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International financial transparency

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Summary

International financial transparency is based on governments obtaining financial information on their citizens and businesses and exchanging it with other governments. The process is carried out according to rules agreed by intergovernmental institutions in order to combat illicit financial flows.

Indeed, some of the main international organisations and forums have been regulating various aspects of financial transparency for 30 years. This working paper analyses the

conceptual framework and metrics of this international agenda and delves into the connections of financial transparency to other variables such as economic development, democratisation and offshore finance.

Despite the growing importance of this issue in the context of globalisation, its links to major transnational issues such as tax evasion, corruption and terrorism and its inclusion on the 2030 Agenda, there are significant disparities in the compliance of individual States with international financial transparency standards. This paper advocates clear concepts and ways of measuring transparency and illicit financial flows as a first step to improving the communication of the agenda and ultimately making it more effective.

Introduction

Financial transparency in the era of globalisation is determined by cooperation between governments and their shared concern about illicit financial flows, including tax evasion, the proceedings of corruption and organised crime, and terrorist finance. The agenda has formed gradually at summits backed by the G7 and the G20, the Organisation for Economic Co-operation and Development (OECD), the Bretton Woods institutions and various United Nations agencies, and is scattered across different international agreements. In 2015 the issue became a priority for the United Nations General Assembly, with the inclusion of a target in the Sustainable Development Goals (SDG target 16.4), alongside numerous references in the Addis Ababa Action Agenda on Financing for Development (United Nations, 2015a).

Despite its importance, there are significant disparities in countries' compliance with international standards on financial transparency. This working paper argues that clear concepts and metrics can improve the communication of the international agenda on financial transparency and make it more effective.

The first section paper provides an overview of the history of financial transparency, from the creation of the Financial Action Task Force on Money Laundering (FATF) in 1989 through to the adoption of the SDGs in 2015. It also discusses the most influential NGOs in the area, using their discourse to identify the key concepts touched upon in this paper: illicit financial flows and international financial transparency.

The second section summarises the main measures that have facilitated analysis and debate on illicit financial flows –also produced by NGOs– and proposes new financial transparency indicators based on compliance with the 40 FATF recommendations, in line with its peer review system. The third section explores the relationships between financial transparency and other variables, such as economic development, democratisation, tax havens and offshore finance.

(1) History and definition of financial transparency

The concept of transparency is related to accountability and the correct functioning of democracy and the rule of law and its use in political theory and practice dates back to the Enlightenment.[1] Financial transparency, understood as the access to and exchange of financial information on individuals and organisations by governments, is a newer and less well established subconcept. The issue has been placed on the international agenda by a series of civil society organisations (CSOs), under the umbrella of the Financial Transparency Coalition and gradually extended by governments (Government of France, 2017), international organisations (UNODC & OECD, 2016) and the media. The term captures a series of measures fostered by international cooperation initiatives, which, despite their different origins, share a common denominator: the production and exchange of financial information between countries to reinforce the capacity of States in a wide range of policy areas, including tax and the fight against terrorism.

The origins of financial transparency: the fight against drug trafficking

The first of these initiatives arose in 1989 and marked a turning point for banking secrecy laws. The G7 summit in Paris that year adopted an economic declaration, which, in addition to analysing the global economic context and debating trade and public debt, included an entire section on drugs. It saw major world leaders commit to work together nationally and internationally to fight drug trafficking and its financial flows. Eight measures were agreed, with varying scopes and levels of implementation, the last of which involved the creation of the Financial Action Task Force (FATF) to prevent the banking system and financial institutions being used for laundering money from drugs (G7, 1989).

The task force adopted 40 recommendations on money laundering (FATF, 1990), which advocated limiting national banking secrecy laws and intensifying international cooperation on investigations, arrests and extraditions. They also set out more specific requirements for States, including creating an offence of money laundering, participation in various international cooperation instruments for drug trafficking and imposing requirements on banks to identify account holders and people making deposits, and keep records and documents that could be used for future investigations.

Throughout the 1990s, FATF successively extended its mandate until consolidating its status as a permanent institution. It also broadened its scope to cover all organised crime and extended surveillance from the banking sector to Designated Non-Financial Businesses and Professions (DNFBPs), a group that includes lawyers, notaries and advisers, as well as certain businesses classed as risky, such as those involved in cash remittances and the exchange of precious metals and stones. In geographic terms, the mechanism for extending the scope of FATF was highly original. Instead of encouraging States to sign-up and reach a global scope, it promoted the creation of similar institutions

[1] The concept of political transparency dates back to the 18th century, when it was first used by authors such as Kant and Rousseau. It entered the British political tradition through Jeremy Bentham's idea 'the more strictly we are watched, the better we behave' (Hood, 2006; Prat, 2006).

in other regions, which then joined FATF as associate members until obtaining full global coverage.[2]

Despite various adaptations, all versions of the FATF recommendations have a similar scope, which can be summarised in terms of two main commitments: States agree to set up an information system with clear powers and responsibilities and to require banks and other key players in the financial system to collect relevant information including reporting suspicious transactions.

[2] These bodies and the dates they were formed are as follows: Caribbean Financial Action Task Force (CFATF), 1992; Asia-Pacific Group on Money Laundering (APG), 1997; Moneyval, a Council of Europe body, 1997; Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), 1999; Inter-Governmental Action Group against Money Laundering in West Africa (GIABA), 1999; Financial Action Task Force of Latin America (GAFILAT), originally formed as the Financial Action Task Force of South America (GAFISUD) in 2000; Middle East and North Africa Financial Action Task Force (MENAFATF), 2004; Eurasian Group, 2010; and the Task Force on Money Laundering in Central Africa (GABAC), 2012.

Figure 1. The 40 FATF recommendations: scope and examples

Regulated area	Recommendations	Example of recommendation and content	
Policies and coordination	1 – 2	R1. Assessing risks and applying a risk-based approach	Countries should identify, assess and understand the money laundering and terrorist financing risks for the country, and should take action, including designating an authority or mechanism to coordinate actions to assess risks, and apply resources, aimed at ensuring the risks are mitigated effectively. Countries should require financial institutions and designated non-financial businesses and professions (DNFBPs) to identify, assess and take effective action to mitigate their money laundering and terrorist financing risks.
Money laundering and confiscation	3 – 4	R3. Money laundering offence	Countries should criminalise money laundering.
Terrorist financing and financing of proliferation	5 – 8	R5. Terrorist financing offence	Countries should criminalise terrorist financing.
Preventive measures	9 – 23	R9. Financial institution secrecy laws	Countries should ensure that financial institution secrecy laws do not inhibit implementation of the FATF recommendations.
Beneficial owner	24 – 25	R24. Transparency and beneficial ownership of legal persons	Countries should take measures to prevent the misuse of legal persons for money laundering or terrorist financing. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities.
Powers and responsibilities of competent authorities and other institutional measures	26 – 35	R26. Regulation and supervision of financial institutions	Countries should ensure that financial institutions are subject to adequate regulation and supervision; prevent criminals or their associates from holding, or being the beneficial owner of, a significant or controlling interest; and should not approve the establishment, or continued operation, of shell banks.
International cooperation	36 – 40	R36. International instruments	Countries must join at least four agreements for the exchange of financial information for fighting crime.

Source: FATF (2012)

Raising awareness of certain risks of financial globalisation

In 1998 Michel Camdessus, at the time the Managing Director of the International Monetary Fund (IMF), gave a historic speech at the FATF plenary, which helped raise awareness of the problem of dark money. In his declaration, Camdessus explained how the increasing interconnectedness of financial systems over the last half-century multiplied the potential for laundering the proceeds of crime (FATF, 1990; IMF, 1998). When money of illicit origin crosses borders, it makes it easier to evade authorities in the country where the crime is committed, and funds can even be repatriated with a perfectly legal appearance.

Michel Camdessus also estimated the size of the criminal economy to be 2%-5% of global GDP and gave a qualitative assessment of the damaging effects (IMF, 1998): corruption and destabilisation of markets; disincentives for productivity and economic growth; macroeconomic instability caused by unforeseen changes in the demand for money and foreign currencies; and the weakening of the social fabric and collective ethical standards.

The blacklist of tax havens

Around the same time, the OECD (1998) highlighted how the movement of capital had created 'harmful tax competition', whose maximum expression was found in tax havens. The OECD produced 19 recommendations for governments to curb competition that impeded their capacity for tax collection and distorted the global economy. Progress in implementing the recommendations was measured two years later in a report on international tax cooperation (OECD, 2000). The report included a list of tax havens based on the criteria in the previous report on the use of aggressive and harmful tax competition to attract financial capital from non-residents.

9/11 and financial transparency

The attacks on 11 September 2001 acted as a stimulus for international counter-terrorism cooperation on all fronts, including financial. Terrorist financing became a priority for intelligence agencies in Western countries and the FATF mandate was expanded. The month following the attacks, the organisation was renamed the Financial Action Task Force on Money Laundering and Terrorist Financing.

