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Regulating Money Laundering and Tax Havens: The Role of Blacklisting

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Abstract

Since ten years, and more so, since September 11, 2001, international organizations such as the IMF, OECD and EU try to combat harmful tax competition, money laundering and terrorist financing. Blacklisting, the naming and shaming of uncooperative countries, was one of the strategies used from the very beginning of this new policy area. An analysis of the black listed countries over time shows, that the black lists got shorter and shorter over time. In 2006, Myanmar was the only country listed for money laundering, until it was finally also removed from the list.

The paper wants to explore a) the reasons for removing large countries and especially EU countries from the list b) the wanted and unwanted effects blacklisting had for the named and shamed countries and discusses c) whether this necessarily means the end of blacklisting. We want to show d) a new way of greylisting which might be more compatible with the international diplomatic requirements. We developed a new indicator for rating countries with regard to cooperative behavior for tackling money laundering, which might also allow for benchmarking, a concept probably more accepted within the EU than blacklisting.

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1. Introduction

"Shaming is a route to a freely chosen compliance" (Braithwaite, 1989, p.10). Braithwaite (1989, 2002) shows that shaming can be a successful tool in order to prevent criminals from misbehaving. Offenders get stigmatized. 'Leave him alone, he is punished by shame' is a Maori saying, which expresses this well (Braithwaite 2002, p. 74).

Shaming is also an instrument to sanction corporations. Reputation sanctions in commercial relations have been widely studied by social scientists from various fields, especially law and economics (Karpoff et al 2005).

A company which finds itself on a list of environmental polluters, or is disguised as a lousy employer with low labour standards, can experience severe reputation damage and sanctions by the consumers. "When regulators deliberately try to inflict reputational damage, the traditional boundary between criminal sanctions that are imposed by court, and reputational sanctions that are imposed by the market, is blurred. Public reputational sanctions thus are hybrid in character, which brings about all kind of questions about their effectiveness, working mechanism, and legitimacy" (van Erp 2007).

But in how far do these findings also apply to the shaming of countries and can the theories and experiences from criminals and corporations be transposed to national and supranational levels on a one to one scale? Or to phrase it differently: is shaming an appropriate instrument when regulating the regulators?

At the moment "the literature on effectiveness of international regimes is still in its infancy." (Eden and Kudrle, 2005, p.124). At a supranational or intergovernmental level the EU's Open Method of Coordination (OMC) can be mentioned as a potential candidate to test for the effectiveness of naming and shaming when regulating the regulators. The OMC was officially named, defined and endorsed at the Lisbon Council for the realm of social policy in 2000. Since then it has been applied to many policy areas such as pensions, immigration, education and culture and its use has also been suggested for health and environmental affairs.

The open method rests on guidelines for countries, on indicators, benchmarking and sharing of best practices. This means that there are no official sanctions for laggards or non cooperative countries. Rather, the method's effectiveness relies on a form of peer pressure and naming and shaming, as no member state wants to be seen as the worst in a given policy area.[1]

[1]The OMC works in stages. First, the Council of Ministers agrees on (often very broad) policy goals. Member states then transpose guidelines into national and regional policies. Thirdly, specific benchmarks and indicators to measure best practice are agreed upon. Finally, results are monitored and evaluated. However, the OMC

Benchmarking on all kind of performance indicators, such as budget, unemployment rates, poverty rates, school education, and number of beds provided by hospitals, should bring convergence among EU countries. Creating transparency, publishing lists of performance should also help to publicly identify those who do not cooperate: to name and shame them.

So, even if the literature on the use of naming and shaming in international relations is in its infancy, gradually some experience will be acquired on the effectiveness of regulating the regulators by naming and shaming in specific policy areas.

The following paper wants to add to this literature, by analyzing the use of blacklisting for countries that have lax anti money laundering and tax haven regimes. These two issues are related to each other. Money laundering means to disguise the true origin of criminal proceeds by using the financial system. (For example to bring drug proceeds to a bank and send it somewhere else where it is not identifiable as drug money anymore). Tax havens are countries that attract these criminal proceeds and proceeds from tax evasion. The latter can be income from regular work and business which is just not submitted to the taxman. Some countries, however, would consider tax evasion as fraud, and therefore define tax evaded money as part of money laundering. In any case, given the fact that tax havens attract both criminal and tax evading money, it seems wise to analyze the use of naming and shaming for both offences.

