

COMBATING BLACK MONEY:  
MONEY LAUNDERING AND  
TERRORISM FINANCE,  
INTERNATIONAL COOPERATION AND  
THE G8 ROLE♦♦

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# COMBATING BLACK MONEY: MONEY LAUNDERING AND TERRORISM FINANCE, INTERNATIONAL COOPERATION AND THE G8 ROLE

## 1. Introduction

In the aftermath of September 11th, growing attention has been paid to the role of Non-Cooperative Countries and Territories (NCCT) in money laundering and terrorist financing<sup>1</sup>. Policymakers concentrate their attention on the possibility that NCCT jurisdictions might facilitate the task of terrorists as well as criminal organizations (*black money*). Since 1989 the G7/G8 countries expressed the general commitment to define a strategy to combat black money (Table 1); on October 2001 the G7 Finance Ministers explicitly stressed the urgency to develop a process to identify jurisdictions that facilitate black money and to make recommendations for actions to achieve cooperation from such countries<sup>2</sup>.

Two interacting principles commonly feature in the debate on the relationship between money laundering and NCCTs: a) money laundering is facilitated by lax financial regulation; b) countries adopting lax financial regulation do not cooperate in the international effort aimed at combating money laundering<sup>3</sup>. These two principles characterized the mandate of the Financial Action Task Force (FATF)<sup>4</sup> for the prevention of money laundering. On the one hand, to address the

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<sup>1</sup> As Norgren (2004) noted, money laundering is defined as the processing of criminal proceeds to disguise their illegal origin in order to legitimize the gains of crime, while terrorist finance can be characterised as the direct or indirect provision of funds—illegal or legal—with the intention that they should be used in terrorist acts. But the techniques are quite similar, or at least overlapping. On similarities and differences between money laundering and terrorism finance (or money dirtying), see Rider (2003), Masciandaro (2004). On the key role of the US legislation in promoting the international financial war against terrorism see Wasserman (2002), Banoun, Cephas and Fruchtman (2002), Preston (2003), Van Cleef (2003); see also Davis (2003).

<sup>2</sup> See the Appendix for an overview.

<sup>3</sup> See International Monetary Fund (1998), Holder (2003).

<sup>4</sup> The Financial Action Task Force on Money Laundering (FATF) is an inter-governmental organization that seeks to develop and promote policies at both national and international levels to combat money laundering. The FATF was established following the G7 Summit held in Paris in 1989. G7 members are: Canada, France, Germany, Italy, Japan, the United Kingdom (UK) and the United States (US). Initially, the FATF was convened from the G7 member States, The European Commission (EC) and eight other countries, but it now has a

problems associated with money laundering risks it is fundamental to develop legal standards for rules and regulations. The FAFT standards (Recommendations) became the benchmark for measuring the degree of laxity of financial regulation in every country setting. On the other hand, to monitor the compliance of countries with international standards, the FAFT used a list of specific criteria—consistent with the standards—to determine the NCCT jurisdictions<sup>5</sup>.

The FAFT produces periodic reports on the NCCTs, commonly described as blacklists. From June 2000 to February 2004, nine NCCT lists have been published; the FATF has monitored a total of 45 countries, selected for their potential regulation weakness. Using a worldwide data set on the main 130 countries, we can highlight that these 45 countries represent 8% of total GDP, 15% of total population population, and 25% of foreign bank deposits in the world. Obviously these figures understate the overall relevance of the problem, given the relationships between the non-cooperative attitude, on the one hand, and the global economic and social costs due to the growth of the money laundering risks, on the other<sup>6</sup>.

Therefore the blacklist instrument represents the cornerstone of the international effort to reduce the risks that single countries or territories became havens for money laundering activities. But is this institutional device effective?

It has been argued<sup>7</sup> that the overall result of the blacklisting mechanism is positive, since transparency regarding which countries do not comply has important effects in the financial markets, increasing the market pressures on the NCCT countries. But why is it, then, that various jurisdictions, notwithstanding the blacklist threat, delay or fail to change their rules, confirming their non-cooperative attitude (*reluctant friend effect*)? Furthermore, it is true that most jurisdictions placed on the black list have enacted regulatory measures in an effort to be removed from it. But is regulatory reform sufficient to prove that a country has really changed its non-cooperative attitude (*false friend effect*)?

Perhaps the key problem is that discussions on these often take as *given* that some countries offer financial services to terrorism and organized crime by adopting lax financial regulations. In other words, lax financial regulation is

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membership of 29 jurisdictions, with the EC and the Gulf Cooperation Council as international member organizations. The 29 member jurisdictions are: Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, the United Kingdom (UK) and the United States (US). The FATF has a small Secretariat that is housed in the headquarters of the OECD in Paris, but the FATF is a separate international body and not part of the OECD. See also Alexander (2001).

<sup>5</sup> On differences and similarities between NCCT jurisdictions and offshore centres see Mitchell (2003), Alworth and Masciandaro (2004); on the offshore centres issues see also Errico and Musalem (1999), Hampton and Christensen (2002), Masciandaro (2004).

<sup>6</sup> On the qualitative and quantitative aspects of money laundering see Tanzi (2000).

<sup>7</sup> Norgren (2004). An economic analysis on the FAFT effects is performed by Johnson and Lim (2002). On the first different country reactions to the blacklisting process see Johnson (2001a) and (2001b).

treated as an *independent variable*. Therefore, any regulatory reform consistent with the international standards is sufficient to prove that the country is attempting to become a cooperative jurisdiction, while it fails to explain why specific countries continue in their non-cooperative attitude, notwithstanding the blacklist stigma.

This paper takes a different perspective. We develop the assumption that lax financial regulation may be a *strategic dependent variable* for national policymakers seeking to maximize the net benefits produced by any public policy choice. Therefore, given the structural features and endowments of their own countries, policymakers may find it profitable to adopt financial regulations that attract capital of illicit origin (money laundering services) or destination (terrorism finance services), therefore choosing to be a NCCT jurisdiction.

From a methodological point of view, we follow the classic intuitions of the new political economy, basing our work on three hypotheses: 1) the definition of regulatory policy is not independent, as in the conventional economics, but endogenous; 2) policy is not determined by maximizing a social welfare function but by taking into account the political cost-benefit payoff<sup>8</sup>; and 3) policymaker maximization is constrained and influenced by the structural framework, economic as well as institutional. We are also indebted to a strand of literature, usually associated with the ‘law and economics’ movement, which we deem to be strictly, though indirectly, related to the subject matter of our research, i.e. the literature on the competition in regulation. More specifically, we take the approach developed by authors that have tackled the issue in the “transaction cost economics” tradition<sup>9</sup> and apply it in a novel area.

The paper proceeds as follows. The second section provides a simple model to describe, through the policymaker payoff maximization, the relationships between specific country features and endowments, on the one hand, and lax financial regulations, on the other hand. Given that in the real world relatively lax regulation means a non-cooperative attitude in the international fight against money laundering, in the third section we empirically test the above theoretical relationship in the case of the NCCT jurisdictions. The policy consequences on the pros and cons of international blacklisting procedures are discussed in the conclusive fourth section.

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<sup>8</sup> For the new political economy see Drazen, (2000) and Persson and Tabellini, (2000).

<sup>9</sup> See Romano (1985), (1993) and (1999).