In addition to changing its name, the FATF recommendations were expanded. The 40 standards originally adopted in 1990 and reviewed in 1996 to adapt them to the evolution of money laundering techniques were expanded with eight new special recommendations on detecting terrorist financing (FATF, 2002).[3] The eight special FATF recommendations were soon expanded to nine and finally, under a general review of its methodology in 2003, the majority were merged with other general recommendations on financial supervision, leaving just two specifically dedicated to terrorist financing: one on

[3] Terrorist financing differs from money-laundering insofar as the crime takes place at the destination and not the origin. However, it also uses opaque financial instruments and systems to erase traces of money and, as such, is combated in a similar way, by considerably increasing financial transparency to improve access to information.

the terrorist financing offence and another on the fraudulent use of non-profit organisations. The other aspects introduced in the 2001 reform became covered by general recommendations that also applied to the fight against money laundering.[4]

The agenda against corruption and the recovery of public assets

In 2007, the World Bank and the United Nations Office on Drugs and Crime (UNODC) created the Stolen Asset Recovery Initiative (StAR). At the time, bribes received by public officials in developing countries and the embezzlement of public resources in totalitarian regimes were estimated at between US$20 billion and US$40 billion, equivalent to 20%-40% of official development assistance (ODA) (World Bank, 2007).

In the following years, another three anti-corruption instruments based on the exchange of information and international coordination were developed by the OECD. In 2009 the organisation set some rules on bribery of foreign public officials in international business transactions (OECD, 2009). In 2010 the Anti-Corruption Working Group was created with backing from the G20. Finally, in 2012 FATF incorporated a standard on the surveillance of international financial transactions for politically exposed persons (PEPs) by banks into its recommendations. PEPs are individuals who perform or have performed significant public roles in a foreign country and include heads of State or government, high-ranking politicians, senior government, legal and military officials, senior executives in State companies and key members of political parties (GAFILAT, 2018).

Tax information in times of crisis

In 2000 the OECD's work on tax havens resulted in the creation of the Global Forum on Transparency and Exchange of Information for Tax Purposes to set standards for the effective exchange of information between jurisdictions upon request. In 2009, at the height of the financial crisis, the forum was given new impetus and restructured to allow the participation of non-OECD countries, boosting its efforts and ambitions. Three major projects were subsequently launched in this area. The first was a peer review system for analysis and continuous improvement of the tax regulations of the countries participating in the forum. The second was the Exchange of Information on Request (EOIR) standard to facilitate sharing information between countries of the forum. The third was the Automatic Exchange of Information (AEOI) standard, which was much more ambitious than the previous one, to establish an automatic mechanism for the accountability of companies to national authorities and allow the sharing of information with other countries in the forum.

Around the same time, at a meeting of the G20 in London, a widely reported declaration was issued supporting the OECD measures (G20, 2009), exerting pressure on certain countries. The measure had positive results: between the summit in April and the end of 2009, over 300 treaties for the exchange of information were signed (Johannesen &

[4] When the fight against terrorism converged with the fight against money laundering, the FATF institutional documents also incorporated specific references to the funding of weapons of mass destruction, reflecting the international security priorities of the US government at the time. However, these references have been watered down over time.

Zucman, 2014). This led the British Prime Minister Gordon Brown, who was president of the group at the time, to declare the end of tax havens.

The next step in this area came at the G20 meeting in Saint Petersburg in 2013, with the launch of the OECD Base Erosion and Profit Shifting (BEPS) plan (G20, 2013). Key to this project was the introduction of national legislation that would require multinational companies to provide country-by-country accounts in a standard format, making it possible to quickly detect discrepancies between the tax contributions of a company in a country and its activity and income.

However, three years later, in 2016, optimism in this area received a setback with the leaking of confidential documents of the Panama financial advisers Mossack Fonseca, showing the widespread use of companies domiciled in countries like Panama for tax evasion by elites. The contents of the documents undermined the perceived effectiveness of efforts to combat the problem, since Panama was not on the list of tax havens. Spain, for example, had ceased to class Panama as a tax haven in 2010, when both countries signed an agreement to prevent double taxation, which, like many such agreements, included an article on the exchange of information, which justified the removal of Panama from the Spanish list. In 2002 the OECD had also removed Panama from the list in response to a written commitment by its government to apply a series of principles on information sharing and transparency.

The Financial Transparency Coalition

All these intergovernmental initiatives, which have achieved varying degrees of success, have been backed –and sometimes preceded– by a transnational civil society movement pushing in the same direction. In 2003 the Tax Justice Network (TJN), an NGO bringing together experts and activists on tax havens, tax avoidance and illicit financial flows, was formed in London. Its founder, John Christensen, had worked in offshore financial services and had even been an economic adviser for Jersey, which is classed as a tax haven. According to the press, the idea behind the TJN arose as an initiative of residents of Jersey who wished to denounce the effects of secrecy on the poorest groups and countries (Guardian, 2016).

The TJN began publishing its Financial Secrecy Index in 2009 and its successive editions have helped raise awareness of financial secrecy. The index classifies countries based on their contribution to the problem of financial secrecy and, according to the organisation's website, it has been cited in numerous political texts and legislative preambles, as well as in international reports and indexes on country risks, business environments and commitments to development (TJN, 2018c).

The same year the index was launched, a study by Global Financial Integrity (GFI), another NGO founded in Washington DC in 2006 by the entrepreneur Raymond Baker, joined forces with the TJN to report illicit financial flows and their impact on the poorest countries. The first report (GFI, 2018) found that illicit flows of money out of developing countries to OECD States and satellite countries totalled around US$1 trillion a year. The text highlighted the North-South dimension of the problem,[5] noting that the figure was ten times more than the aid received by developing countries from the OECD.

The two organisations joined another seven NGOs to form the Financial Transparency Coalition (FTC).[6] The coalition defines financial transparency as public measures to combat illicit financial flows, including the key measures of the international agreements reviewed above, such as producing country-by-country annual accounts for companies, under the BEPS plan, or keeping records of the real owners of financial assets, per the FATF recommendations (FTC, 2017). The pioneering organisation behind the FTC, the TJN, defines illicit financial flows as movements of money that have been concealed from the authorities of a country in a premeditated manner, regardless of whether their legality has been confirmed by a judge (Cobham, 2012).[7]

Hence, while intergovernmental organisations have developed partial views of illicit financial flows, NGOs have built up a bigger picture and created a much more comprehensive discourse based on the opposition of the concept of financial transparency and illicit (or concealed) financial flows.

It should also be noted that NGOs involved in the fight against illicit financial flows share two substantial ideas that differ from the approach that has characterised intergovernmental cooperation in this area. They argue that financial transparency must go beyond merely providing information to governments and also make it available to the general public, advocating the creation of records based on open data systems available online. Furthermore, they denounce the lack of inclusiveness and legitimacy of solutions based on the OECD or the G7/G20 and Bretton Woods institutions, instead proposing agreements backed and implemented by the United Nations.

Illicit financial flows and the 2030 agenda

The language used by NGOs and, more specifically, the term illicit financial flows were introduced to the United Nations system in 2010 in a publication by UNODC, the body behind the StAR initiative mentioned above. The publication systematised different methods for estimating the phenomenon and also offered a new estimate: US$2.1 trillion a year, equivalent to 3.6% of GDP (UNODC, 2010). More recently, in 2014, the United Nations set up a high-level forum to address the problem in Africa and endorsed the TJN's definition of illicit financial flows as money secretly transferred from one jurisdiction to another, denouncing its harmful effects on the continent (United Nations, 2014).

[5] The report was last updated in 2013, with similar figures (Kar & Leblanc, 2013).

[6] Other NGOs involved in the FTC include Christian Aid, Eurodad, Global Witness, Centre for Budget and Governance Accountability, Latin American Network on Debt, Development and Rights and the Tax Justice Network Africa. Some of these organisations are networks of other NGOs. For example, Eurodad, a European network on debt and development serves as an umbrella organisation for various NGOs, including Oxfam and Save the Children, which are present in various countries.

[7] Other works have also emphasised their criminal or illegal nature. In an article related to the Financial Secrecy Index, Reuter (2012) defines them as illegal flows within a regime with democratic legality and, in a report for the World Bank, Jansky (2013) defines them as flows of criminal origin resulting from tax evasion.

The following year, in 2015, two major agreements backed by the United Nations placed the issue at the heart of the international cooperation agenda: the SDGs and the Addis Ababa Action Agenda on Financing for Development (United Nations, 2015b, 2015a). SDG 16 on the promotion of fair, peaceful and inclusive societies includes target 16.4 of eliminating illicit financial flows by 2030. Similarly, the Addis Ababa Conference on financing for development endorsed the idea that loopholes in financial systems erode the resources required for global development, making it harder for poor countries to make progress on agendas like the SDGs. Its proposals for mobilising alternative sources of finance to development assistance including building the capacity of developing countries by reducing this drain on resources.

