estimated € 1,200 billion managed by the funds, but differ in their opinion about how to respond. The UK and the US prefer a light touch but Germany, backed by the European Central Bank president, want stiffer regulation.²¹ However, vigilance on hedge funds is eroding according to the Financial Stability Forum (FSF).²²

International efforts to regulate the grey financial system

Starting in 1998 three initiatives to tackle money laundering, tax evasion and harmful tax competition as well as the disruptive role of offshore held capital focused on the main vehicles for these transgressions. Tax havens had already been criticised by the FATF for facilitating money laundering. At the UN General Assembly Special Session on drugs in 1998 the UN published the report *Financial Havens, Banking Secrecy and Money Laundering*, identifying tax havens as an important conduit for money laundering. The same year the OECD tried to tackle ‘harmful tax competition’, in particular as practiced by a group of roughly three-dozen tax haven states. The publication the OECDs report on *Harmful Tax Competition: An Emerging Global Issue*, sent shock waves through the international tax avoidance industry and the community of small island

18. See for an overview of international action against tax evasion and avoidance: John Christensen, *The Long and Winding Road: Tackling Capital Flight and Tax Evasion*, paper prepared for the seminar Money Laundering, Tax Evasion and Financial Regulation, Transnational Institute, June 12-13, 2007.

19. Senate Permanent Subcommittee on Investigations, *Tax Haven Abuses: The Enablers, The Tools and Secrecy*, August 2006.

20. *Yet Another Levin Bill To ‘Stamp Out Offshore Tax Evasion By Americans’*, Tax-News.com, February 20, 2007.

21. *Berlin calls for voluntary hedge fund code*, Financial Times, May 20 2007

22. *FSF makes recommendations to address potential financial system risks relating to hedge funds*, FSF press release, May 19, 2007. The Financial Stability Forum (FSF) was formed in the wake of the 1997 Asian financial crisis and charged with reforming the ‘international financial architecture’ to avoid the problem of contagion during a crisis, and to this end it tried to improve regulatory standards in offshore financial centres.

tax havens.²³ Scrutiny intensified in 1999 when the FSF identified the huge volume of private assets held offshore as a potential source of global financial instability.

The reports stimulated debate about the possibility that money laundering and tax competition can have adverse macroeconomic impacts, and emphasised how abusive tax practices distort global markets and undermine development. In 2000 – disappointed at the pace of change in some ‘rogue financial states’ on implementing money laundering regulations and seeking wider international sanctions and legitimisation than could be provided by national advisories alone – the FATF engaged in a ‘naming and shaming’ campaign and identified countries guilty of non-cooperation, in the so-called Non-Cooperative Countries or Territories (NCCT) initiative. In 2000, the G-7 issued a report entitled *Actions against Abuse of the Global Financial System*,²⁴ which acknowledged connections between money laundering and corruption, tax havens and harmful tax practices, offshore financial centres and their threat to the stability of the international financial system and the distortion of economic behaviour and erosion of national tax bases. It called upon the international financial institutions to take action. At the initial instigation of the US but supported by the G-7 after the peaceful resolution of some *internal* threats to ‘blacklist’ each other for non-compliance, the FATF overturned the commitment to *mutual* evaluation and instituted the NCCT initiative.²⁵ Those members and non-members alike who failed to meet ‘sufficiently’ the FATF AML criteria would be listed and ‘punished’ by ‘enhanced due diligence’ (i.e. slowing down) or even exclusion from normal international banking facilities.

The NCCT initiative, although considered a potent coercive tool that shifted many of the most recalcitrant jurisdictions into legislative and institutional reform on money-laundering,²⁶ withered away when the IMF and the World Bank became involved in the AML system in 2002, pressured by the G-7 group of rich countries who wanted the AML profile raised after the 9/11 attacks.²⁷ The IMF insisted that the FATF blacklisting be discontinued because the practice was seen as inappropriate and in danger of being discredited as arbitrary and discriminatory.²⁸ Endorsement by the IMF of the FATF recommendations was based on a narrow compromise that included winding down the NCCT list and emphasising consensus, cooperation and a fair and transparent methodology instead. The inclusion of the IMF in the regime addressed some of the membership

23. Christensen, op. cit.

24. *Actions against Abuse of the Global Financial System*, report from G7 Finance Ministers to the Heads of State and Government, July 21, 2000

25. Initially when the blacklist was being drawn up, Britain insisted that Switzerland be included because of its financial secrecy provisions. The Swiss delegation replied that if Switzerland was on the list, they would retaliate by making sure Britain was blacklisted as well. Subsequently both parties came to a quiet compromise whereby each agreed that the other would be left off the list. (Jason C. Sharman, *International Organisations, Blacklisting and Tax Haven Regulation*, paper presented at the European Consortium on Political Research Joint Sessions, Uppsala, Sweden, April 13-18, 2004.