**Table 1 G7/G8 Terrorism Financing and Money Laundering:  
Main Steps**

- 1978- Bonn Statement on Air Hijacking:** Terrorism enters in G7 Agenda.
- 1981- *Ottawa Summit:* Statement on Terrorism.
- 1984- *The London Declaration on International Terrorism* : It's recognized the international character of the terrorist threat.
- 1986- *Tokyo Summit:* international effort against terrorism and first network of expert.
- 1989- *Paris Summit:* G7 recognizes the need of a financial action task force to fight money laundering.
- 1989- FATF is created.
- 1990- *Huston Summit:* G7 countries declare to commit to a full implementation of all FATF's 40 Recommendations.
- 1995- *Ottawa, Ministerial Declaration on Counter Terrorism:* guidelines to fight terrorism, among them "depriving terrorist of funds".
- 1996- *Paris, Ministerial Conference on Terrorism, Agreement on 25 Measures:* among them some measures specifically defined to prevent terrorist fund raising (goals No.19,20 and 21)
- 1997- *Counterterrorism Directory of Skills and Competencies* is created.
- 1998- *G8 Justice and Interior Ministers Virtual Meeting on Organized Crime and Terrorism Funding:* It's underlined international cooperation against money laundering and terrorist funding. French proposal for a UN Convention on terrorist financing.
- 1999- *Moscow Conference:* G8 supports the negotiations on the draft international convention against financing of terrorism
- 2000- *Okinawa Summit: Action against Abuse of the Global Financing System* where a comprehensive strategy against money laundering, tax havens and offshore financial centre is defined. G7 declares, if necessary, prepared itself to implement counter-measures against 15 non-cooperative countries identified by FATF.  
G7 welcomes the creation of FIUs
- 2001- *Rome, Fighting the Abuse of the Global Financial System* (second report) where G7 monitors the FATF's work.
- 2001- (*After September 11*): G8, condemning the terrorist attacks in New York and Washington, declares the need of a comprehensive, international strategy against terrorism and highlights the main role of specific financial measures.
- 2001- The FATF's mandate to combat terrorist financing is expanded. G8 will implement UN sanctions to block terrorist assets.  
*Special Recommendation* to fight terrorism financing are issued by FATF and the Action Plan of FATF is defined.
- 2001- G7 issues *Action Plan to Combat the financing of Terrorism*. It's highlighted the linkage between terrorism prevention and financial abuses prevention. G7 is implementing UNSCR 1333 and UNSCR 1373. All States are called on to freeze terrorist funds and financial assets.
- 2001- IMF issues *Communiqué of the International Monetary and Financial Committee* where some specific measures against terrorist financing are set out.
- 2002- *Ottawa: Progress Report on Combating the Financing of Terrorism:* It's monitored the implementation of the strategy against terrorist financing.
- 2002- Many countries have set up a FIU.
- 2002- *Foreign Ministers' Progress on the Fight against Terrorism*
- 2002- *G8 Recommendations on Counter-Terrorism:* a revision of the 25 Measures, adopted in Paris, 1996.
- 2002- *G7 Combating the Financing of Terrorism: First Year Report:* It's monitored the implementation of the G7 Action Plan (2001).
- 2003- *Evian Summit, Building International Political Will and Capacity to Combat Terrorism: a G8 Action Plan:* It's underlined the need of an international cooperation and institutional network to support CTC, FATF and to encourage fulfilling UNSCR 1373 obligations. Creation of Counter-Terrorism Action Group (CTAG).
- 2004- *Washington, Joint Statement on Combating Terrorist Financing*

## 2. Country Endowments, Policymakers and Lax Financial Regulation. A Simple Model

To design the key elements of our approach, we shall use a very simple model, in order to present the economic intuitions in a compact and casual framework. Our goal is to discuss the possible relationships between specific country features, policymaker payoff maximization and lax financial regulation against money laundering, highlighting the key variables of the problem.

Let us assume that a policymaker is aware that a potential demand for money laundering exists on the part of one or more criminal or terrorist organizations<sup>10</sup>, for a total amount equal to  $W$ . We analyze a situation in which the international market for money laundering is demand-driven, as it is likely to be in the real world. Therefore every potential lax regulation jurisdiction is a relatively "small country".

The policymaker can decide to launder an amount of money equal to  $Y$ , where, of course,  $0 < Y < W$ . For the sake of simplicity in our model, the decision on the optimal level of money laundering services is equivalent to the choice of the optimal degree laxity in financial regulation. Calling  $U$  the payoff function of the policymaker, it is obvious that the expected payoff from unlaundered liquidity is zero, whatever the amount:

$$U(W - Y) = 0 \quad (1)$$

On the other hand every dollar (or euro?)<sup>11</sup> laundered can have a positive expected value for the policymaker, if his country, given scarce natural resources, derives benefits from offering financial services that facilitate money laundering. In particular, we can intuitively assume that the *lower* the national income and the *higher* the proportion of that income that depends on the financial industry, the greater will be the propensity to offer money laundering services, all other things being equal. In general, let us to define those expected benefits as *laxity national benefits*.

To be more precise, the fact that the laundered money provides an expected profit for the policymaker may be captured by imagining that the monetary value  $B$  of this benefit is equal to:

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<sup>10</sup> For a general microeconomic analysis of the money laundering demand see Masciandaro (1996) and (1998). For the peculiar relationship between money laundering demand and tax evasion see Yaniv (1994) and (1999); see also Alldridge (2001).

<sup>11</sup> For the use of dollar or euro in the black economy, see Boeschoten and Fase (1992), Rogoff (1997), Sinn and Westermann (2001).

$$B = mY \quad (2)$$

Where  $m > 0$  is the expected net rate of return on the money laundering services offered (i.e. on the degree of laxity) by the country. The inflow of black and grey foreign capital produces national revenues, increasing the activity of the financial industry and then throughout the traditional macroeconomic multiplier effects<sup>12</sup>. On the contrary, the implementation of a severe regulation against money laundering in the same country generates high compliance costs<sup>13</sup>. The role of the financial industry represents an economic endowments that determine the policymaker choices.

If the decision to launder were cost-free, it would be a trivial matter to see that we shall have  $Y = W$ . But things are not that simple.

First of all, policymakers may face *international reputation costs*. To be more attractive to criminal or terrorist organizations, a country must make legislative and regulatory choices that increase its credibility as a lax financial regulation (LFR) jurisdiction<sup>14</sup>. These choices may carry a reputation cost, however, since being an LFR jurisdiction may cause negative repercussions, whether in relation to capital, intermediaries and companies sensitive to integrity or to international relations in general. In fact, we have to acknowledge the possibility that under-regulation may be as unattractive for some legal investors as over-regulation<sup>15</sup>. As we noted in the Introduction, the existence of the international reputation costs represents the rationale for the blacklisting device.

Secondly, a policymaker must consider that laundering money means strengthening internal organized crime or terrorism, i.e. there may be *national crime and terrorism costs*. Policymakers have to consider the possibility that domestic social damage may derive from the fact that the country may become a possible growth engine for illegal organizations. It is obvious, on the other hand, that the less the country registers the actual or potential presence of criminal or terrorist organizations internally, the lower the policymaker will perceive the costs of crime to be. The level of criminal and terrorism risk is a peculiar social endowment that influences the policymaker decisions.

Within our framework, we do not separate expected crime costs from expected terrorism costs. From the theoretical standpoint, we prefer to stress the different sensitivity of the policymaker to expected international costs and expected national

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<sup>12</sup> For a macroeconomic analysis of the interrelationships between money laundering, banking industry, legal and illegal economic sectors see Masciandaro (2000). For the peculiar vulnerability of securities markets see Jayasuriya (2003).

<sup>13</sup> Masciandaro (1999).

<sup>14</sup> Masciandaro and Portolano (2003).

<sup>15</sup> The inflow of legal capital can be assumed as negatively correlated with financial laxity, because of two main effects: 1) in the legal financial sector, competition is distorted and the allocative efficiency of the market is undermined because of extreme financial laxity (competition effect); and 2) legal customers may fear a loss of reputation by locating their business in a country highly suspected for money laundering (reputation effect). See Basel Committee on Banking Supervision (1988).

costs, based on a clearly different political cost-benefits analysis. Furthermore, for each country, it should not be difficult to introduce in expression (3) a specific parameter for each expected national cost factor.