Figure 2. Timeline of the international fight against illicit financial flows

Year	Event
1989	The G7 summit in Paris establishes the Financial Action Task Force on Money Laundering (FATF).
1990	Adoption of the 40 FATF recommendations to combat money laundering.
1998	Michel Camdessus estimates the scale of the criminal economy to be around 2%-5% of global GDP.
	The OECD declares harmful tax competition an emerging global issue and issues recommendations on international tax cooperation.
2000	The OECD issues a list of tax havens and establishes the Global Forum on Transparency and Exchange of Information for Tax Purposes.
2001	Following the 9/11 attacks, FATF is renamed the Financial Action Task Force on Money Laundering and Terrorist Financing and issues special recommendations on terrorism and weapons of mass destruction.
2003	The Tax Justice Network is established in London.
2006	The NGO Global Financial Integrity (GFI) is established in Washington DC.
2007	The World Bank and the United Nations Office on Drugs and Crime (UNODC) create the Stolen Asset Recovery Initiative (StAR).
2009	The Global Forum adopts the Exchange of Information on Request (EOIR) and Automatic Exchange of Information (AEOI) standards.
	The G20 summit in London proposes abolishing tax havens.
	TJN publishes the first edition of its Financial Secrecy Index and GFI estimates illicit financial flows from developing countries to be around US$1 trillion a year.
2010	The G20 creates the anticorruption group.
	UNODC publishes an estimate of illicit financial flows of US$2.1 trillion a year, equivalent 3.6% of GDP.
2012	A new version of the FATF recommendations includes surveillance of politically exposed persons (PEPs).
2013	The G20 launches the Base erosion and profit shifting (BEPS) project in Saint Petersburg.
2014	The high-level forum on illicit financial flows in Africa highlights these flows as a major obstacle to the continent's development.
2015	Eradicating illicit financial flows becomes target 16.4 of the Sustainable Development Goals (SDGs) and a core part of the financing for development strategy proposed at the Addis Ababa Conference.
2016	Leak of the Panama papers.

Source: the authors.

Definition of international financial transparency

The developments discussed above show that intergovernmental organisations have identified different dimensions of the same problem in different circumstances. The laundering of money from drugs trafficking, the funding of international terrorism, covering up the embezzlement of public funds and tax evasion are all concealed movements of money that facilitate and encourage crime and fraud. NGOs and the United Nations have used the term illicit financial flows to describe these movements.

Intergovernmental organisations have reacted to these problems with measures based on access to and the exchange of financial information. The reporting of suspicious transactions by banks, maintaining records of real ownership, the production of country-by-country accounts by multinational firms, systems for exchanging tax information and cooperation to recover stolen assets are all measures that form part of the concept of financial transparency promoted by these organisations.[8]

Box 1. Definitions

Illicit financial flows	In international cooperation, the term illicit financial flows refers to movements of money that are wholly or partially concealed and frequently pass through two or more countries to evade the control of national authorities. The concept is also referred to as hidden transnational finance.
International financial transparency	The term international financial transparency refers to the various measures related to access to and the exchange of financial information on individuals and companies by governments, as agreed and regulated at an intergovernmental level, to combat illicit financial flows.

(2) Measuring international financial transparency

The most common financial transparency indicators are negative (in the sense that they measure secrecy) and are not official, since they are produced by NGOs. Two of these indicators are described below: the TJN Financial Secrecy Index and the GFI estimate of hidden outflows from developing countries. This section then presents a new indicator of international transparency, which differs from the others on account of being a positive measure and entirely based on official sources.

Estimates of hidden financial flows

According to the GFI study, illicit financial flows in developing countries make up US$1 trillion (Kar & Leblanc, 2013). This figure, which is ten times higher than ODA has had a significant impact on cooperation for development and was referenced by the OECD and the Addis Ababa Conference. However, the figure has not been mentioned in any official documents or endorsed by governmental or intergovernmental institutions.

[8] The term financial transparency in academic literature also refer to reliability of companies' annual accounts (Barth and Schipper, 2008) and to disclosure of information on government expenditure (Guillamón, Bastida & Benito, 2011; Wehner & de Renzio, 2013; Tekeng & Sharaf, 2015).

Similar estimates have previously been published by experts at the World Bank and IMF but were not included in official indicator systems. In 1993, two World Bank officials estimated capital outflows in developing countries not communicated to the corresponding authorities to be between US$10 billion and US$92 billion (Claessens & Naude, 1993). Over the following years, a number of academic studies were carried out, which the IMF synthesised in the previously mentioned range of 2%-5% of global GDP. All these estimates followed a similar logic to the subsequent GFI estimate of US$1 trillion, based on identifying two types of balance of payments discrepancies (between a country's declared exports in its balance of payments and the corresponding import declarations of trade partners, and the internal discrepancies of each national balance of payments, using the net errors and omissions account).

Attributing these discrepancies to the criminal economy has been hotly debated by national and international experts. As such, none of these individual exercises has been replicated or has resulted in an officially-backed, systematic implementation of the monitoring of illicit financial flows. Furthermore, following the adoption of the 2030 Agenda and the inclusion of indicator 16.4.1 on the total value of illicit financial inflows and outflows, UNODC and the United Nations Conference on Trade and Development (UNCTAD), the agencies responsible for designing and providing data for the indicator, have refused to use the estimates published to date and to adopt their methodology. This decision was made after various consultations with experts from national and international institutions and has resulted in a full-scale methodological project that is still at the discussion stage, meaning that target 16.4 does not count towards the monitoring system, as is the case with the remainder of the 2030 agenda.[9]

[9] Both agencies are still developing indicators for this variable as part of a series of projects in which TJN plays an active and influential role. Their proposal for measuring illicit financial flows was described in an analysis by the Elcano Royal Institute (Cobham, 2018).

Figure 3. Estimates of illicit financial flows

Approach	Scope	Year	Produced by	Concept	Method	Magnitude	Reference
Macro	Global	2013	GFI	Gross outflows of illicit money from developing countries.	Residual method and misinvoicing.	US$946.7 billion	Kar & Lebanc (2013)
	Global	1998	IMF	Money laundering transactions.	Identification of a consensus range among experts.	2%-5% of GDP	Camdessus (1998)
	84 developing countries	1991	World Bank	Unreported transactions.	Residual method and misinvoicing.	US$10-92 billion	Classens & Naudé (1993)
	Global	2007	StAR	International money trafficking. Stolen assets in developing countries.		US$1-1.6 billion	StAR (2007)
	Global	2011	UNODC	Proceeds of crime (including tax evasion).	Meta-analysis of national estimates.	US$3 trillion (1.7%-4.5% of GDP)	UNODC (2011)
	Global	2011	UNODC	The illegal drug trade.	Case studies of the illegal drug trade and estimates of global consumption.	US$870 billion (1.5% of GDP)	UNODC (2011)
Micro	UK	2004	UK Office of National Statistics	Proceeds of crime (excluding tax evasion).	Estimates of the market for illegal drugs, prostitution, the sale of stolen goods and illegal betting.	1.2% of GDP	UNODC (2011)
	Germany	2007	Germany – IMF	Proceeds of crime (excluding tax evasion).	Estimates of the market for illegal drugs, prostitution, the sale of stolen goods and illegal betting.	2.3% of GDP	UNODC (2011)
	Italy	2009	SOS Impresa (NGO)	Proceeds of crime (excluding tax evasion).	Estimates of the market for illegal drugs, prostitution, the sale of stolen goods and illegal betting.	7.7% of GDP	UNODC (2011)

Source: the author.

The Financial Secrecy Index

Instead of measuring illicit flows and the impact on developing countries, TJN seeks to measure financial secrecy, or the lack of financial transparency, in 112 countries. More specifically, its index 'uses a combination of qualitative data and quantitative data to create an objective measure of each jurisdiction's contribution to the global problem of financial secrecy' (TJN, 2015c, p. 2). The qualitative component of the index (financial secrecy) is given as the percentage of non-compliance with 15 transparency principles chosen by TJN, including various international recommendations by FATF and the Global Forum on Transparency and Exchange of Information for Tax Purposes (see Figure 4).