2. Blacklisting

The first blacklist related to money laundering and tax havens was published by the IMF, in 1999. The IMF presented a list of countries and territories with Offshore Financial Centres (OFCs). "OFCs are jurisdictions where offshore banks are exempt from a wide range of regulations which are normally imposed on onshore institutions […] Countries may decide to establish OFCs for a number of reasons, including gaining acces to international capital markets, attracting needed foreign technical expertise and skills, and introducing an element of competition in domestic financial systems while, at the same time, somewhat sheltering domestic institutions." (IMF, 1999, p.6) But, and this is the main point of the blacklist, "OFCs can be exploited for dubious purposes. OFCs attract funds partly because they promise anonymity and the possibillity of tax avoidance or evasion. A high level of bank secrecy is almost invariably used as a selling point by OFCs some of which have been (and are) exploited also for activities related to money laundering" (IMF, 1999, p.10). The second column of Table 1 and Table 3 below shows the extensive list of all the countries and

differs significantly across the various policy areas with regard to the length of reporting periods, guidelines may be set at EU or member state level and enforcement mechanisms may be harder or softer.

jurisdictions that have been blacklisted by the IMF. This list was doomed to stay a unique one of its kind. No further IMF blacklisting happened (see under Section 2).

After this blacklist of historic value established by the IMF in 1999, tax haven revelations were left to the OECD and money laundering blacklisting was delegated to the Financial Action Task Force (FATF). In 1989 at the G-7 Summit in Paris the Financial Action Task Force on Money Laundering (FATF) was established. The FATF is an intergovernmental body which tries to combat money laundering and terrorist financing by developing and promoting policies in all different countries. This intergovernmental organization blacklisted countries with regard to money laundering and terrorist financing, by naming and shaming them as Non-Cooperative Countries and Territories (NCCTs). The blacklist was developed based on assessing countries with regard to the 'Criteria for Identifying Countries and Territories Non-Cooperative in Anti-money Laundering and Terrorist Financing'. It contains 25 'negative' criteria, such as banking secrecy, some loopholes of law and financial regulation (for the complete list see FATF 2000) The countries that meet many[2] of these 25 negative criteria, have a poor anti-money-laundering record and are listed as NCCTs.

When one looks at the development of this annual blacklist, and at the countries disappearing from the list every year, one does not get the impression that this list is very effective. As Table 1 and Table 2 show, between 1999 and 2006 less and less countries seemed to launder and in June 2006 only Myanmar, the former Burma and Birma was left. As of 13th October 2006 there are no NCCTs according to the FATF (2006). Countries seem to be eager to disappear from the black list. Is this absence of countries on the list an indication of compliance or only of declared compliance, compliance in the books? Is there no more laundering worldwide? In any case, we can conclude that the FATF blacklisting of non cooperative countries is no longer a way of identifying money laundering countries.

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[2] FATF (2000) lists countries on the blacklist that met 14 of the 25 criteria, like Jersey, but there does not seem to be a clear quantitative threshold. The FATF (2000a, p.2) defines: "meeting the criteria" means that the concerned jurisdictions were found to have detrimental rules and practices in place' by the FATF team.

Table 1: Money Laundering Blacklist Source Unger and Rawlings (2005), plus update from www.fatf-gafi.org	IMF List 1999	FATF NCCTs 2000	FATF NCCTs 2001	FATF NCCTs 2002	FATF NCCTs 2005	FATF NCCTs June 2006	FATF NCCTs Oct. 2006
Africa							
Djibouti	x						
Liberia	x						
Egypt			x	x			
Mauritius	x						
Nigeria	x		x	x	x		
Seychelles	x						
Tangier	x						
Asia and Pacific							
Australia	x						
Cook Islands	x	x	x	x			
Federal States of Micronesia	x						
Guam	x						
Hongkong	x						
Indonesia			x	x			
Japan	x						
Macau	x						
Malaysia	x						
Myanmar (Burma)			x	x	x	x	
Marianas	x						
Marshall Islands	x	x	x				
Nauru	x	x	x	x	x		
Niue	x	x	x				
Philippines	x	x	x	x			
Samoa	x						
Singapore	x						
Thailand	x						
Vanuatu	x						
Europe							
Austria	x						
Andorra	x						
Campione	x						
Cyprus	x						
Gibraltar	x						
Guernsey/Sark/Alderney	x						
Hungary	x		x				
Ireland	x						
Isle of Man	x						
Jersey	x						
Liechtenstein	x	x					
Luxemburg	x						