Therefore the overall cost  $C$  of offering money laundering for a policymaker will consist of two parts. First, let us assume that the reputation cost is proportional—according to a parameter  $c > 0$ —to the amount of money he is asked to launder. Secondly, there will be a crime or terrorism cost whose expected value rises as the amount of laundered money increases, by a multiple of the parameter  $g > 0$ . Let us assume that for political-electoral reasons the policymaker, all other things being equal, is more sensitive to the crime and/or terrorism costs, which can weigh directly on the country's citizens, than to the international reputation costs, whose effect on the citizens-voters is probably less perceptible and direct. We have:

$$C = cY + g^2Y \quad (3)$$

Finally, we must consider that being a lax financial regulation jurisdiction could be an increasing source of economic, political and social risk for the international community as a whole. Therefore, when policymakers decide whether and to what extent to institute a financial regulatory design that will in essence offer money laundering services, they must consider that this activity is risky, since presumably the international community might consider it a bad policy, perhaps even prohibited, and as such subject to sanctions and punitive countermeasures.

Let us assume, therefore, that offering *de facto* money laundering services may bring with it an international sanction, with an equivalent monetary value of  $S$ , and a probability  $p$  that this conduct will be discovered by the international community and thus sanctioned. The probability  $p$  can be defined as the *degree of technical enforcement* of the international stigma. Let us call these risks the *expected international sanction costs*. Our model can thus contemplate in the simplest way the possibility that the international community will issue explicit sanctions against the LFR country<sup>16</sup>.

The monetary value of the damage from sanctions  $S$  against the money laundering must at least equal the value  $Y$  of the laundered money. In reality, the damage from a sanction is certainly a multiple, because of the value of the intangible non economic damage related to such an international sanction. So we can assume that the amount of the international sanction is a multiple of the “laundry” volume, equal, for simplicity of computation, to the square of that sum.

And we should also consider that once the crime is recognized, the international community would apply the sanction with a varying degree of severity, based on its own political cost-benefit analysis. The rapidity and procedure for applying the punishment may vary, affected by national or international structural variables; this

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<sup>16</sup> Sanctions and enforcements characterized the classic a’ la Becker approach: Becker (1968).

*severity* with which the sanction is applied (or *the degree of international political enforcement*)<sup>17</sup> can be captured by variations in the parameter  $t$ :

$$S = tY^2 \quad (4)$$

Thus the dilemma of choice facing a policymaker is the following: if I design lax financial regulations that favor the offering of money laundering services, and the international community does not sanction it, the benefit for the country is positive, net of the expected cost associated with international reputation costs and national crime and terrorism risks. If, on the other hand, the LFR country is hit by an explicit international sanction, it will not only sustain the relative costs but will also be damaged by the international sanction. This game is the classic interaction between the policymaker and Nature, given that we assume the "small country" hypothesis.

The policymaker, modeled as a risk-neutral agent, is thus faced with the problem of deciding whether and how much to launder, i.e. defining the optimal level of laxity. The optimal policy is not derived by any social utility function but is just the result of the policymaker's maximizing process, based on his own political cost-benefits analysis.

The policymaker's expected payoff  $E$  can now be better specified as:

$$E(U) = u[(1-p)(B-C) - p(C+T)] \quad (5)$$

But since we have defines  $B = mY$  and  $C = cY + \mathbf{g}^2 Y$ , then 5) becomes:

$$E(U) = u(1-p)\{mY - cY - \mathbf{g}^2 Y\} - up(cY + \mathbf{g}^2 Y + tY^2) \quad (6)$$

Therefore:

**PROPOSITION ONE:** *It is possible to define the policymaker's optimal level of laxity, depending, coeteris paribus, on specific country endowments.*

$$Y^* = \frac{m(1-p) - c - \mathbf{g}^2}{2pt}$$

$Y^*$  represents the optimal level of money laundering supply services, which is equivalent to the optimal degree of financial regulation laxity. Let us observe that for  $Y^* > 0$  it must be  $m(1-p) - c - \mathbf{g}^2 > 0$ , i.e. the factor of expected benefit

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<sup>17</sup> Rider (2002) noted that, in the field of financial regulation, international monetary policy has been susceptible to political considerations.

from the money-laundering activity, considering the probability of an international sanction, is greater than the sum of the reputation and crime and terrorism cost factors. Let us define this condition as the *laxity condition*.

Now we can evidence the relationships with the structural variables of the model for the optimal level of laxity. Firstly, the optimal offering of money laundering will be inversely proportional to the probability of international sanctions:

$$\frac{\partial Y^*}{\partial p} = \frac{(c + \mathbf{g}^2 - m)}{2p^2t} < 0$$

$$\frac{\partial^2 Y^*}{\partial p} = \frac{-4pt(c + \mathbf{g}^2 - m)}{4p^4t^2} = \frac{m - c - \mathbf{g}^2}{p^3t} > 0$$

This confirms:

**PROPOSITION TWO:** *the optimal degree of laxity increases as the degree of technical enforcement decreases.*

Secondly, the laxity of financial regulation is affected by the severity of the international community in applying the sanction: In fact

**PROPOSITION THREE:** *the optimal degree of laxity increases as the level of international political enforcement decreases.*

$$\frac{\partial Y^*}{\partial t} = \frac{-2p[m(1-p) - c - \mathbf{g}^2]}{4p^2t^2} < 0$$

The laxity of financial regulation will also depend on the profitability of offering money-laundering services. In fact

**PROPOSITION FOUR:** *the optimal degree of laxity increases as the level of national benefits increases.*

$$\frac{\partial Y^*}{\partial m} = \frac{(1-p)}{2pt} > 0$$

Furthermore, we can express the relationship between the reputation cost of money-laundering operations and the amount of money to be laundered .

**PROPOSITION FIVE:** *the optimal degree of laxity increases as the level of international reputation costs decreases.*

$$\frac{\partial Y^*}{\partial c} = \frac{-1}{2pt} < 0$$

Finally, the money-laundering activity of the LFR country will also depend on the expected crime and terrorism costs, represented by the parameter  $\mathbf{g}$

**PROPOSITION SIX:** *the optimal degree of laxity increases as the level of national crime and terrorism costs decreases.*

$$\frac{\partial Y^*}{\partial \mathbf{g}} = \frac{-\mathbf{g}}{pt} < 0$$

### **3. Lax Financial Regulation and Non Co-Operative Countries: An Empirical Investigation**

In the previous paragraph we illustrated the following relationship in a formal framework: given the specific structural features and endowments of his own country, a policymaker may find it rational to design lax financial regulations in order to attract capital of illegal origin.

The policymaker finds it advantageous to transform his country into an LFR jurisdiction because, in defining its objective function, the national economic benefits expected from offering money-laundering services are greater than the expected national costs associated with the internal risk of developing terrorism and organized crime, the international risk of loss of reputation and, finally, the possibility of a sanction by the international community. Therefore, peculiar economic and social country endowments can increase the probability of having lax financial regulation.

Now, how we can test this relationship? In the real world, the international community considers LFR countries as potential non-cooperative jurisdictions (NCCTs) in the fight against money laundering. Therefore we can assume that the NCCT jurisdictions share common structural features; we can test this hypothesis using econometric techniques.

In particular, since the international context (i.e. the technical and political enforcement described in our model) is constant, we can assume that:

- An NCCT jurisdiction will be one that, in terms of economic characteristics, has relatively scant physical resources to spend in

international trade, and that this is the first channel of *national benefit* expected from lax financial regulation (*Proposition Four*);

- At the same time, an NCCT jurisdiction has the potential for developing financial services, fundamental for money-laundering purposes, and this is the second channel of *national benefit* expected from lax financial regulation (*Proposition Four*);
- An NCCT jurisdiction also has social characteristics that shield it to some extent from the risks of terrorism and/or of organized crime, thus reducing the *expected cost* of lax financial regulation (*Proposition Six*);

Now the time has come to analyze the NCCT jurisdictions. Since 22 June 2000, the FATF has been publishing a periodic report on the NCCT jurisdictions: the blacklist. The report lays down 25 criteria, plus eight recent special recommendations on terrorist financing, that, if violated, identify the national rules that in each country are detrimental to international cooperation in the fight against money laundering. From June 2000 to February 2004, 45 countries have been monitored, and nine blacklists have been published, indicating the jurisdictions that fail to conform to the criteria.