Figure 4. Score for indicator 1 on banking secrecy

Dimensions	Condition(s)	Assessment	Sources
Statutory standing	Banking secrecy does not have legal standing.	0.2 points (1)	OECD (2010); peer reviews by Global Forum.
Availability of relevant information	No anonymous accounts – FATF Rec. 5.	0.2 points	FATF, FATF-like regional bodies, or IMF.
	Keep banking records for at least five years – FATF Rec. 10.	0.2 points	
	Maintain records over time, especially of large or unusual transactions.	0.1 points	Bureau for International Narcotics and Law Enforcement Affairs.
	Report large transactions.	0.1 points	
Effective access	Sufficient powers to obtain and provide banking information.	0.1 points	Global Forum peer reviews elements B.1 and B.2 (incl. factors and text).
	No undue notification and appeal rights against information exchange.	0.1 points	

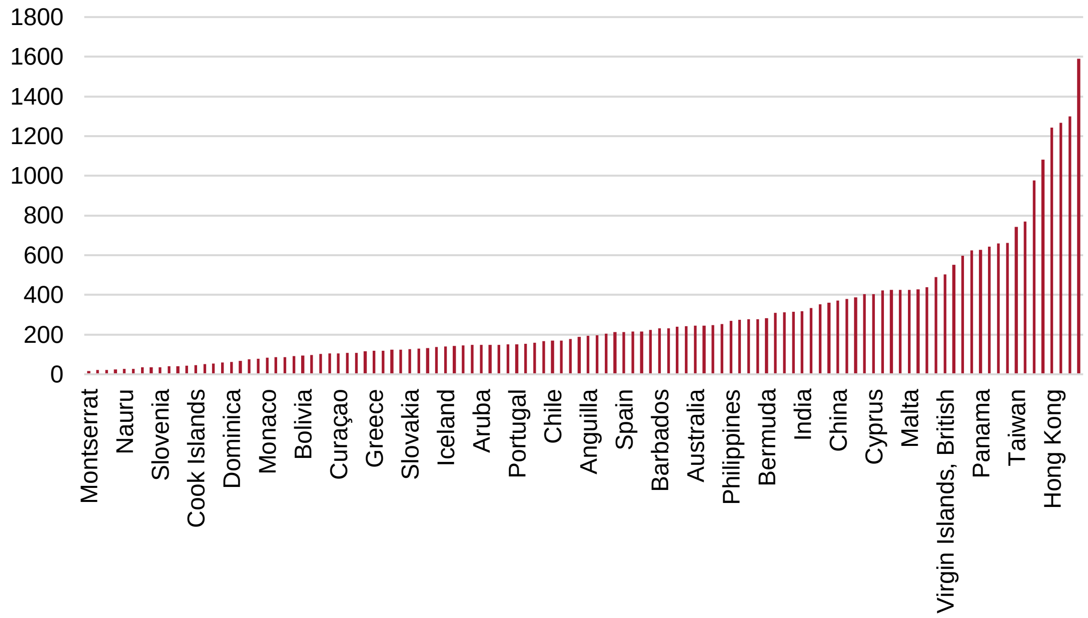
(1) In this indicator and the other 14 in the index, 0 denotes full non-compliance and 1 denotes full compliance. However, at the point of aggregating the scores, in addition to expressing them as percentages, they are also negated. For example, Finland has an average score of 0.69, making its level of financial secrecy 31% (1 - 0.69 x 100%).

Source: TJN (2015c).

The second component of the index, the quantitative or financial scale, measures the participation of countries in the financial services market for non-residents, calculated using IMF balance of payments statistics.[10] TJN uses this component to answer the question 'how much damage is each secrecy jurisdiction actually responsible for?' (TJN, 2015c, p. 2).

[10] For some countries, TJN produces estimates using trade flow projections based on assets held by non-residents (TJN, 2018g, p. 158).

Figure 5. The Financial Secrecy Index, 2018



Maximum = 1,590 (Switzerland); minimum = 17 (Montserrat); average = 283; N = 112.

Source: TJN (2018f).

The results of the Financial Secrecy Index, with countries like Switzerland, Luxembourg, Hong Kong and Germany at the top of the list, are used by TJN and other NGOs to denounce the contributions of major OECD countries to the problem of illicit financial flows, which are larger than many small developing countries classed as tax havens. They are frequently referenced in political texts and preambles to legislation, and systematically form part of international reports and indexes on country risks, the business environment and a commitment to development (TJN, 2018c).

Notwithstanding the extent to which it has stimulated the debate on international financial transparency, the Financial Secrecy Index has two drawbacks when it comes to analysing compliance with international norms on financial transparency. First, the score it assigns to countries is strongly influenced by the relative size of their offshore financial sector, a variable that is more an explanatory factor than a dimension of financial transparency. This means that a country like Finland, which meets 89% of the TJN transparency criteria is classed as having a high level of financial secrecy –on a par with Dominica (24%)– due to the small share of both economies in the international financial services market.[11]

Moreover, not all the criteria of the Financial Secrecy Index are backed by an international agreement. For example, the criterion for income tax of physical persons 'analyses whether a jurisdiction applies a Personal Income Tax (PIT) regime which is

[11] The qualitative component of the index does not suffer from this drawback although there are some reliability issues. Despite reflecting an international consensus, the transparency criteria of this component are individually applied to countries by the TJN analysts, with limited resources, as explained in their own methodology (TJN, 2018g).

compatible with the (progressive) income tax systems of most jurisdictions worldwide, or if its laws provide laxity around citizenship and/or residency' (TJN, 2018g, p. 97). This is a key indicator of tax competition, an area that can be regarded as complementary to financial secrecy, but the criterion is not yet subject to an international agreement.

Proposal for an indicator based on FATF peer reviews

The international institutions that have established financial transparency norms have also implemented systems to evaluate their application. The drawback with these evaluations is that they are not as concise or easily communicated as the initiatives described so far. However, they already have the backing and acceptance of the government being assessed.

The Global Forum (OECD 2016), which is responsible for promoting the exchange of information for tax purposes, evaluates three aspects of international financial transparency for each system: availability of information; appropriate access to information; and exchange between countries. These aspects and components are divided into 10 criteria measured on a scale with four values (non-compliant, partially compliant, largely compliant, compliant), as set out in Figure 6.

Figure 6. Global Forum peer review of information sharing

Assessment criterion	Score
A. Availability of information	Non-compliant Partially compliant Largely compliant Compliant
A1 – Ownership information	
A2 – Accounting records	
A3 – Bank information	
B. Access to information (national)	
B1 – Access powers	
B2 – Rights and safeguards	
C. Information exchange	
C1 – Exchange of information mechanisms (international)	
C2 – Network of agreements	
C3 – Confidentiality	
C4 – Rights and safeguards	
C5 – Timely exchange of information	

Source: Global Forum (OECD, 2016).

FATF has a longer-running mutual evaluation system than the Global Forum, with four rounds over 30 years. Its assessments cover some of the Global Forum criteria, as well as many other aspects of financial transparency contained in its 40 recommendations.[12] It also covers more of the offences that underly the concealment of funds (drug trafficking, organised crime, corruption and tax evasion).

FATF assessments are conducted by a team normally comprising five expert advisers from member States, in addition to the secretary. Its main activity is a visit to the country being assessed. Before visiting, the assessment team reviews documents supplied by the country, based on a standard questionnaire and other FATF countries provide information on the international cooperation of the country being assessed.

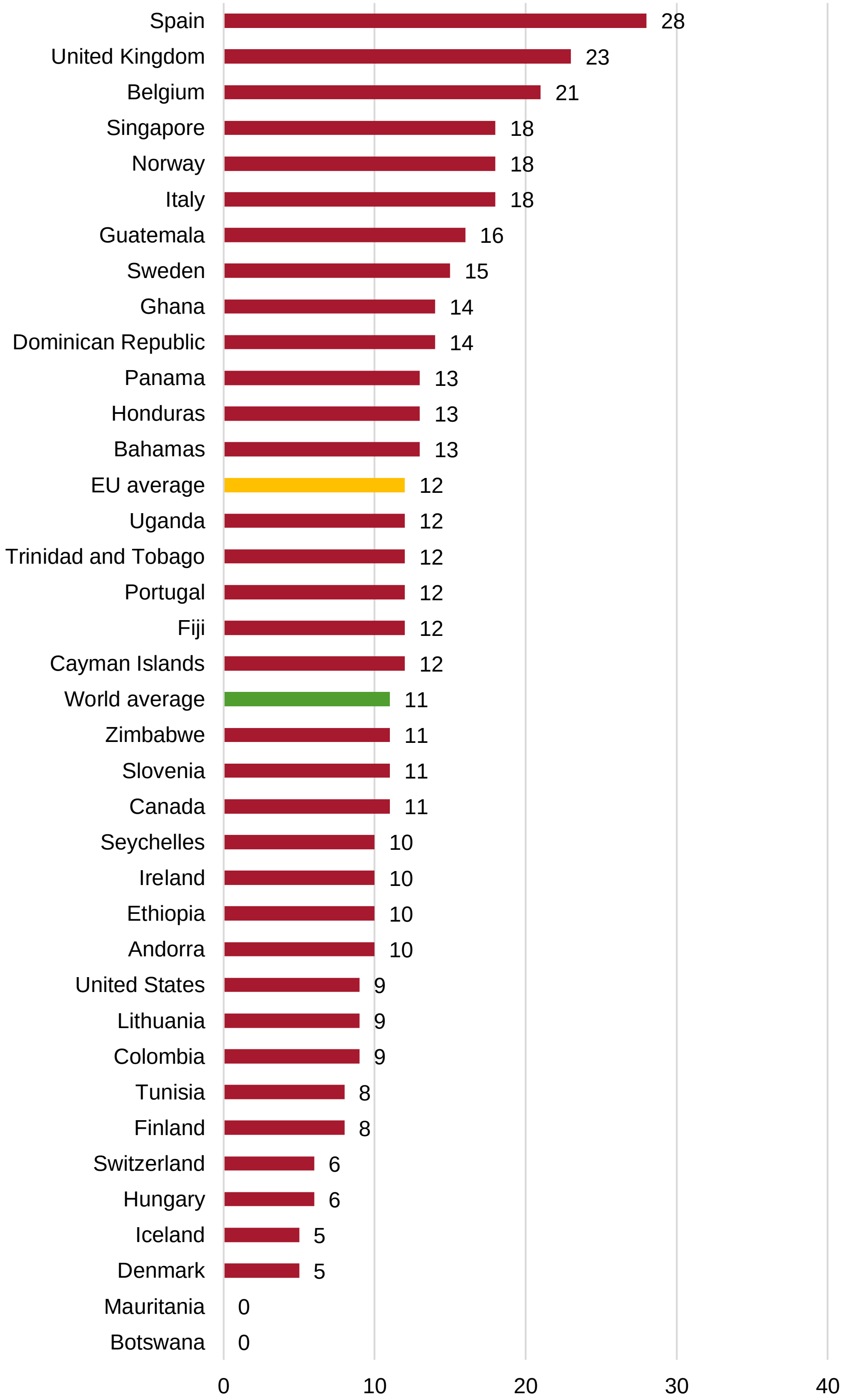
The main outcome of a FATF evaluation is a report that includes a process of written comments by the country undergoing assessment, a face-to-face review between the assessors and the country, quality control by the FATF secretariat and a plenary discussion. Reports are detailed texts containing long descriptions of how each recommendation has been applied in each country, alongside points for potential improvement. They also contain a score similar to the Global Forum, measuring the technical application of each of the 40 recommendations and the effectiveness of the seven components under which they are grouped.