Table 1 continued	IMF List 1999	FATF NCCTs 2000	FATF NCCTs 2001	FATF NCCTs 2002	FATF NCCTs 2005	FATF NCCTs June 2006	FATF NCCTs Oct. 2006
Madeira	x						
Malta	x						
Monaco	x						
Netherlands	x						
Russia	x	x	x				
Switzerland	x						
Ukraine			x	x			
United Kingdom	x						
Middle East							
Bahrain	x						
Dubai	x						
Israel	x	x	x				
Kuwait	x						
Lebanon	x	x	x				
Oman	x						
Americas							
Antigua & Barbuda	x						
Anguilla	x						
Aruba	x						
Bahamas	x	x					
Barbados	x						
Belize	x						
Bermuda	x						
British Virgin Islands	x						
Cayman Islands	x	x					
Costa Rica	x						
Dominica	x	x	x				
Grenada	x		x	x			
Guatemala			x				
Montserrat	x						
Netherlands Antilles	x						
St Kitts and Nevis	x	x	x				
St Lucia	x						
Panama	x	x					
Puerto Rico	x						
St Vincent & the Grenadines	x	x	x	x			
Turks & Caicos Islands	x						
United States	x						
Uruguay	x						

What is obvious from the above blacklist is that many countries, also European countries must have made quite some effort to disappear from the list, especially from the money laundering list. We wil discuss later whether these efforts were in line with what the policy goals intended by those who established the blacklist.

Table 2: Disappearance of European countries from the money laundering black list

Blacklist	N	European countries
IMF list 1999	69	19; Austria, Hungary, Ireland, Luxemburg, Netherlands, Russia, Switzerland, Ukraine, UK and 10 smaller European countries
FATF NCCTs 2000	15	2; Liechtenstein and Russia
FATF NCCTs 2001	19	3; Hungary, Russia and Ukraine
FATF NCCTs 2002	10	1; Russia
FATF NCCTs 2005	3	0; No European countries only: Nigeria, Myanmar and Nauru
FATF NCCTs 2006	1	0; Myanmar (Burma) removed as last country in October 2006

Source: own calculation from Table 1. N = total number of countries on the list

While the FATF money laundering blacklist is now empty, there are only three countries, all of them European, left on the OECD blacklist[3], which is a shorthand description of 'the list of uncooperative tax havens'. These three European countries left are Andorra, Liechtenstein and Monaco, after the Marshall Islands have been de-listed in August 2007.[4] The OECD launched its campaign in May 1998 with the release of its 'Harmful Tax Competition' report which, amongst others, sought to define what constituted a 'harmful' tax haven. The OECD would then use the criteria it had defined to identify countries with undesirable tax policies.[5]

"The OECD released its first blacklist of jurisdictions to be 'named and shamed' in June 2000. See Table 3 and Table 4 for an overview of the countries and territories listed on the IMF blacklist in 1999 and the OECD blacklists from 2000 till 2006 as tax havens.

[3] Although the OECD list is not called a blacklist, it is used as one by national governments. (Rawlings and Sharman, 2006, p.42)
[4] See: http://www.oecd.org/document/13/0,3343,en_2649_37427_39095565_1_1_1_37427,00.html
[5] In the meantime, in 1999, the IMF published the earlier mentioned list of countries with OFCs, which could be used for both money laundering and tax avoidance or evasion.

Table 3: List of uncooperative tax havens Source Unger and Rawlings (2005), plus update from www.oecd.org	IMF List 1999	OECD Tax Havens 2000	OECD Tax Havens 2001	OECD Tax Havens 2004	OECD Tax Havens 2006
Africa					
Djibouti	x				
Liberia	x	x	x	x	
Mauritius	x				
Maldives		x			
Seychelles	x	x			
Tangier	x				
Asia and Pacific					
Australia	x				
Cook Islands	x	x			
Federal States of Micronesia	x				
Guam	x				
Hongkong	x				
Japan	x				
Macau	x				
Malaysia	x				
Marianas	x				
Marshall Islands	x	x	x	x	
Nauru	x	x	x		
Niue	x	x			
Philippines	x				
Samoa	x	x			
Singapore	x				
Thailand	x				
Tonga		x			
Vanuatu	x	x	x		
Europe					
Austria	x				
Andorra	x	x	x	x	x
Campione	x				
Cyprus	x				
Gibraltar	x	x			
Guernsey/Sark/Alderney	x	x			
Hungary	x				
Ireland	x				
Isle of Man	x	x			
Jersey	x	x			
Liechtenstein	x	x	x	x	x
Luxemburg	x				