26. Levi, op. cit.; (Sharman, op. cit.)

27. In a November 2002 agreement with the IMF, the FATF agreed to discontinue its NCCT list, though jurisdictions on the list at that point remained until they had enacted specified reforms. *IMF blocks terror fund blacklist*, BBC News, 2 September, 2002.

28. Sharman, op. cit.

shortcomings of FATF, however, it also raised the question of whether financial assessments can deal with standards closely linked to criminal justice in an efficient and legitimate manner.²⁹ The IMF's audits of offshore jurisdictions are very different in conduct and tone with a much more inclusive and consensual approach.

The NCCT process has also been criticised, both for being wound down despite its effectiveness in changing regulatory and legislative frameworks and, most importantly, for being arbitrary and lacking a consistent methodology. For many commentators on the AML regime, it reinforced the political character of FATF and highlighted the influence of core G-7 countries. Questions have been raised about the willingness (or possibility) of the FATF to apply its consistent principles to the more powerful nations. There are indications that the tighter control of "off-shores" is aimed at generating a competitive advantage for the core FATF members.³⁰ The United States (as well as Canada) has consistently been assessed as not meeting many of the FATF 40 Recommendations, yet its chances of ending up on the NCCT list are close to zero, despite the fact that Delaware's standards are worse than some jurisdictions on the NCCT list.

In addition, the OECD blacklisting initiative against harmful tax practices initiative has withered away as well. The OECD proposals lost momentum in the face of strong resistance from the tax haven community, from banks in OECD and non-OECD countries, and from low-tax lobby organisations. A major weakness was that the OECD proposals were restricted in geographical scope to tax evasion by corporate and individual residents of OECD countries. The OECD also restricted its list of tax havens to 38 jurisdictions, mostly small island tax havens, and excluded major tax haven jurisdictions like Luxembourg, Switzerland, the United Kingdom and the United States. The smaller (and often relatively poorer) tax havens in the Caribbean and elsewhere raised a storm of protest about this discrimination, and their demands for a more level playing field stalled the process.³¹

Another weakness was that the OECD proposals did not opt for automatic exchange of information, but for information exchange on request through Tax Information Exchange Agreements (TIEAs), which is far weaker, more expensive and difficult to operate, and consequently less likely to deter tax evasion. Applications for information must demonstrate a 'foreseeable relevance' for tax compliance, which means applicant countries need to provide evidence to back their requests, and cannot simply embark on 'fishing trips' for information. By 2005 the OECD's process was effectively stalled. At the November 2005 meeting of the OECD Global Forum on Taxation in Melbourne the OECD abandoned the time periods it had imposed on tax havens to comply with its transparency and information exchange requirements. This was a major retreat, effectively transforming the OECD proposals into relatively toothless voluntary codes of conduct.

29. Tsingou, *op. cit.*

30. Levi, *op. cit.* At the core of the regime, FATF promotes global standards but is essentially a political organisation in its membership and practices; while its scope is global, its website states that to qualify for membership a country has to be "strategically important". (Tsingou, *op. cit.*)

31. Christensen, *op. cit.*; Rawlings, *op. cit.*

The OECD has historically had the lead role in international tax issues. However, its agenda has largely reflected the interests of its member states, and rising concerns about the role of tax havens, the majority of which are directly or indirectly connected to OECD member states, has identified a need for a more broadly based multilateral forum, including developing countries as well. The OECD's Global Forum on Taxation does not provide a genuinely multilateral framework for dialogue between equals, partly because participation is by invitation only, but the agenda is under the control of OECD countries, and decision-taking is generally reserved for OECD countries in closed meetings.

A recent report, entitled *Assessing the Playing Field*, published by the Commonwealth Secretariat in London and commissioned by the International Trade and Investment Organisation (ITIO), a grouping of small countries with international finance centres, showed yet another weakness: OECD member countries do not operate to a higher standard than so-called offshore centres and in important cases they operate to a lower standard. Many US states, including Delaware and Nevada, do not require companies to provide beneficial ownership information. The US, UK, Canada, France, Germany, Italy, Switzerland, Austria, Luxembourg and Costa Rica still permit bearer share companies and therefore accept a reduction in transparency. Major players in international finance like Hong Kong and Singapore restrict exchanging tax information to domestic interests and Switzerland restricts it to cases of tax fraud and the like.³²

According to an analysis by Gregory Rawlings the 'blacklisting' process might even have had a reverse effect. Although a number of states have abolished their offshore facilities, reduced the number of offshore financial products, or experienced a serious loss of business to the point where their continued viability is doubtful, other key OFCs have prospered with increasing business.³³ Through complying with the OECD initiatives OFC states – such as the Cayman Islands, Bermuda, Jersey, Guernsey, and the Isle of Man, alongside unlisted centres of international private banking such as Singapore – have re-inscribed their reputation and political soundness in the eyes of investors and have become jurisdictions characterised by "good governance" meeting the highest international standards. The preservation of fiscal sovereignty and a redefinition of reputation and governance enhanced the viability of key OFCs. They continue to be ideal locales for structuring transnational business ventures.