In contrast to the Financial Secrecy Index, the FATF assessments are not summarised in a ranking that permits the situation and progress of financial transparency in the individual countries to be easily compared and communicated. However, the 40 scores assigned to each country for the different recommendations (compliant, largely compliant, partly compliant and non-compliant) are summarised in a large table that is published online and updated as new assessments are conducted during the fourth round of FATF evaluations (FATF, 2019). At least two summary indicators of financial transparency can be derived from the tables.

First, we can simply count the number of recommendations the country fully complies with and establish a compliance ranking from 0 to 40. Figure 7 shows the results based on the April 2019 data.

[12] Information on ownership, banking information and access powers are Global Forum criteria that are also covered by the FATF recommendations. In contrast, the criteria for exchange of information, which specifically refers to the Global Forum standards are analysed by FATF.

Figure 7. How many of the 40 FATF recommendations does each country fully comply with?



Source: fourth round of FATF evaluations.

Secondly, modifying the comparison in Figure 7 to cover the full range of FATF scores for each recommendation (compliant, largely compliant, partly compliant and non-compliant) and scaling them linearly from 0 to 100, gives a second indicator of the average compliance with the 40 FATF recommendations. This indicator ranges from 0% (failure to comply with any of the 40 recommendations) to 100% (full compliance). The Financial Secrecy Index contains a similar indicator, which currently combines data from the third and fourth rounds of FATF evaluations to provide a figure for a larger number of countries. Figure 8 shows this indicator for Spain, the EU and the world based on average values and the data from just the fourth round of evaluations, which is based on a different version of the recommendations and evaluation methodology from the third round.[13]

Figure 8. Level of compliance with the 40 recommendations

			Spain		Average	
Block	Rec.	Recommendation	Score (1)	%	EU	World
Policies and coordination	R.1	Assessing risks and applying a risk-based approach	C	100	69	55
	R.2	National cooperation and coordination	LC	67	69	68
Money laundering and confiscation	R.3	Money laundering offence	LC	67	69	75
	R.4	Confiscation and provisional measures	C	100	69	75
Terrorist financing and financing of proliferation	R.5	Terrorist financing offence	C	100	69	73
	R.6	Targeted financial sanctions related to terrorism and terrorist financing	PC	33	69	54
	R.7	Targeted financial sanctions related to proliferation	PC	33	69	40
	R.8	Non-profit organisations	LC	67	69	41
Preventive measures	R.9	Financial institution secrecy laws	C	100	69	90
	R.10	Customer due diligence	LC	67	69	61
	R.11	Record-keeping	C	100	69	84
	R.12	Politically exposed persons	C	100	69	64
	R.13	Correspondent banking	C	100	69	67
	R.14	Money or value transfer services	C	100	69	74
	R.15	New technologies	C	100	69	70
	R.16	Wire transfers	C	100	69	61
	R.17	Reliance on third parties	LC	67	69	65
	R.18	Internal controls and foreign branches and subsidiaries	C	100	69	67
	R.19	Higher-risk countries	C	100	69	61
	R.20	Reporting of suspicious transactions	C	100	69	82
	R.21	Tipping-off and confidentiality	C	100	69	83
	R.22	DNFBPs: customer due diligence	LC	67	69	45
	R.23	DNFBPs: Other measures	C	100	69	50
Beneficial owner	R.24	Transparency and beneficial ownership of legal persons	LC	67	69	42
	R.25	Transparency and beneficial ownership of legal arrangements	LC	67	69	45

[13] The Financial Secrecy Index version of the indicator will be used further on in this paper for regressions with a larger number of countries.

Powers and responsibilities of competent authorities and other institutional measures	R.26	Regulation and supervision of financial institutions	LC	67	69	56
	R.27	Powers of supervisors	C	100	69	77
	R.28	Regulation and supervision of DNFBPs	LC	67	69	40
	R.29	Financial intelligence units	C	100	69	74
	R.30	Responsibilities of law enforcement and investigative authorities	C	100	69	86
	R.31	Powers of law enforcement and investigative authorities	C	100	69	74
	R.32	Cash couriers	C	100	69	63
	R.33	Statistics	C	100	69	57
	R.34	Guidance and feedback	C	100	69	63
	R.35	Sanctions	C	100	69	54
International cooperation	R.36	International instruments	C	100	69	73
	R.37	Mutual legal assistance	C	100	69	67
	R.38	Mutual legal assistance: freezing and confiscation	C	100	69	63
	R.39	Extradition	C	100	69	71
	R.40	Other forms of international cooperation	C	100	69	63
Total		*Average*		88	72	64
		No. of recommendations with full compliance (total for Spain and average for EU and world)		28	12	11

(1) The evaluation of each country gives one of the following scores for each recommendation (best to worst): C, compliant; LC, largely compliant; PC, partly compliant; NC, non-compliant.

Source: *FATF fourth round ratings* (FATF, 2019).

The percentage of compliance with the FATF recommendations by individual countries could serve as a valid indicator of their financial transparency and would be as concise and easy to communicate as other indicators produced by NGOs. The data is currently available from two sources (TJN and FATF) with different scopes and updated at different intervals, although these are not directly available to the public. The following section presents and explains the differences in financial transparency throughout the world.

Box 2. Financial transparency indicators based on FATF

Number of recommendations with full compliance	Total number of FATF recommendations fully complied with by a country based on the last mutual evaluation report or monitoring report. Theoretical range: 0%-40% Real range (April 2019): 0% (Botswana) – 28% (Spain)
Level of compliance with the 40 recommendations	Average of the quantification of the scores obtained by each country for compliance with each recommendation as a percentage: compliant = 100%, largely compliant = 66%, partly compliant = 33% and non-compliant = 0%). Theoretical range: 0%-100% Real range (April 2019): 15% (Botswana) – 88% (Spain)

(3) Statistical analysis

Lack of compliance with international financial transparency rules

Indicators based on the FATF evaluations show that there are significant discrepancies when it comes to compliance with international financial transparency standards throughout the world. Based on the data from April 2017, the 77 countries evaluated only fully comply with an average of 11 recommendations. If partial compliance is taken into account, the global average is around 62% (where 100% does not represent ideal transparency but strict compliance with internationally agreed standards).

Moreover, compliance is highly uneven. The range of the indicators oscillates between Botswana, which does not fully comply with any of the recommendations and has a compliance level of 15%, and Spain, which fully complies with 28 of the recommendations and has a compliance level of 88%. In general terms, this finding is in line with the data and discourse of NGOs on financial transparency.

There are also significant variations in financial transparency within homogeneous regions. In Europe, countries comply with an average of 12 recommendations, with the lowest levels in the Czech Republic, Denmark and Switzerland (four, five and six recommendations, respectively).[14] In fact, the former Governor of the European Central Bank, Mario Draghi, criticised the lack of effectiveness of the authorities in the fight against money laundering due to the poor exchange of information between countries.[15] Draghi focused on the Eurozone countries, which, in addition to sharing a long history of political integration, have established an increasingly integrated financial system. As such, the fight against money laundering should be even less effective in other regions.

[14] Historically, Luxembourg is the country with the lowest level of compliance with the FATF recommendations, although it is not included on the list because it has yet to be assessed for the fourth evaluation round.

[15] For more information on these declarations, see *La Vanguardia* (2018).