Having identified a sample of NCCT jurisdictions, it is possible to perform some econometric exercises. Using a worldwide data set on the main 130 countries<sup>18</sup>, we do a Probit analysis. The dependent variable is a Binary Probit Variable equal to 1 for the 45 potential NCCTs and 0 otherwise.

The best estimated equation<sup>19</sup> is as follows:

$$(BinaryLI)_t = \mathbf{b}_1 + \mathbf{b}_2 (AI)_t + \mathbf{b}_3 (CI) + \mathbf{b}_4 (E1) + \mathbf{e}_t$$

with  $t = 1 \dots N$

where:

$AI$  = Landuse<sup>20</sup>;

$BI$  = GDP per capita<sup>21</sup>;

$CI$  = Foreign deposits per Capita<sup>22</sup>;

<sup>18</sup> Given the 267 world countries (UN members=180), our 130 countries (BRI sample) represent the 98% of the world GDP and the 90% of the world population.

<sup>19</sup> Masciandaro and Portolano (2004).

<sup>20</sup> **Landuse**: This entry contains the percentage shares of total land area for five different types of land use: *arable land* - land cultivated for crops that are replanted after each harvest like wheat, maize, and rice; *permanent crops* - land cultivated for crops that are not replanted after each harvest like citrus, coffee, and rubber; *permanent pastures* - land permanently used for herbaceous forage crops; *forests and woodland* - land under dense or open stands of trees; *other* - any land type not specifically mentioned above, such as urban areas. Source: Central Intelligence Agency.

<sup>21</sup> **Gdp-capita**: This entry shows GDP on a purchasing power parity basis divided by population (year 2001). Source: Central Intelligence Agency

$EI = \text{Terroism and organized crime}^{23} \text{ Index}^{24}$ .

**Table 2 Binary Laxity Index determinants (130 countries and territories)**

Dependent variable	Binary Laxity Index
Landuse	0.0079108 **** (0.003060)
Gdpcapita	-0.0000723**** (0.0000190)
Fordepositcapita	3.18E-06**** (1.36E-06)
Terrorismorgcrime	- 0.5737521 **** (0.2436112)

STANDARD ERRORS IN PARENTHESES. SUPERSCRIT ASTERISKS INDICATE STATISTICAL SIGNIFICANCE AT 0.01 (\*\*\*\*), 0.02 (\*\*\*), 0.05 (\*\*), 0.10 (\*).

<sup>22</sup> **Fordepositscapita:** The data on foreign deposits are derived from reporting as such or calculated by subtracting separately reported data on positions other than deposits from total external assets and liabilities. The only exception is the Netherlands Antilles, which does not provide this information separately (year 2001). Source: BRI. The deposit data are then divided by the population (year 2001).

<sup>23</sup> Regarding the Organized Crime Dummy, the size of the drug market dimension is evidently an indirect and imperfect indicator of the organized crime problem. At the same time, the drug market has given organized crime its massive resources. It has been correctly noted that during the '70s the drug trade became far too profitable and easy for even traditional and "conservative" organized crime organisations to ignore (see Rider (2002), pag.17), Furthermore, it is also noted there that even terrorist groups entered the market and by so doing became virtually indistinguishable from "ordinary" organized crime.

<sup>24</sup> **Terrorism and Organized Crime Index:** we built this variable by summing two separate variables for each country: Organized Crime Dummy = 1 if there is drug production and/or drug markets in the country, 0 otherwise (Source: CIA); Normalized Terrorism Indicator = average number of terrorist episodes in the country (years 1968-91) / max average number of terrorist episodes in a country (1968-91); the Terrorism indicator therefore ranges from 0 to 1 (Source: Blomberg). Consequently, our Index ranges from 0 to 2

Data Sources; Central Intelligence Agency – [www.cia.gov/cia/publications/factbook](http://www.cia.gov/cia/publications/factbook); Democracy Index – [www.geocities.com/CapitolHill/Lobby/3535/country/list-di.htm](http://www.geocities.com/CapitolHill/Lobby/3535/country/list-di.htm); Foreign Bank Deposits: Bank for International Settlements – [www.bri.org/publ/qtrpdf/r\\_qa0206.pdf#page=44](http://www.bri.org/publ/qtrpdf/r_qa0206.pdf#page=44); ; Terrorism Indicators, see Blomberg B.S., Hess D.G., Weerapana A., *Terrorism From Within: An Economic Model of Terrorism*, May 2002 and ITERATE Data Set.

The econometric results (Table 2) seem interesting, generally confirming that the probability of being an NCCT jurisdiction will depend on specific country endowments (*Proposition One*).

Firstly we note that the probability a country will become an NCCT jurisdiction tends to be higher the more it experiences economic growth problems, measuring those problems in terms of per-capita GDP and the level of land exploitation. This variable represents a proxy of the first channel of national laxity benefits (*Proposition Four*).

Secondly we note that the probability a country will become an NCCT jurisdiction tends to be higher the more it has developed the flow of foreign deposits. This variable represents a proxy of the second channel of national laxity benefits (*Proposition Four*).

Thirdly we use a joint Index of the terrorism risks and organized crime risks. In our approach, every national policymaker cares about both risks, and lax financial regulation can benefit in principle either terrorism or organized crime. In fact we note that the probability a country will become an NCCT jurisdiction tends to be higher as the degree of terrorism and organized crime risks decrease (*Proposition Six*).

We must point out that we have found no data for testing the role of international reputation sensitivity (*Proposition Five*)<sup>25</sup>.

It is possible to do a further step if we hypothesize different levels of non-cooperative attitude. We can transform in an order probit variable (Table 3) the fact that the 45 NCCTs jurisdictions have different stories: countries just monitored by the FAFT (non-cooperative attitude=1), countries with at least one presence in the black list (non-cooperative attitude=2), and finally the countries that actually remain in the black list (non-cooperative attitude=3)<sup>26</sup>; the non-cooperative attitude is obviously 0 for the other 85 countries of the sample.

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<sup>25</sup> Obviously we cannot use a cross-country analysis to test the role of international economic and political enforcement, since from the standpoint of traditional economic policy the variables are not country-specific, while from the standpoint of new political economics, they should be more testable *prima facie* using country case studies.

<sup>26</sup> The following list of NCCTs is current and was last changed on February 2004: Cook Islands, Guatemala, Indonesia, Myanmar, Nauru, Nigeria, Philippines .

**Table 3 Ordered Laxity Index (OLI)**

	<b>Countries</b>	<b>OLI</b>
1	Antigua	1
2	Bahamas	2
3	Barbuda	1
4	Belize	1
5	Bermuda	1
6	British Virgin I.	1
7	Cayman I.	2
8	Cook I.	3
9	Cyprus	1
10	Czech Republic	1
11	Egypt	2
12	Dominica	1
13	Gilbratar	1
14	Grenada	2
15	Guatemala	3
16	Guernsey	1
17	Hungary	2
18	Indonesia	3
19	Isle of Man	1
20	Israel	2
21	Jersey	1
22	Lebanon	2
23	Liechtenstein	2
24	Malta	1
25	Marshall I.	2
26	Mauritius	1
27	Monaco	1
28	Myanmar	3
29	Nauru	3
30	Nigeria	3
31	Niue	2
32	Panama	2
33	Philippines	3
34	Poland	1
35	Russia	2
36	Samoa	1
37	Seychelles	1
38	Slovak Rep.	1
39	St. Kitts Nevis	2
40	St. Lucia	1
41	St. Vincent	2
42	Turk Caicos	1
43	Ukraine	2
44	Uruguay	1
45	Vanuatu	1

We carry out an Ordered Probit analysis with the following results( Table3):

**Table 3 Ordered Laxity Index determinants (130 countries and territories)**

Dependent variable	Ordered Laxity Index	
Landuse	0.0135717 **** (0.0049385)	0.0144398 **** (0.0049597)
Gdpcapita	-0.0000523**** (0.0000155)	-0.0000527 **** (0.0000161)
Fordepositcapita	8.86E-08*** (3.98E-08)	9.04E-08*** (4.05E-08)
Terrorismorgcrime	- 0.3313072 (0.2245221)	
Organized crime		- 0.4018445* (0.2414516)
Terrorism		0.0099674 (0.0293882)

STANDARD ERRORS IN PARENTHESES. SUPERScript ASTERISKS INDICATE STATISTICAL SIGNIFICANCE AT 0.01 (\*\*\*\*), 0.02 (\*\*), 0.05 (\*), 0.10 (\*).