Table 3 continued	IMF List 1999	OECD Tax Havens 2000	OECD Tax Havens 2001	OECD Tax Havens 2004	OECD Tax Havens 2006
Madeira	x				
Malta	x				
Monaco	x	x	x	x	x
Netherlands	x				
Russia	x				
Switzerland	x				
United Kingdom	x				
Middle East					
Bahrain	x	x			
Dubai	x				
Israel	x				
Kuwait	x				
Lebanon	x				
Oman	x				
Americas					
Antigua & Barbuda	x	x			
Anguilla	x	x			
Aruba	x	x			
Bahamas	x	x			
Barbados	x	x			
Belize	x	x			
Bermuda	x				
British Virgin Islands	x	x			
Cayman Islands	x				
Costa Rica	x				
Dominica	x	x			
Grenada	x	x			
Montserrat	x	x			
Netherlands Antilles	x	x			
St Kitts and Nevis	x	x			
St Lucia	x	x			
Panama	x	x			
Puerto Rico	x				
St Vincent & the Grenadines	x	x			
Turks & Caicos Islands	x	x			
United States	x				
US Virgin Islands		x			
Uruguay	x				

Similar to the money laundering list, one can see that all big or medium sized non European and European countries were also eager to disappear from the tax haven list. In 1999 there were still 69 countries on the list, including the US and 19 European countries. One year later, countries like the Netherlands, Ireland, Hungary, Russia and Switzerland have disappeared. From 2001 on only three European countries remain on the list: Andorra, Liechtenstein and Monaco (see Table 4).

Table 4: Disappearance of most of the European countries from the tax haven blacklist

Blacklist	N	European countries
IMF list 1999	69	19; Austria, Hungary, Ireland, Luxemburg, Netherlands, Russia, Switzerland, Ukraine, UK and 10 smaller European countries
OECD list 2000	35	7; Andorra, Gibraltar, Guernsey/Sark/Alderney, Isle of Man, Jersey, Liechtenstein and Monaco
OECD list 2001	7	3; Andorra, Liechtenstein and Monaco
OECD list 2004	5	3; Andorra, Liechtenstein and Monaco
OECD list 2006	3	3; Andorra, Liechtenstein and Monaco

Source: own calculation from Table 3. N = total number of countries on the list

3. How did countries manage to be de-listed from the blacklists?

In how far are the two blacklists reliable? The OECD blacklist has been criticized of being incomplete. In particular big and powerful countries are missing. "By the criteria set by the OECD, the United States is now guilty of practicing harmful tax competition. One case in point is that banks in the US are the depositories for hundreds of billions of dollars from non-residents whose interest income is not taxed. Resident interest income is taxed at 30%. This "no tax" policy of the US has kept this large sum of money in the banking system since 1921." According to critics, all of the following countries indulge in "harmful tax practices" under the criteria set by the OECD but are not on the list.[6] . If you type in the internet address of footnote 4, you will get at Table 5, reproduced below. From there you can click on every country listed, in order to get detailed information on those OECD criteria on harmful tax practices that the respective country violates. In Appendix II we show the results for the US and the UK.

[6] This list and its argumentation is retrieved from the internet; http://www.offshore-fox.com/offshore-corporations/offshore_corporations_0401.html

Table 5: The Tax Havens that the OECD Forgot to List

OECD Members	Others
United States United Kingdom Denmark Iceland Madeira, Portugal Canary Islands, Spain Hungary	Israel Uruguay Costa Rica Singapore Labuan, Malaysia Brunei

Source: http://www.offshore-fox.com/offshore-corporations/offshore_corporations_0401.html

Rawlings and Sharman (2006) studied the tax blacklists used by different countries and asked themselves, why some countries appeared on a blacklist while others did not. These national blacklists "are one measure that governments use to control tax flight, avoidance, and evasion. Governments seek to maintain their capacity to raise revenue through taxation by restricting or prohibiting transactions undertaken by companies and private individuals using specified countries and territories" (Rawlings and Sharman, 2006, p.41). In their study they also find indications for specific coutries missing on tax blacklists. They compared the results of a study by Sullivan (2004) with the results of their research. "Sullivan shows that the top 11 tax havens for the US firms include not only countries such as the Cayman Islands and Bermuda, but also the Netherlands, Belgium, and Denmark. Indeed, the top 'tax haven' noted by Sullivan was the Netherlands. None of these three countries appears on any list that have been analyzed in [their] research"[7] (Rawlings and Sharman 2006).