The conclusion seems to be that these multilateral initiatives have had the reverse effect to what was originally intended: through allowing OFCs to demonstrate their good governance to the world they maintain their client base and sustain an ongoing fiscal competition between states for tax revenues. Through complying with the OECD, the EU, and the IMF, offshore sovereignty has been enhanced, sustaining its continued appeal for international finance. The move towards responsive regulation has had the opposite effect of what multilateral initiatives had originally

32. *The culprits of harmful tax*, BBC Caribbean, May 9, 2007.

33. See the data in Rawlings, *op. cit.*

intended. Without strong enforcement capacities from the very outset, the multilateral approach was vulnerable to bilateralism from the very beginning.³⁴

The way forward

Despite the impressive paper framework the AML regime appears to be not very effective. Tax evasion and avoidance, harmful tax practices, flight capital and transfer pricing have been recognised as having an even greater damaging impact on the global financial system and as a major impediment for countries to sustain their tax base, and in particular for developing countries to sustain their own development. However, even less has been achieved in building an effective global regime to counter tax transgressions. Offshore centres, tax havens, private banking and lax bookkeeping regulations play a major role in undermining both AML and tax regulation, as well as facilitating the confidentiality and unaccountability of hedge funds and private equity funds that undermine the stability of the world's financial system. Taken together it seems to call for an effective re-regulation of the international financial architecture.

Efforts to give the regimes some teeth have failed. The soft law approach and mutual evaluation seem to have one major deficiency: ultimately there is no enforcement capacity. The tendency at the AML level seems to be that the reason the 'medicine' has not worked is that the dose administered has been too small, and that the logical response should be to apply a stronger dose: more intrusive regulations covering more financial institutions and professions (including car-sales men and jewellers) and the creation of legal frameworks that promote the easy availability of relevant and useful information, remove obstacles to the flow of such information, develop pathways through which such information can efficiently flow, and achieve a culture of cooperation across all private and public sector entities and persons that play a role in AML/CFT regimes, preferably at an international level.³⁵ As far as tax regulation is concerned, states seem to be more inclined to compete with each other to attract capital and protect or attract the financial services sector, than to work on an international regulatory system.³⁶ The buzz phrase is to ensure 'a level playing field'.³⁷ That seems to result in a race to the bottom where the lowest denominator of regulation is likely to prevail. While all involved stress the need for a 'level playing field', it is used nowadays to maintain a status quo.

34. Rawlings, op. cit.

35. See for instance: Carrington & Hams, op .cit.

36. The UK is promoting itself as a "tax haven" on a government website, highlighting the unusually generous tax treatment of foreign residents ('Tax haven' tag generates growing unease, Financial Times, May 4, 2007. The Netherlands was also identified as a tax haven in a report by the Centre for Research on Multi-national Corporations (SOMO): *The Netherlands: A tax haven?*, November 2006.

37. 'Maintaining a level playing field', 'ensuring the competitiveness of the financial sector' and 'reducing unfair competitive advantage of inadequately regulated jurisdictions' were consistently cited as important reasons for the global scope of the AML regime in a series of interviews in the United States, mentioned by Tsingou, (interviews with officials in the US Treasury -FinCen and FATF delegation-, the Office of the Comptroller of the Currency and the Federal Reserve Board). Officials in Congress and the General Accounting Office also explicitly linked the AML regime and FATF to US foreign policy priorities and national security. (Tsingou, op. cit.)

Overseeing the efforts to tackle money laundering and financial flight capital over the past two decades, the picture is not very encouraging. The resulting policies amount to little more than inflated rhetoric and offers bureaucratic solutions to ill-defined problems and a set of entrenched attitudes based on facts-by-repetition which are extremely difficult to eliminate. It seems to amount to an elaborate cosmetic exercise with detrimental effects on the weaker actors of the system. The legitimacy failures call for a broader evaluation of the interests represented and promoted in the regimes. Despite the emphasis on financial integrity, there are strong competitive pressures from the specialised financial services industry and offshore financial centres, which exploit the weaknesses in the regimes and the incapacity of the international community to come up with just and effective control measures. A plethora of overlapping non-governmental, multi-lateral, intergovernmental, and supranational organisations have been created each with their vested interests to maintain them.

An evaluation and overhaul of the entire system of international financial regulation is necessary. The result of that process should be a comprehensive approach to tackle money laundering, tax evasion and avoidance and financial flight capital as interconnected phenomena and provide the necessary enforcement mechanisms. The United Nations might be the right arena to provide a 'level playing field' to negotiate such a comprehensive approach. Over the past two decades it has shown its ability to produce conventions that have laid the basis for the AML regime and efforts to tackle organised crime and corruption. One can question the usefulness of some of the elements of those conventions, but not the legitimacy of the UN as the arena for the international community to address common problems, once it has recognised the necessity and urgency to do so.