The regression confirms the robustness of the two channels of national laxity benefits, while the proxy of the terrorism and organized crime risks has the right sign, but it is not significant. If we split the organized crime dummy from the terrorism dummy, we find that the non-cooperative attitude is inversely related with the organized crime risk.

Finally, the econometric analysis allows us to affirm that the non-cooperative attitude does not coincide with the harmful tax competition attitude. While there is a theoretical presumption that international tax evasion and money laundering through *offshore centres* should overlap<sup>27</sup>, this is not necessarily the case.

We carried out another Probit analysis where the dependent variable is now an Offshore Binary Probit Variable, that is equal to 1 for the OECD offshore countries and 0 otherwise<sup>28</sup> (Table 4).

<sup>27</sup> Yaniv (1994) and (1999), Alworth and Masciandaro (2004).

<sup>28</sup> Alworth and Masciandaro (2004).

**Table 4 Comparing Binary Offshore Index and Binary Laxity determinants (130 countries and territories)**

<i>Dependent Variable</i>	<i>Binary Laxity Index</i>	<i>Binary Offshore Index</i>
Landuse	0.007*** (0.003)	-0.002 (0.005)
Gdpcapita	-7.07E-05**** (1.92E-05)	-2.04E-07 (2.60E-07)
Fordepostcapita	3.18E-06**** (1.36E-06)	1.71E-06 (1.33E-08)
Terrorismorgcrime	-0.508*** (0.224)	-1.888**** (0.448)

STANDARD ERRORS IN PARENTHESIS. SUPERScript ASTERISKS INDICATE STATISTICAL SIGNIFICANCE AT 0.01 (\*\*\*\*), 0.02 (\*\*\*), 0.05 (\*\*), 0.10 (\*).

As can be see, with the exception of the crime and terrorism index, none of variables have any explanatory power. This seems to suggest that the underlying economic characteristics of offshore centres and our NCCTs tend to differ. In general, therefore, we can reject the hypothesis that the causes of lax financial regulation decisions and of offshore activities are exactly the same.

In conclusion, the non-cooperative attitude seems to be dependent on key structural features of the country. Now, what are the consequences of our analysis on the debate concerning the effectiveness of blacklisting procedures?

#### **4. Conclusions. Is Blacklisting an Effective Device?**

In this paper we theoretically discuss and empirically test the relationships between specific country features, policymaker choices toward lax financial regulation, and national non-cooperative attitude with respect to the international effort to combat money-laundering phenomena. Our results suggest two main prescriptions for designing international policies aimed at reducing the global risks of terrorism and organized crime. These prescriptions can help to identify a possible role for the G8 countries in combating black money.

First of all, a pure and just formal “name and shame” approach may even prove counterproductive. Assuming that the international community is capable of effectively singling out NCCT jurisdictions that are indeed involved in black money schemes, a cautious approach is still deemed necessary. When the international community points the finger at a given country as a leading supplier of money-laundering financial services, it may also be certifying, to the benefit of the country itself, that that country is indeed specialized in that business. The

signaling effect embedded in the “name and shame approach” should not be underestimated. The main difficulty for a genuine LFR country is credibly solving the commitment problem. Then, what is a better choice for an LFR country than having the international community—not exactly its closest friends—solving that problem through a public statement certifying a non-cooperative attitude (*reluctant friend effect*)?

Listing should also be regarded as a sort of third party bonding, which is likely to generate two interacting effects. First, it is capable of cementing the commitment by the LFR country. Secondly, naming increases the transaction-specific nature of investments in reputation. Inclusion in a black list increases the value of the (sunk) investments in reputation. In terms of our analysis, for specific countries, the actual effect of the blacklisting procedures can be to increase the expected national benefits rather than improve international political enforcement. As we will point out later, other complementary countermeasures can be necessary to increase the expected costs of the non cooperative attitude.

Furthermore, a country that is engaged in money laundering and finds itself blacklisted will find it even more difficult to switch course and decide to exit the market, thus being encouraged to compete aggressively in the market. The final result does not change much. It still needs to move forward.

The second conclusion that can be reached based on the empirical evidence we have examined is that we must not exclude the possibility that there are LFR countries not presently included in the FATF monitoring action. This is true, perhaps, because they are highly effective in bringing their formal rules in line with international precepts, while in their deeds they remain lax in the fight against black money. By the same token, by modifying their formal rules former NCCT countries could not automatically cease to be lax countries, since the incentives for laxity in combating the laundering of illicit capital may be very deep-rooted (*false friend effect*).

This is not to say that the international community should not endeavor to list countries involved in the market for money laundering services. What this paper argues, is that a “name and shame” approach *per se*, separated from other initiatives, could not produce effective results. Names should be named, but only if blacklisting goes hand in hand with other measures.

Appropriate countermeasures that increase the actual level of international political enforcement and/or the level of international reputation costs should be grounded on the premise that in a global world even the most efficient LFR country will still need to be integrated into the world financial markets.

This implies that no matter how many layers of transactions cover the predicate offence, terrorism or criminal organizations will still need to place that money within the lawful financial sector. This step is necessary, at a minimum, to exploit the capital in lawful uses, once it has been laundered. Money laundering is by definition instrumental to a later use.

In this regard, there is one fundamental feature of the initiative taken by the FATF that appears to be pivotal for its success: the FATF has not limited its initiative to a mere recognition of “non co-operative countries and territories.” FATF member

states have also applied “Recommendation 21”<sup>29</sup> to the countries included in the list. “Recommendation 21” requires a higher scrutiny by financial intermediaries in evaluating the suspect nature of transactions with counter parties, including legal persons, based in a country listed as non-cooperative. As a result of the FATF initiative, many countries included in the list have already taken initiatives aimed at overcoming the serious deficiencies observed by the FATF.<sup>30</sup>

These initiatives need to be evaluated in the medium-to-long term, because some of the enacted laws, for example, will require the issue of secondary regulations to become effective, or, more generally, the initiatives taken at the legislative level will need to be followed by concrete actions. It can be argued, however, that the threat of being crowded out by the international community has played a key role in spurring the adoption of the above mentioned initiatives. However it may be the case to go beyond that. The international community could consider the possibility to introduce effective punitive measures, as a *financial quarantine* for every country that did not adhere to the international standards<sup>31</sup>. The G8 countries could play the role of promoting a complete strategy to combat black money focused on the financial quarantine threat; it could be the effective stick to intertwine with appropriate carrots in defining a new “name and shame” approach. Finally, the above conclusions imply a constant effort on the part of international organizations, particularly the FATF, to update the criteria and monitor the countries.

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<sup>29</sup> See FAFT, (1990). (2000). In addition, on June 2001 the FAFT agreed to a process of stricter countermeasures for reluctant NCCTs; see Norgren (2004).

<sup>30</sup> See FAFT press communiqué of October 5<sup>th</sup>, (2000).

<sup>31</sup> On the possible features of a financial quarantine see Tanzi (2000).

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## Appendix

### The G7/G8, the Terrorism Financing and the Money Laundering: an Overview

Since 1978, the G7 partners have worked together to counter terrorism.