From the very beginning the OECD list was precarious, by allowing (some) countries to avoid getting on the list. We have not studied the concrete negotiation process of both the money laundering list and the tax haven list, and leave this work up to political scientists and international relation specialists. But, we can at least conclude from the results that something there seems dubious:

"In advance of the OECD list release, six jurisdictions made 'advance commitments' to bring their country's laws into compliance with the OECD's recommendations and so managed to stay off the blacklists. Ironically, this included two of the most significant offshore financial centers, the Cayman Islands and Bermuda (the other four were Cyprus, Malta, Mauritius, and San Marino)." (Maurer, 2008, p.163)

[7] Rawlings and Sharman (2006) conducted a research on the national blacklists of Argentina, Australia, Brazil, Canada, France, Germany, India, Italy, Mexico, Portugal, Spain, United Kingdom, United States and Venezuela

It seems that the construction of this blacklist violated a very important principles that Erp (2007) mentioned as crucial for the success of naming and shaming: transparency. Is the selection of companies/countries that deserve to be warned against or sanctioned, transparent? Though it was perfectly transparent which criteria had to be fulfilled in order to qualify for being or not being on the tax haven list, the actual list just did not contain all the countries which fulfilled these criteria. It stayed intransparent which countries, though they qualified for the list, managed to escape. The fact that some countries could pre-negotiate to improve their tax system in order to avoid getting on the list, while others apparently could or did not, makes the list appear dubious. Is it arbitrary, discriminating against small countries and/or a political list? Or can it be justified by purposeful behaviour which we know from the literature on naming and shaming of companies? Very often not all companies but only very specific companies are selected for naming and shaming in order to threaten and have an impact on the behaviour of others. Has dwarf country Andorra been selected to warn the UK, the US or may be Switzerland?

The blacklist for money laundering and terrorist financing is ambiguous with regard to **transparency** as well. Rawlings and Sharman (2006) concluded that the national blacklists used by countries "tend to be out of date, inaccurate, and arbritary" and that "the methodologies used to compile blacklists are often opaque and do not tend to follow any formal procedure.". The blacklist used by the FATF is transparent with regard to the conditions under which a country gets on the blacklist or not; the FATF publishes 'Criteria for Identifying Countries and Territories Non-Cooperative in Anti-money Laundering and Terrorist Financing' and also publishes the assessments of blacklisted countries and the development of these countries regarding the criteria. There is, however, no clear threshold level. Originally the FATF asked its members, which countries seemed suspect of laundering. A total of 23 suspect countries were identified (see FATF 2000a). No additional jurisdictions were reviewed since that time. This means that the origin of this list was completely arbitrary. It was based on members subjective feeling what a suspect country is and was not adjusted over time. Since all countries have been removed from the list, the list can be viewed as a failure to identify countries with lax anti money laundering policy.

Beside transparency, the second issue for an effective blacklist concerns the **publication strategy**. The communicative quality of the publications determines whether the message will actually reach the public and contribute to its risk awareness (Pawson, 2002 quoted in van Erp 2007). The IMF list (1999) was only part of an IMF Working Paper on offshore banking. However, the reaction of media to the reports and also of country officials had quite some impact, though not always the one intended (see Section 4).

A third issue for an effective blacklist concerns the choice between **public warning and fine/penalty.** For money laundering, the public warning itself is already a penalty, because of the reputational damage it can create. Contrary to sanctions for criminals and companies, there is no legal way for intergovernmental organizations to sanction countries. Blacklists are soft law arrangements; there is no fine or penalty for blacklisted countries. So, intergovernmental organizations can just hope that the international community will react and punish the listed countries by withdrawing from business and by reducing exports or imports. It can only hope that serious banks will avoid dealing with them. The Maori attitude towards criminals 'Leave him alone, he is punished by shame' will transform into its opposite for a country 'Name and shame it and it will be left alone'.