Figure 9. Full compliance with FATF recommendations in Europe

Country	Number (1)
Spain	**28**
UK	23
Belgium	21
Austria	18
Italy	18
Norway	18
Sweden	15
Portugal	12
Slovenia	11
Ireland	10
Lithuania	9
Finland	8
Hungary	6
Latvia	6
Switzerland	6
Denmark	5
Czech Republic	4

(1) How many of the 40 recommendations the country fully complies with, based on the consolidated results of the fourth round of evaluations in April 2019.

Source: based on FATF (2019).

Why are some countries more transparent than others?

The links between the international agenda for financial transparency and major issues such as tax collection, development finance and the fight against drug trafficking and international terrorism raises the question of why governments throughout the world have such different levels of financial transparency.[16] Given that the matter is governed by international standards, answering this question first means analysing why these standards allow such uneven compliance. Such an analysis would doubtless note that the 40 FATF recommendations are just that and not an agreement of public international law with a mechanism for enforcement.

[16] The different measures of financial transparency used in the quantitative analysis of section 4 and based on standards have broad ranges with minimums of 5%-10% and maximums of 80%-90%.

Many analyses of global governance have highlighted the current limitations of collective action being organised under national structures while transnational relations are becoming more intensive and extensive (Rosenau & Czempiel, 1992; Archibugi, 1998). Other analyses have shown how global collective action has a more developed institutional framework than may be first thought. While recent decades have been marked by the lack of new treaties and organisations in public international law, there has been a proliferation of other institutional solutions, which have effectively regulated transnational matters. The solutions are characterised by the absence of a clear normative and institutional hierarchy, alongside dialogue and cooperation between parties, peer review and the involvement of civil society (OECD, 2003; de Búrca, Keohane & Sabel, 2014; Ostrom, 2015; Ortega, Pérez & Sanz, 2018).

Secondly, despite the theoretical interest of FATF for new trends in global governance, the widely varying levels of compliance with this largely voluntary framework means it is necessary to conduct a traditional exercise in comparative politics and explore the differences between political systems correlated with different levels of financial transparency. This approach is common to many analyses of transparency and public finance and can also be applied to the study of the transparency of the financial system as a whole.[17]

As such, like fiscal or political transparency, financial transparency can be linked to the correct operation of democratic institutions. Existing empirical analysis has shown that the relationship between transparency levels in countries, regions and municipalities and indicators of democracy and good governance, such as the existence of elections and electoral competition (Alt, Lassen & Rose, 2006; Albalate del Sol, 2013; Wehner & de Renzio, 2013), accounts courts (Zuccolotto & Teixeira, 2014) and the quality of institutions (Tekeng & Sharaf, 2015). Some of these studies have concluded that while fiscal transparency is not significantly correlated to the main indicators of democracy, there is nonetheless a positive correlation with the Corruption Perceptions Index (Bastida & Benito, 2007) Others identify economic variables that affect the relationship between democracy and transparency. Tourism, for example, has a negative influence on transparency for Spanish municipalities, as do extractive activities in developing countries (Albalate del Sol, 2013; Tekeng & Sharaf, 2015; Wehner & de Renzio, 2013).

The NGOs that have placed illicit financial flows and financial transparency on the global agenda offer their own explanation of the differences in financial transparency between countries, which also identifies the influence of certain economic interests. They argue that the concealment of funds is a source of significant profits for banks and consulting businesses, which can lobby the authorities to halt or slow down the financial transparency agenda.

[17] Both issues –fiscal transparency and financial transparency– can be understood as part of the same quality of the rule of law, where effective accountability requires information on public decision-making, application to the parties involved and control of its application. Lodge (1999) defines the transparency of the regulatory state in terms of five dimensions: the transparency of the adoption of standards, of the rules themselves, of the regulated actors, of the control of their application, and of feedback processes.

John Christensen (2012, p. 336) has published a case study on the rise of offshore finance in Barbados, a Caribbean country once dependent on sugar cane exports: 'In 1989 the government formed an Advisory Committee on International Business which combined banking interests from the private sector with senior public officials. This Advisory Committee has played a prominent role in devising new legislation to attract offshore banking, insurance, shipping and trust formation and administration'. The TJN country reports on the main financial centres contain similar accounts. In the text for Switzerland, for example, the country's status as the 'grandfather' of tax havens and its low financial transparency (27%) is linked to its global leadership in the transnational management of financial assets, with a 28% share of the market (TJN, 2018a). The NGO also sees a clear political intention in the relationship between financial secrecy and the size of the financial sector, which has influenced Switzerland's legislation for centuries. Similarly, TJN view Luxembourg, with 500,000 inhabitants and 12% of the global financial services market as a tax haven based on a consensus among elites (2015b, p. 1).

These explanations also apply to other countries with larger and more diversified economies, such as Germany and the Netherlands, which also have low levels of financial transparency (TJN, 2015a, 2018e). While largely unnoticed, Germany's financial secrecy is part of a strategy that aims to recover the ground lost by Frankfurt to other international financial centres. Its strategy consists of fighting tax havens abroad while tolerating higher levels of secrecy at home (TJN, 2015a). To support this claim, TJN cites delays in signing up to the exchange of information, the surprisingly low level of suspicious transactions reported to FATF and the lack of fines for failing to comply with financial transparency.

Finally, examining the range of compliance with the FATF recommendations (Botswana 0%, Spain 28%), inevitably reveals a potential two-way correlation between economic development and financial transparency. As the Addis Ababa Conference noted, the lack of control over opaque finance acts as a drag on development. It also noted that it is comparatively easier for more developed countries to implement an information system of the scale and sophistication required by FATF.

The relationship between corruption, offshore finance and financial secrecy

Based on the theoretical explanations above, Figure 10 shows various multivariate regressions for international financial transparency, measured by the level of compliance with the 40 FATF recommendations. In order to cover more countries, the TJN consolidated data for the third and fourth FATF evaluation rounds is used, making it possible to cover the majority of the world's population and GDP.

The first three models combine the variable democracy, as measured by various components of the Democracy Index (Economist Intelligence Unit, 2017) and the Corruption Perceptions Index (Transparency International, 2017), together with a dichotomous variable for offshore finance using the OECD list of tax havens or jurisdictions with aggressive tax competition OECD (2000). Models 4 to 6 introduce GDP per capita as an indicator of economic development and use the dichotomous variable

Small Island Developing States (SIDS), which is proposed as a control variable for the list of tax havens, on account of their specific features.

First, these regressions show that the most complete democracy indicators appear to correlate to financial transparency but do not exceed the GDP per capita control. In other words, the relationship between democracy and financial transparency could be the result of the influence of both on a third variable, economic development.

However, the Corruption Perceptions Index, which is also an indicator of the correct functioning of democratic institutions, does exceed the GDP per capital control and, taken together with the list of tax havens, provides a model with greater explanatory capacity than the other models discussed. In other words, statistical analysis confirms the view that financial transparency is part of the agenda of good governance, as well as the discourse of NGOs relating the interests of offshore finance, the lack of integrity of public institutions and financial secrecy.

Figure 10. The causes of financial transparency: multivariate regressions on the level of compliance with the 40 FATF recommendations

Explanatory variables		Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
Constant		−0.103188	−0.159370	-0.1809f	-0.1486	−0.185018	-0.1773	−0.153652
		(0.144631)	(0.150386)	(0.1178)	(0.1457)	(0.2183)	(0.1222)	(0.3061)
Democracy index	General	0.302074 (b)			0.08992			−0.101445
		(0.136617)			(0.1608)			(0.7187)
	Elections		−0.256504					
			(0.204027)					
	Government effectiveness		0.535211 (b)			0.169098		0.0648953
			(0.205373)			(0.3396)		(0.8451)
	Participation		0.0470937					
			(0.160928)					
Corruption perceptions index				0.4247 (c)			0.4083 (b)	0.394422 (a)
				(0.09518)			(0.1710)	(0.0902)
Tax haven list		-0.921643 (a)	−0.770709	-1.087 (c)	-0.9422 (a)	−0.874463	-1.036 (c)	−0.771066
		(0.550786)	(0.549988)	(0.2649)	(0.5390)	(0.1112)	(0.3655)	(0.1587)
GDP per capita					0.2511 (b)	0.221283 (b)	0.01890	0.0275103
					(0.1014)	(0.0396)	(0.1428)	(0.8596)

Small Island Developing States				0.09757	0.0673050	- 0.06482	0.152162
				(0.4568)	(0.8831)	(0.3540)	(0.7407)
N (d)	74	74	85	73	73	84	73
Adjusted R^2	0.098373	0.121815	0.3221	0.1508	0.158387	0.3058	0.241096

Note: for every model and variable, regression coefficients are provided along with standard deviations in parenthesis. The significance of each coefficient is indicated as follows * means significance over 90%, ** means significance over 95%, and significance over 99%.