In the first stage (from 1978 to 1980) “terrorism” enters in G7 agenda. Only a vague commitment to cooperate against terrorism was expressed, and no concrete action was planned<sup>32</sup>.

In the second stage G7 strategy against terrorism was more detailed: in 1981 Ottawa Summit, G7 started to take action against the problem. In 1984 London Summit G7 highlighted several goals including the raising of funds through drug trafficking. The London Declaration signalled the first recognition of the transnational character of the terrorist threat<sup>33</sup>.

In 1986, the Tokyo Summit was the first G7 document expressing a vague commitment to lead international effort against terrorism and established the first network of expert groups on terrorism. From 1987 to 1990, G7 adopted some comprehensive counter-terrorism document. However, from 1990 to 1995, terrorism didn't appear in G7 Agenda.

Terrorism re-appeared (third stage) on the G7 summit agenda at the Halifax summit of 1995, which initiated a process resulting in the Ottawa Ministerial Declaration on Countering Terrorism. After the Ottawa Declaration, the G7 commitment against the terrorism has been constant and increasingly concerned on a comprehensive strategy.

- *Ottawa 1995: Ministerial Declaration on Countering Terrorism*<sup>34</sup>.

G7 calls on all states to strive to become party to the existing international conventions concerned with countering terrorism and urgently bring their domestic legislation into harmony with those conventions by the year 2000. The Declaration calls upon all States that assist terrorists to renounce terrorism and to deny financial support, the use of their territory or any other means of support to terrorist organizations.

In the Declaration, Ministers have agreed to pursue measures aimed at depriving terrorists of their sources of finance. All States are encouraged to take action in cooperation with other States, to prevent terrorists from raising funds in any way support terrorist activities and explore the means of tracking and freezing assets used by terrorist groups.

In the Declaration, Ministers declare they will take action to implement these guidelines:

- Calling on all States to strive to join existing international treaties on terrorism by the year 2000
- Promoting mutual legal assistance and extradition
- Sharing of intelligence and information on terrorism
- Pursuing measures to prevent terrorist use nuclear, chemical and biological materials
- Urging all states to refuse to make substantive concessions to hostage takers
- Pursuing measures to prevent the falsification of documents

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♦ The Appendix was prepared by Margherita Saraceno, Paolo Baffi Centre, Bocconi University.

<sup>32</sup> Belelieu A., 2003, *The G8 and Terrorism: What Role can the G8 Play in the 21<sup>st</sup> Century?* G8 Governance No.8..

<sup>33</sup> *ibidem*.

<sup>34</sup> [www.g8.utoronto.ca/terrorism/terror96.htm](http://www.g8.utoronto.ca/terrorism/terror96.htm).

- Protection of aviation, maritime and other transportation systems, infrastructures and public facilities against terrorism
- Depriving terrorist of funds.

- *Paris 1996: Ministerial Conference on Terrorism, Agreement on 25 Measures.*

It's interesting to read the whole text of the Agreement. For our aim, we highlight goals No. 19, 20 and 21<sup>35</sup>.

### ***Terrorist Fund Raising***

#### ***We call on all States to:***

*19. Prevent and take steps to counteract, through appropriate domestic measures, the financing of terrorists and terrorist organizations, whether such financing is direct or indirect through organizations which also have, or claim to have charitable, social or cultural goals, or which are also engaged in unlawful activities such as illicit arms trafficking, drug dealing, and racketeering. These domestic measures may include, where appropriate, monitoring and control of cash transfers and bank disclosure procedures.*

*20. Intensify information exchange concerning international movements of funds sent from one country or received in another country and intended for persons, associations, or groups likely to carry out or support terrorist operations.*

*21. Consider, where appropriate, adopting regulatory measures in order to prevent movements of funds suspected to be intended for terrorist organizations, without impeding in any way the freedom of legitimate capital movements.*

From 1996 to 1998, the action of G8 against terrorism including the creation of a Counterterrorism Directory of Skills and Competencies (1996), chaired by Great Britain, is characterized by several Experts Meeting (Washington, 1997; London 1998; G8 Justice and Interior Ministers Virtual Meeting on Organized Crime and Terrorism Funding).

- *1998, G8 Justice and Interior Ministers Virtual Meeting on Organized Crime and Terrorism Funding*

In this meeting many goals were discussed on Organized Crime and Terrorist Funding. Ministers have recognized the importance of a coordinated strategy to fight money laundering and terrorist funding. Ministers stressed the need for an international cooperation for confiscating criminal assets (experts have drafted a model agreement for sharing confiscated assets) and welcomed the French proposal for a UN Convention on terrorist financing and agreed to work towards its early adoption.

In 1999, G8 reaffirms (in Moscow Conference and in other meetings in Berlin) its purpose of fighting terrorism and declares that it is necessary to take measures to deny terrorist organizations access to sources of financing. G8 supports the negotiations on the draft international convention against financing of terrorism and intends to continue resolute efforts to limit the possibilities for terrorists to obtain and transfer money for their criminal activities.

G8 calls on all the countries which have not yet done so to accede to the 11 universal anti-terrorist conventions and to continue work to strengthen the international legal framework for the struggle against terrorism<sup>36</sup>.

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<sup>35</sup> Source: U.S. Department of State. Released at the Ministerial Conference on Terrorism, Paris, France, July 30, 1996.

In 2000, G7 Summit in Okinawa was indirectly relevant to contrast terrorism financing. The most important document, for our purpose, is the report from G7 Finance Ministers to the Heads of State and Government “*Action against Abuse of the Global Financial System*”.

In this document, a comprehensive strategy against money laundering, tax havens and offshore financial centre is defined<sup>37</sup>. G7 recognizes the need of an international cooperation in order to fight effectively against the abuse of the global financial system.

In particular, G7 welcomes the work of FATF, its rules and practices and its identification of 15 non-cooperative countries on the basis of the criteria in accordance with FATF’s Forty Recommendations. G7 also strongly urges the non-cooperative countries to improve expeditiously their anti-money laundering regime and to remedy the deficiency identified. The G7 Countries declare “we are prepared to act together when required and appropriate to implement coordinated countermeasures against those non-cooperative countries that do not steps to reform their system appropriately, including the possibility to condition or restrict financial transaction with those jurisdictions”.

G7 welcomes the creation of FIUs and endorses the establishment of information exchange arrangements among FIUs operating in the G7 in order to facilitate an active exchange of information among the anti money laundering authorities. G7 have also some peculiar issues about money laundering and calls upon the FATF to consider the scope for revising its Forty Recommendation to address these issues (“Gatekeepers” as the involvement of professional such as lawyers an accountants in fighting against terrorism, evolution of International Payment System, measures to prevent unlawful use of Corporate Vehicles, vulnerability of government institution to money laundering).

In 2001, G7 issued a second report about fighting the abuses of the Global Financial System<sup>38</sup>: G7 continues to monitor the work of FATF; G7 observes that a significant progress has been achieved during the 2000. In this report also the other arguments (offshore financial centres, tax, and the role of financial institutions) are monitored.

On September 11 2001 there are the terrorist attacks in New York and Washington: a new era is starting in the discussion about terrorism. In September 19, the leaders of the G8 condemn in the strongest term the attacks and declare: “*The 12 United Nations counter terrorism conventions set the standard for international action in the fight against terrorism. In response to the brutal events of 11 September, we urge all countries to take steps to ratify these instruments as soon as possible, and to implement the terms of these conventions immediately, even prior to ratification.*

*We have asked our foreign, finance, justice, and other relevant ministers, as appropriate, to draw up a list of specific measures to enhance our counter terrorism cooperation, including: Expanded use of financial measures and sanctions to stop the flow of funds to terrorists, aviation security, the control of arms exports, security and other services cooperation, the denial of all means of support to terrorism and the identification and removal of terrorist threats. By identifying and implementing specific measures, we underscore our*

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<sup>36</sup> Statement by Participant of the Moscow Conferences of G8 Ministers on Counteracting Terrorism, 199, [www.g8.utoronto.ca](http://www.g8.utoronto.ca)

<sup>37</sup> G7, Okinawa 2000, *Action against Abuse of the Global Financial System*, [www.g8.utoronto.ca](http://www.g8.utoronto.ca)

<sup>38</sup> G7, 2001 Rome, *Fighting the Abuses of the Global Financial System*, [www.g8.utoronto.ca](http://www.g8.utoronto.ca)

*determination to bring to justice the perpetrators of this outrage, to combat all forms of terrorism, to prevent further attacks, and to strengthen international cooperation in the fight against this global scourge. We welcome all others who stand ready to join us in these efforts, and we stand ready to help them.”*

We highlight that the first issue, included such as specific measure against terrorism, is the use of financial measures and sanction to stop the flow of funds to terrorists.