´When the Pacific island Nauru was blacklisted for money laundering, economic sanctions were discussed and media reports indicated that it was threatened with sanctions. But not much happened. The US authorities issued cautions to its banks to take special precautions when dealing with Nauru. When only three countries remained on the blacklist – Nauru, Nigeria and Myanmar – some banks and financial institutions took their own initiatives and refused to make any transactions with any of these countries, but they were the decisions of individual corporations, not particular countries, and definitely not multilateral sanctions´ (e-mail interview with Greg Rawlings, 25.4.2008).

In the Netherlands, the Dutch Ministry of Finance asked the supervisory board for financial markets (the Financial Market Authority) to take initiatives to stop all financial transactions with Nauru.[8] In the absence of an international law or any legal basis for sanctions, economic sanctions are the only threat for blacklisted countries. These economic sanctions can be relatively easily pronounced towards small countries with little trade relations (the Dutch – Nauru economic relations are of minor importance to the Dutch economy), but are very difficult to apply to the major trading partners (the Dutch – US economic relations are of importance to the Dutch economy, so stopping financial or trade relations with the US would be very costly for the Netherlands).

This last fact of mutual trade dependence seem to explain best why large countries such as the US (or the Netherlands or the UK) cannot be found on a tax haven list after the

[8] For the official statement of the Dutch Ministry of Finance, see (in Dutch) http://www.minfin.nl/nl/actueel/kamerstukken_en_besluiten,2004/08/fm04_900.html

historically unique IMF list of 1999. While sanctioning Andorra or Liechtenstein with its 15,000 inhabitants is much less of an economic cost to the sanctioning countries.

A final question is: how did all European countries manage to get removed from the money laundering list, while some of them have not been removed from the tax haven list? European countries seem to fear the integrity of their financial markets. The fear to loose reputation by being open for criminal money seems to be larger than reputation loss for being a tax haven. For small countries, such as Liechtenstein, it can still pay to be known as a tax haven, as long as it is not connected with criminal money or dictator's capital flight money. While tax evasion is in many European countries still considered a 'gentleman's misdemeanour', cooperating with organized crime is not.

4. Wanted and unwanted effects of blacklisting

Let us for a moment suppose, the blacklists had been fairly and transparently established, all the countries that failed the thresholds had been put on the list, optimal publication strategies had been followed. Would the list be effective? Would it help to reduce money laundering and tax evasion?

The history of blacklisting money laundering and tax havens shows that it is a very sensitive point for international relations; this is why all of the above assumptions do not hold. But even if they had, the blacklists seem to have some unwanted side effects. Rawlings (2007) showed that blacklisting might have had reverse effects. Some states have experienced loss of business, but other OFCs have prospered. "Through complying with these initiatives [i.e. the OECD blacklist requirements] OFC states have reinscribed their reputation and political soundness in the eyes of investors and have become jurisdictions characterized by 'good governance' meeting the highest international standards. They continue to be ideal locales for structuring transnational business ventures. Thus, these multilateral initiatives have had the reverse effect of what they originally intended: through allowing OFCs to demonstrate their good governance to the world they maintain their client base and sustain an ongoing fiscal competition between states for tax revenues." (Rawlings, 2007, p. 58) Examples of these OFCs are Cayman Islands, Bermuda, Jersey Guernsey and the Isle of Man.

A problem with the current use of blacklists is identified by Rawlings and Sharman (2006, p. 64); "such lists tend to be out of date, inaccurate, and arbitrary". "Although not called a blacklist, multilateral listings like that of the OECD have been converted into outright blacklists by national governments in a punitive and discriminatory way (Rawlings and Sharman, 2006, p.42).

However, does this necessarily mean the end of blacklisting? We think that the short description and judgment of countries being either the good guys or the bad guys is, indeed, not a very subtle method of international comparisons and certainly not a diplomatic way of giving incentives to cooperate. And, as Maurer (2008, p.168) states, "It would be a mistake, however, to argue that the OECD and FATF initiatives were entirely without effect. Tax haven jurisdictions did seek to comply, and compliance had a number of tangible and practical consequences. For example, new financial services commissions, separate from government finance ministries, were established; corporate registries were formed; Know Your Customer and due diligence procedures were put in place. All of this increased the costs of running an offshore center, leading some of the more marginal ones, particularly in the Pacific, effectively to cease operations."

We think that blacklists should be replaced by a more subtle greylist, which we will present in Section 5. Deeper information on countries and the way lists are constructed is needed, grey zones have to be identified, so that these lists are more accepted and have more legitimacy. In the next sections we want to show a new way of greylisting instead of blacklisting, which might be more compatible with the international diplomatic requirements, and come closer to the Open Method of Coordination, mentioned in the beginning.