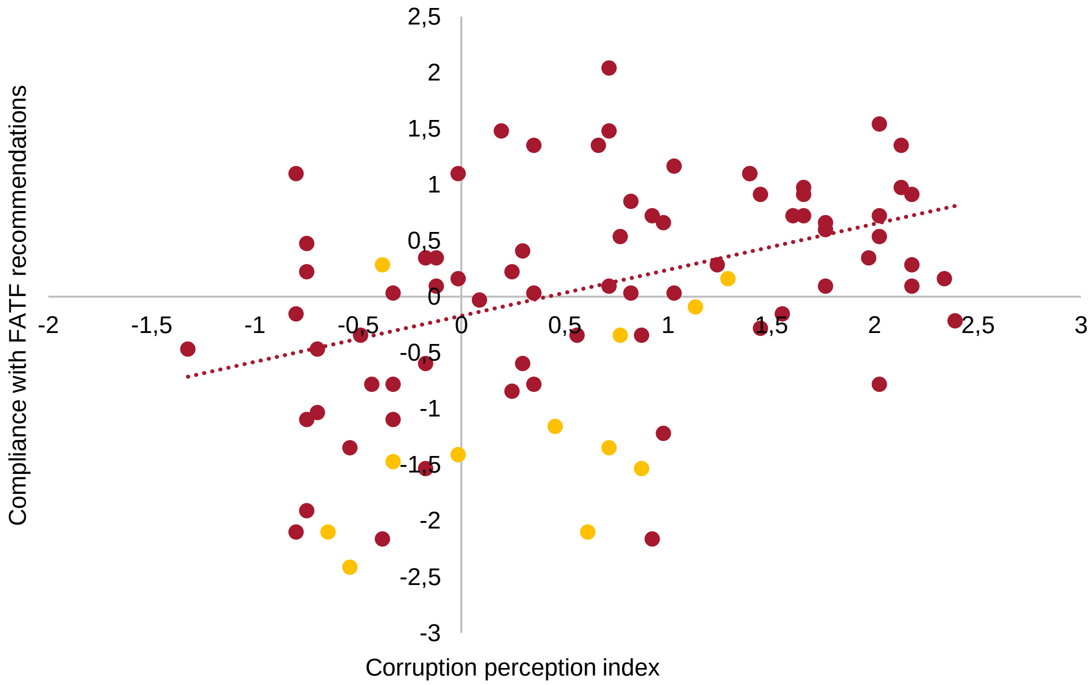
(The number of countries (N) rank from 74 to 85, where 85 represents a group of countries with 92% of global income and 71% of the world's population.

Source: the explanatory variables are the Democracy Index (Economist Intelligence Unit, 2017) and its components on elections, government effectiveness and participation, the Transparency International Corruption Perceptions Index (Transparency International, 2017), the OECD blacklist of tax havens (2000), GDP per capita based on UNCTAD figures (2018) and the United Nations list of Small Island Developing States (2018).

Figure 11 shows the combined influence of corruption and offshore finance on financial transparency. Each point in the graph corresponds to a country and indicates its level of compliance with the 40 FATF recommendations (vertical or y-axis) and its position in the Corruption Perceptions Index (horizontal or x-axis). The points highlighted with their abbreviation correspond to countries pointed out by the OECD in 2000 for aggressive tax competition practices. While all the points reveal an upward trend (improved score in the Corruption Perceptions Index, increased financial transparency), the countries on the OECD blacklist clearly display their own trend, one that is almost parallel to the general trend but considerably lower on the vertical axis. This shows that tax havens are also more transparent when their institutions are less corrupt, despite being less so than countries not classed as tax havens but with similar levels of corruption.[18]

[18] This holds for 11 of the 12 countries listed. Bahrain, whose financial transparency is higher than the trend line for the level of corruption, is the only exception. It should be noted that the trend line for the other 11 tax havens appears to be projected over a point with a favourable corruption score (level 2) but nonetheless visibly below the average for financial transparency. This country is Luxembourg, which has the highest value in the world for the quantitative indicator of offshore finance. The case of Luxembourg will be discussed in the comparative European analysis.

Figure 11. Tax havens in the corruption–financial transparency model (1): least-squares regression of level of compliance with FATF recommendations (Y) and the Corruption Perceptions Index (X)



(1) The countries in the list are: Liberia (LR); Maldives (MV); Bahrain (BH); Panama (PA); Vanuatu (VU); Granada (GD); Saint Lucia (LC); Dominica (DM); Saint Vincent and the Grenadines (VC); Seychelles (SC); Bahamas (BS); and Barbados (BB).

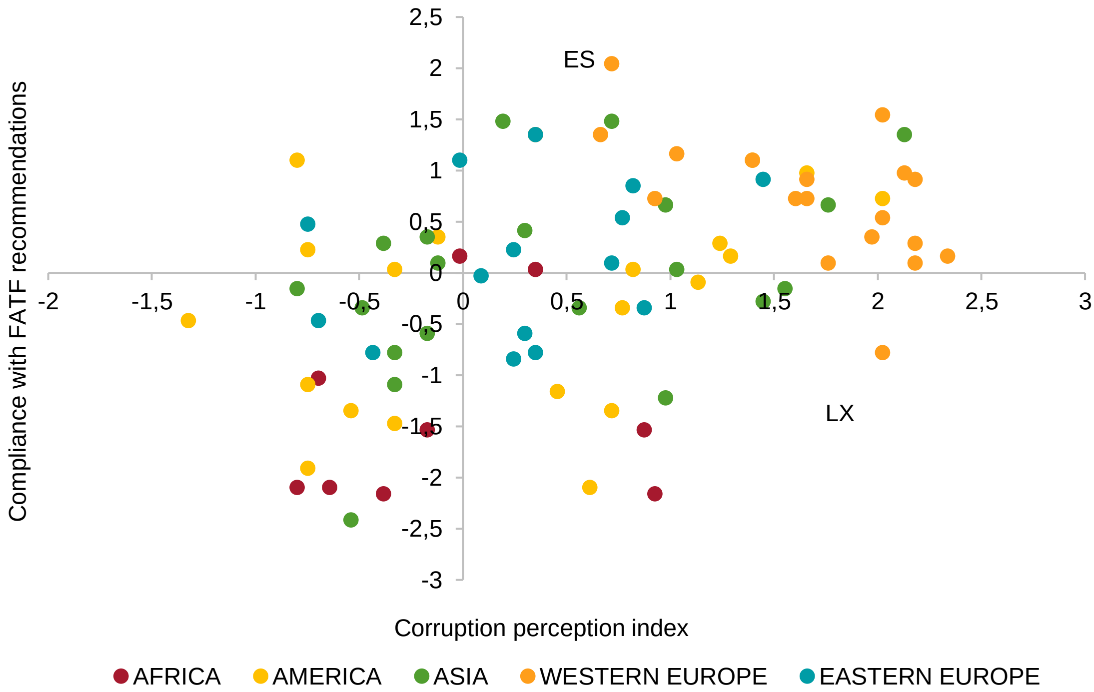
Source: the author.

Other obstacles to progress on financial transparency

Corruption and offshore finance provide the best possible explanation of financial secrecy. However, the explanatory power of this model is limited ($R^2 = 0.32$), as shown in the case of Western Europe. In the global corruption-financial transparency scatter plot in Figure 12, Western European countries are more transparent and less corrupt than other regions. With the exception of Luxembourg, all are located in the upper right quadrant. However, if we exclude non-European countries from the analysis, the relationship between the two variables is clearly negative. In other words, the relationship between the integrity of institutions and financial transparency is inverted in Western Europe, suggesting that, despite the conclusive results of the previous statistical analysis, it is nonetheless worth exploring new factors behind financial transparency to improve the explanatory power of the model.[19]

[19] The significance of the resulting model is not high. The Student tests on the P value of the regressors have been exceeded with a margin of error 0.5% but with a significance of $R^2 = 0.34$.