On October 2001, the G7 – Finance Ministers met to discuss international efforts to combat the financing of terrorism.

G7 has declared the commitment to vigorously track down and intercept the assets of terrorists and to pursue the individuals and countries suspected of financing terrorists.

G7 declared that will implement UN sanctions to block terrorist assets and welcomed the decision by the Financial Action Task Force to hold an extraordinary plenary session to expand its mandate to combat terrorist financing.

The *Action Plan to Combat the financing of Terrorism*<sup>39</sup>, issued by G7 during the meeting, highlights the strong linkage between terrorism prevention and financial abuses prevention.

The text of the Action Plan describes a complete and comprehensive strategy to use instruments to avoid financial abuses to combat terrorist financing:

*“We, the G-7 Finance Ministers, have developed an integrated, comprehensive Action Plan to block the assets of terrorists and their associates. We pledge to work together to deliver real results in combating the scourge of the financing of terrorism.*

*More vigorous implementation of international sanctions is critical to cut off the financing of terrorism. We are implementing UNSCR 1333 and UNSCR 1373, which call on all States to freeze the funds and financial assets not only of the terrorist Usama bin Laden and his associates, but terrorists all over the world. Each of us will ratify the UN Convention on the Suppression of Terrorist Financing as soon as possible. We will work within our Governments to consider additional measures and share lists of terrorists as necessary to ensure that the entire network of terrorist financing is addressed.*

*The Financial Action Task Force (FATF) should play a vital role in fighting the financing of terrorism. At its extraordinary plenary meeting in Washington D.C., FATF should focus on specific measures to combat terrorist financing, including:*

- *Issuing special FATF recommendations and revising the FATF 40 Recommendations to take into account the need to fight terrorist financing, including through increased transparency;*
- *Issuing special guidance for financial institutions on practices associated with the financing of terrorism that warrant further action on the part of affected institutions;*
- *Developing a process to identify jurisdictions that facilitate terrorist financing, and making recommendations for actions to achieve cooperation from such countries.*

*Enhanced sharing of information among financial intelligence units (FIUs) is also critical to cut off the flow of resources to terrorist organizations and their associates. We call on all countries to establish functional FIUs as soon as possible. The G-7 countries will all join the Egmont Group, which promotes cooperation between national FIUs, and turn around information sharing requests as expeditiously as possible. We also call on the Egmont Group to enhance cooperation among its members, to improve its information exchange with the FIUs in other countries, and to exchange information regarding terrorist financing.*

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<sup>39</sup> G7, 2001, *Action Plan to Combat the financing of Terrorism*, [www.g7.utoronto.ca](http://www.g7.utoronto.ca)

*We encourage all countries to establish a terrorist asset-tracking centre or similar mechanism and to share that information on a cross-border basis.*

*Financial supervisors and regulators around the world will need to redouble their efforts to strengthen their financial sectors to ensure that they are not abused by terrorists. We welcome the guidance by the Basel Committee on Banking Supervision on customer identification to stop the abuse of the financial system by terrorists and urge that it be incorporated into banks' internal safeguards. We urge the International Monetary Fund to accelerate its efforts, in close relation with the Financial Stability Forum, to assess the adequacy of supervision in offshore financial centres and provide the necessary technical assistance to strengthen their integrity.*

*We ask all governments to join us in denying terrorists access to the resources that are needed to carry out evil acts.*

In 2002, G7/G8 has issued several documents and reports on combating the financing of terrorism.

On February 2002, G7 produced a *Progress Report on Combating the Financing of Terrorism*<sup>40</sup> where the implementation of the strategy against terrorist financing was monitored:

- Over 200 countries had expressed support for the fight against terrorist financing.
- Almost 150 countries had issued order to freeze terrorist assets.
- Over \$US 100 million had been frozen worldwide
- Each G7 country was implementing UN Security Council Resolution 1373 and had signed and was committed to ratify the UN Convention for the Suppression of the Financing of Terrorism
- The FATF had agreed to a set of Special Recommendation on Terrorist Financing and was implementing an action plan encouraging all countries to adopt them (see Appendix).
- All G7 countries had established or were in the process of establishing FIUs.

In this report G7 countries were committed to fully implementing by June 2002 the FATF standards against terrorist financing and urged all countries to commit to the rapid implementation of the standards. G7 urged all countries that have not done, to implement the measures set out in the *November 2001 Communiqué of the International Monetary and Financial Committee* of the IMF. G7 urged also the Basel Committee on Banking Supervision to review its standards to ensure that they address terrorist financing. The Financial Stability Forum was called up to review its role in combating terrorist financing.

In this report G7 offers its technical assistance on bilateral basis and looks forward to the implementation of IMF and World Bank plan to provide technical assistance to combat money laundering and terrorist financing in coordination with FATF, UN and Egmont Group.

On June 2002, G8-Foreign Ministers have issued two documents on counter-terrorism:

-*Foreign Ministers' Progress Report on the Fight against Terrorism*<sup>41</sup>. This non-technical report is organized in three parts: the first about the national measures implemented in the

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<sup>40</sup> G7, 2002 Ottawa, *Progress Report on Combating the Financing of Terrorism*, [www.g8.utoronto.ca](http://www.g8.utoronto.ca)

<sup>41</sup> G8, 2002, *Foreign Ministers' Progress Report on the Fight against Terrorism*, [www.g8.utoronto.ca](http://www.g8.utoronto.ca)

G8 countries, the second about the international measures against terrorism, the third about the commitment to assisting countries in implementing counterterrorism measures.

-*G8 Recommendations on Counter-Terrorism*<sup>42</sup>: These Recommendations are the result of a revision of the Counter-Terrorism Expert Group 25 Measures, adopted in Paris in 1996. These Recommendations include standards, principles, best practices, actions and relationship to improve existing mechanisms to contrast terrorist threats.

The document is divided in 10 specific sections. We show Section 5, about financing of terrorism:

“We (G8 Countries) commit ourselves and urge all other States to:

1. *As rapidly as possible, ensure full implementation of the United Nations Security Council Resolution 1373, the International Convention for the Suppression of the Financing of Terrorism and the Financial Action Task Force's (FATF) Special Recommendations on Terrorist Financing (2001), and participate in the fulfilment of the FATF global action plans.*
2. *Adopt the steps to remove obstacles to effective common action to combat terrorist financing contained in the Report of the G8 Meeting on Legal Measures to Combat Terrorist Financing (2002), endorsed by G8 Justice and Interior Ministers (2002), and move beyond freezing to also forfeit terrorist assets in order to permanently deprive terrorists of their funds.*
3. *Implement the recommendations on "Money Laundering, Related Terrorist Financing and Asset Forfeiture" contained in the G8 Recommendations on Transnational Crime (2002).*
4. *Facilitate, through appropriate domestic measures, the traceability of terrorist funds and ensure that mutual legal assistance is not refused on the grounds of bank secrecy or that the request involves a fiscal offence.”*

On September 2002, one year later “September 11”, in “*G7 Combating the Financing of Terrorism: First Year Report*”, G7 declares: “cutting off the financing of terrorism remains a key element of the fight against terrorism”<sup>43</sup>. In this report, the wide range of measures taken to successfully implement the *G7 Finance Ministers' Action Plan* (2001) was described:

-Over 200 countries had expressed support for the fight against terrorist financing.