Figure 12. Corruption and financial transparency in Western Europe and other regions



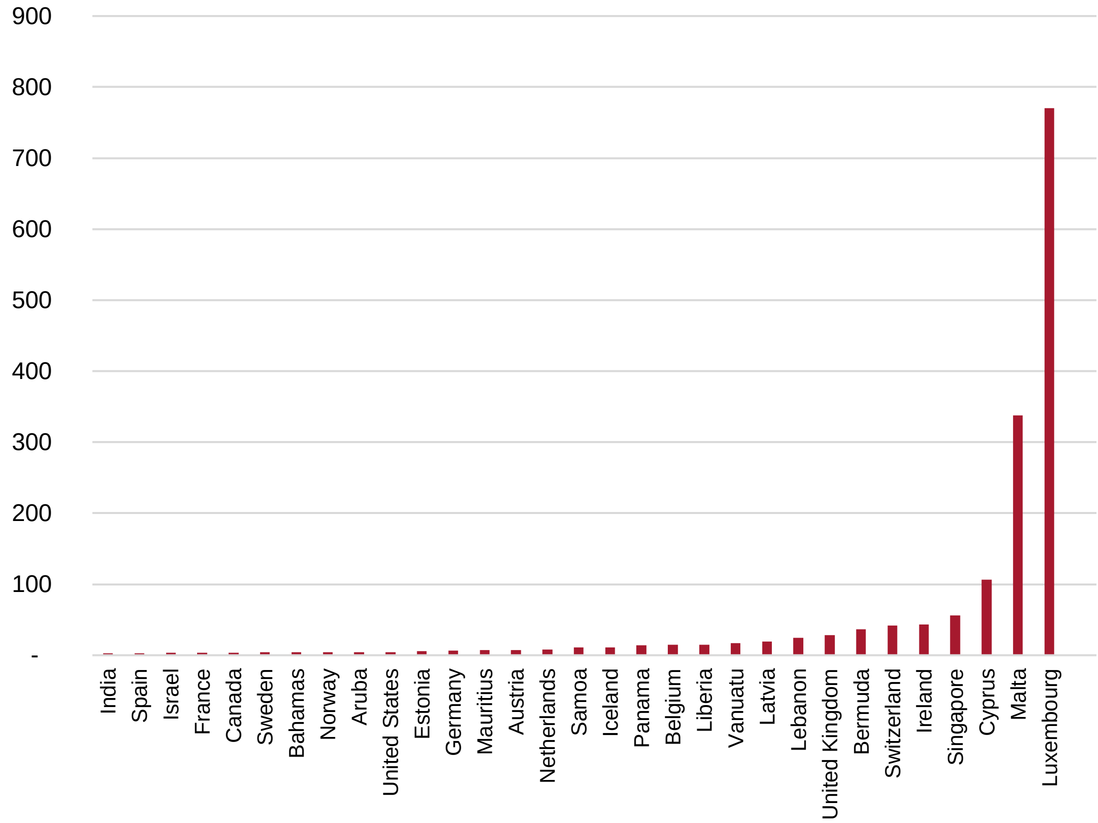
Source: data from the Financial Secrecy Index (TJN, 2018f) and the Corruption Perceptions Index (Transparency International, 2017).

Given Luxembourg's position in Figure 12, let us return to the factor of offshore finance in our analysis of the causes of financial secrecy. The preceding analysis introduced the OECD blacklist of tax havens as a dichotomous variable but it does not account for the grey areas found in Europe.[20] The quotient of the value of financial services for non-residents and the total size of the economy could be used as an alternative indicator of the weighting of offshore finance in a country's economy.[21]

[20] According to the measurement used in the statistical analysis, based on the OECD (1990) report, there are no tax havens in Europe.

[21] The many gaps in the UNCTAD balance of payments database means it has not been possible to calculate this number for enough countries on a global scale, although the data is available for the countries in Western Europe.

Figure 13. Weighting of offshore finance in countries' economies (1)



(1) This figure shows the importance of offshore finance using the quotient of financial services exports from the balance of payments and GDP multiplied by 1,000. Data is available for 58 countries, with the highest value for Luxembourg (700) and lowest for Botswana (0.17).

Source: produced using UNCTAD data.

Luxembourg is the economy with the greatest dependency on financial services in the world. This can be explained by the fact that despite its strong performance in democracy and corruption indicators, it is the only European State where compliance with the FATF recommendations is below the global average. This is confirmed by the TJN report for the country. It explains secrecy in Luxembourg as the result of a consensus among elites to facilitate the professional secrecy of financial advisers and intermediaries in relations with foreign investors (TJN, 2018d). The FATF report also highlights major weaknesses in the control of professions and businesses in key sectors, such as insurance and reinsurance companies and their intermediaries, various roles in finance, such as collective investment managers and advisers, and pension funds and foreign finance workers operating in Luxembourg without an office (FATF, 2010).

It should be noted that the TJN provides a similar description of Switzerland, described as 'the grandfather of the world's tax havens, one of the world's largest offshore financial centres, and one of the world's biggest secrecy jurisdictions or tax havens' (2018a, p. 1). It notes that almost half of its assets originate abroad and that it is the global leader in cross-border asset management, with a 25% share of this market. The report describes the history of Swiss banking secrecy as a pact between elites that dates back to agreements of the Council of Geneva in the 18th century and which has been strengthened by European wars and Switzerland's geographic location and neutral status. However, many European countries now have a similar level of transparency according to internationally agreed standards.

Moreover, the assessment of Norway and Denmark is highly positive, in line with these countries' reputations for democracy, development and modernity. According to TJN, these countries perform well in the Financial Secrecy Index due to the democratic control of their public finances. TJN notes that Denmark is 'a high-tax nation characterised by high levels of social trust and tax compliance. Recent Danish governments have been firmly in favour of combating financial secrecy. While issues remain, a succession of reforms over the past decades in particular have ensured that Denmark today has relatively few characteristics of secrecy jurisdictions' (2018f, p. 1). TJN also attributes the country's high level of taxation to its large welfare state, arguing that 'given the importance of taxation to the modern Danish State and society, tax compliance is paramount, and the government has historically invested in institutions and tools to ensure compliance, to detect evasion and to close loopholes' (*ibid.*). The report also details reactions by the parliament and civil society to news stories of business activities lacking transparency.

Its appraisal of Norway is similar, remarking that the country 'cannot be considered as a haven for secrecy' (TJN, 2018b, p. 1). The TJN report also notes that Norway has been one of the most critical voices of financial secrecy and illicit cross-border flows, citing the official Norwegian report *Tax Havens and Development* (Parliament of Norway, 2009) as an example of an 'early contribution to making the fight against financial secrecy a policy issue for OECD country' (TJN, 2018b, p. 1, *sic*). However, it also notes that the issue has not been a priority for the Conservative government that has been in power since 2013.

As such, the prevailing explanations of transnational civil society when it comes to the causes of financial secrecy do not fully explain differences in this area in Europe in terms of the FATF evaluations. Furthermore, we must ask whether the gap between the perceptions of certain countries and the FATF score dilutes the effectiveness of these non-binding standards. In other words, we might see stricter compliance with the FATF recommendations by certain European countries if the scores were better communicated to the public.

(4) Conclusions

Over the last 30 years, various intergovernmental organisations have promoted international cooperation to fight financial flows related to drug trafficking, the embezzlement of public resources, jihadist terrorism and tax evasion. These efforts have almost always resulted in standards and regulations for producing and exchanging financial information at the international level.

In parallel, CSOs have established a transnational channel for public mobilisation against these illicit financial flows to promote financial transparency. Both these concepts –illicit financial flows and financial transparency– have effectively captured the problems and solutions identified by international institutions, albeit partially, and have fostered a narrative endorsed by the United Nations at the Addis Ababa Conference in 2015 and in the 2030 Agenda.

However, target 16.4 of the 2030 Agenda, on the eradication of illicit financial flows, has not been matched by indicators for monitoring progress, as has been the case with most of the other 169 targets. This is despite the fact that the NGOs that have defined the key concepts of this agenda have also produced their own indicators. Even though the methodology behind the figure of US$1 trillion has been challenged, despite its name, the TJN's Financial Secrecy Index does not only measure financial transparency and its yardstick is not only intergovernmental consensus. It is a composite index that is the product of international agreements on the production and exchange of financial information, as well as tax issues on which there is no consensus, and a measurement of the volume of cross-border financial services for each country. As its methodology indicates, the Financial Secrecy Index aims to answer a question as challenging as 'by providing offshore financial services in combination with a lack of transparency, how much damage is each secrecy jurisdiction actually responsible for?' (TJN, 2015c, p. 2).

This working paper has proposed additional indicators that can be easily produced and communicated by the intergovernmental institutions that have made specific and practical contributions to the international agenda on financial transparency. Given the current international consensus on financial transparency, the simplest and most effective indicator for monitoring the alignment of countries with SDG target 16.4 is arguably counting the number of FATF recommendations fully complied with, based on the FATF mutual evaluation system. FATF currently provides data on this indicator for 77 countries involved in the fourth round of evaluations.

The data affirms the claims of NGOs that there are large spaces of secrecy in the international financial system, as well as the connection of these spaces to policies for attracting offshore finance. The document also confirms an even clearer link between financial transparency and good governance. According to a statistical analysis of 85 countries that make up 92% of global income and 71% of the world's population, the countries that rank lowest in the Corruption Perceptions Index are less rigorous in applying the international financial transparency agenda. Nonetheless, the regressions in this document still leave a significant part of the causes of financial transparency unexplained. This is especially the case in Europe, where there is considerable financial secrecy in countries like Norway, Denmark and Iceland, despite the integrity of their institutions and their irrelevance to offshore finance.

In addition to improving capacity for statistical analysis, providing more accurate concepts and metrics could reinforce the international transparency agenda and make standards more effective. These standards are recommendations adopted in non-binding agreements and the only enforcement mechanism is peer pressure in mutual evaluations (OECD, 2003). Extending the results of these evaluations beyond the realm of politics to influence public opinion and political debate could increase pressure on countries, resulting in stricter and more consistent compliance with the FATF recommendations. When all is said and done, the primary cause of differences in financial transparency between countries is the lack of sanctions –even if merely reputational– for failing to comply with international standards in this area.

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