-Almost 160 countries had issued order to freeze terrorist assets.

-Over \$US 112 million had been frozen worldwide.

-The UN Security Council Committee had listed 313 individuals and entities whose financial assets had to be frozen by member countries.

-The European Union and other countries had identified and listed terrorists for the purpose of applying sanctions.

-Each G7 country had achieved good results in mutual understanding of the information needed to support freezing actions.

- Each G7 country had signed and was ratifying International Convention for Suppression of the Financing of Terrorism. Over 130 countries had signed the Convention and 45 countries had ratified it.

-All FATF countries had completed a self-assessment of their compliance with the Recommendation and were committed to coming into compliance. The FATF, G7 and UN

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<sup>42</sup> G8, 2002, *G8 Recommendations on Counter-Terrorism*, [www.g8.utoronto.ca](http://www.g8.utoronto.ca)

<sup>43</sup> G7, 2002, *G7 Combating the Financing of Terrorism: First Year Report*, [www.g8.utoronto.ca](http://www.g8.utoronto.ca)

Counter Terrorism Committee had encouraged all non-FATF countries to comply with the standards and to accept the FATF invitation to participate in the self-assessment exercise on the same terms as FATF members.

- The FATF agreed to initiate a process to identify jurisdiction that lack appropriate measures to combat terrorist financing.

-It's recognized the crucial role of the UN Counter Terrorism Committee, of the IMF and the World Bank that had significantly intensified their efforts (IMF Financial Sector Assessment Program including the examination of countries' anti-money laundering and combating terrorism financing measures, international coordination, technical assistance, etc.)

During the Summit in Evian in 2003, G8 issued an interesting document: *'Building International Political Will and Capacity to Combat Terrorism: a G8 Action Plan'*.

This document includes a short overview where it's appreciated that since September 11, G8 and other countries have successfully strengthened their own counter-terrorism measures. G8 recognizes that in order to disrupt the terrorist network and secure safety in international community, it's fundamental for the G8 to build counterterrorism cooperation and to provide capacity building assistance to those countries with insufficient capacity to fight terrorism.

In the summit document emerges that a successful capacity to fight terrorism requires a focus in several main areas:

-to deny terrorists the means to commit terrorist acts, for example, to prevent the financing of terrorism and denial of false documents and weapons.

-to deny terrorists a safe haven and ensure that terrorists are prosecuted or extradited (accelerating the conclusion of counterterrorism conventions and protocols and reinforcing law-enforcement).

-to overcome vulnerability to terrorism enhancing domestic security measures and capability for crises management and consequence management.

G8, such as the UN Security Council's Counter-Terrorism Committee (CTC), identifies several areas for capacity building assistance:

-*Counter-Terrorism Legislation*

-*Financial Law and Practice* (assistance in drafting and enforcing legislation, regulation and codes of practice criminalising the financing of terrorism and the seizure and freezing of assets).

-*Custom Law and Practice* (border controls).

-*Immigration Law and Practice*

-*Extradition Law and Practice*

-*Police and Law enforcement*

-*Export control and Illegal Arms Trafficking*

-*Domestic Security measures*

In Evian Action Plan, G8 highlights the need of an international cooperation and an international institutional network supporting CTC and FATF and international financial institution, encouraging countries to fulfil their UNSCR1373 obligations and creating a Counter-Terrorism Action Group (CTAG) to focus on building political will and coordinating capacity building assistance where necessary.

On April 2004, in Washington, G7 issued a new document: *Joint Statement on Combating Terrorist Financing*, where G7 countries as international financial leaders recognize their

special responsibilities for the domestic and multilateral fight against terrorist financing and for protecting the integrity of the global financial system.

G7 welcomes the decision by the IMF and World Bank to make comprehensive assessments of country compliance with the recognized anti-terrorist financing/anti-money laundering standard a regular part of their activities, G7 also welcomes the FATF's decision to enlarge the dialogue with non-FATF countries. G7 promotes the development and the implementation of effective measures to protect charities from potential abuse. This document includes some new issues: G7 recognizes the danger posed by terrorist financiers using cash couriers or transferring cash across borders and undertakes to combat this growing threat by strengthening the control of cross-border cash movements.

G-7 Finance Ministers and Central Bank Governors during the meeting met with Ministers or Governors from China, India, Indonesia, Malaysia, Morocco, Pakistan, Philippines, Russia, Saudi Arabia, Singapore, Spain, and United Arab Emirates, the heads of the IMF and the World Bank, the European Commission, and the President of the Financial Action Task Force on Money Laundering (FATF) to intensify the fight against terrorist financing.

In conclusion we have seen that in last years money laundering and terrorism financing are strongly linked in the G8 strategy.

The money laundering problem became relevant for G7/G8 before long and in eighty's many documents issued by the G7/G8 highlight the need of fighting money laundering.

This phenomenon is initially linked to the drugs trafficking problem. The international cooperation between the G7 countries to fight money laundering was developed in relation to the strategy to counter narcotics production, trafficking and financing<sup>44</sup>. In 1989 Paris Summit, G7 convenes "a financial action task force from Summit participants and other countries interested in these problems. Its mandate is to assess the results of cooperation already undertaken in order to prevent the utilization of the banking system and financial institutions for the purpose of money laundering, and to consider additional preventive efforts in this field, including the adaptation of the legal and regulatory systems so as to enhance multilateral judicial assistance. The first meeting of this task force will be called by France and its report will be completed by April 1990"<sup>45</sup>.

In same year, the FATF was born as inter-governmental body set up (by G7) to combat money laundering (see appendix).

In 1990, during the Huston Summit G7 declares to endorse "new" FATF and to commit its countries to a full implementation of all FATF's Recommendations<sup>46</sup>.

Since 1990, and continuously, G7/G8 supports the FATF, recognize its achievements and its efforts to fight money laundering<sup>47</sup>.

For G7/G8, the FATF work and the fight against money laundering, now mean a constant commitment to avoid abuses of Global Financial System, to counter terrorism financing and

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<sup>44</sup> see. "*Political Declaration*", June 20, 1988, G7 Toronto Summit.

"Drug Issue", July 14-16, 1989, G7 Paris Summit.

Source: [www.g8.utoronto.ca](http://www.g8.utoronto.ca)

<sup>45</sup> "Drug Issue", July 14-16, 1989, G7 Paris Summit.

Source: [www.g8.utoronto.ca](http://www.g8.utoronto.ca)

<sup>46</sup> "Narcotics", July 9-11, 1990, G7 Huston Summit.

Source: [www.g8.utoronto.ca](http://www.g8.utoronto.ca)

<sup>47</sup> See also "Cooperation against Transnational Crime and Money Laundering", July 8-10, 1994 G7 Naples Summit.

Source: [www.g8.utoronto.ca](http://www.g8.utoronto.ca)

drugs trafficking, but also they constitute instruments to fight corruption and to improve transparency<sup>48</sup>. Since 1989, G8 have carefully monitored the FATF's work. Specially, G7/G8 have encouraged the FATF to identify *non-cooperative* countries and *partially cooperative* countries to consult technically with them or to define appropriate and comprehensive set of counter- measures<sup>49</sup>.

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<sup>48</sup> About Corruption and Transparency see: "*Fighting Corruption and Improving Transparency: AG8 Declaration*", June, G8 Evian Summit.

<sup>49</sup> About non-cooperative countries see: *Transnational Organized Crime-G8 Research Group's Compliance*-, 2000 Okinawa Summit..  
The Statements of G-7 Finance Ministers and Central Bank Governors of 1999 (September), 2000 (April and September), 2001 (April).  
Source: [www.g8.utoronto.ca](http://www.g8.utoronto.ca)