5. Back to the source: greylisting based on the forty recommendations

In 1990 the FATF implemented a series of forty recommendations[9] that governments should apply to ensure that effective anti-money laundering programmes are in place. In 1996 and 2003 these recommendations where revised in order to keep up with new developments such as new money laundering techniques (Ferwerda and Bosma, 2007a, p. 33). These recommendations should, in case that they are all fully implemented, provide a country with a complete framework for successfully combating money laundering. These recommendations include among others the definition of money laundering and the predicate crimes for laundering, the sectors which should be monitored more intensely, and the regulatory instutions and international cooperation needed, A short list of these forty recommendations can be found in Appendix I.

Note that the 'Criteria for Identifying Countries and Territories Non-Cooperative in Anti-money Laundering and Terrorist Financing' (and therefore the FATF-blacklist) are largely based on the forty recommendations, and that the 25 negative criteria were developed

[9] Although also the combat against terrorist financing is assessed, we will concentrate solely on the combat of money laundering

ten years later than the forty recommendations. In addition, the criteria were assessed only on the 23 countries identified as NCCTs in 2000-2001 (FATF, 2005, p.3), while compliance with the forty recommendations is assessed for all countries. Although the US refused in the beginning to be assessed (Baker, 2005, p. 253), there is now even an assessment report of the US publicly available.

The procedure of the FATF is to assess countries on the degree of compliance with the forty recommendations. These assessments are public and are published on the FATF-website or on the websites of FATF-style regional bodies[10]. These assessments include a full description of the way a country tries to combat money laundering and in later versions[11] a table with scores for these forty recommendations. These scores vary from fully compliant (FC), along largely compliant (LC) and partly compliant (PC) to not compliant (NC) and include the possibility of a not applicable (NA) score. Such a table gives a good overview of the strengths and weaknesses of the anti-money laundering policy performed by each country. When attributing these scores, the FATF takes the financial possibilities of that specific country into consideration. This means that the same policy could be assessed as a LC for a developing country, while it is assessed as a PC for a developed country.

The problem with this way of evaluation is that the scores are not comparable across countries, which makes also the finding of best practice more cumbersome. In the past, countries took initiatives to compare themselves to others, like Cyprus which compared its anti-money laundering and terrorist financing framework with eight other countries: Australia, Belgium, Hungary, Ireland, Norway, Slovenia, Sweden and Switzerland. Based on the scores of the mutual assessment reports of the countries, Cyprus found itself on the top of the list, as best compliant country. Cyprus proudly declared these results as "a comprehensive response to the various unfounded adverse criticisms aired from time to time against Cyprus" (Central Bank of Cyprus, 2006). But this comparison is not valid because of the difference in countries´ economic possibilities to combat money laundering.[12] At the moment, the Netherlands is doing a best practice research on some recommendations that were assessed as being the weakness of the Dutch anti-money laundering framework. The Dutch Ministry of Finance, the responsible body for money laundering matters, was faced with the problem that

[10] There are 9 FATF-style regional bodies which represent 9 different regions; AGP (Asia/Pacific Group), CFATF (Caribbean FATF), Council of Europe (MONEYVAL, Eastern Europe), EAG (7 Asian countries), ESAAMLG (Eastern and Southern Africa), GAFISUD (Latin America), GIABA (Western Africa), MENAFATF (Northern Africa and the Middle-East) and OGBS (13 small islands and Panama)

[11] New method including a table with scores was first described in February 2004; FATF (2004)

[12] Informal interview with Richard Berkhout (administrator of the FATF secretariat, part of the assessment team of several countries) at the Dutch Ministry of Finance, by Ferwerda and Bosma in 2006.

it could not make use of the scores even when comparing the Netherlands to its neighbouring countries, because one does not know whether the FATF evaluating team has judged the economic situation of, say, Belgium similar to that of the Netherlands. So that a FC in Belgium on one recommendation is not, per se, also a FC in the Netherlands for the same performance.[13]

In the following, we want to present a solution to the above mentioned problems. We propose a modified system of evaluation, which is more in line with the diplomatic standards used in the European Union nowadays and comes closer to the Open Method of Coordination practiced by the EU.

6. The construction of our proposed greylist

In the following, we try to establish a framework in which countries can benchmark themselves and can find the best practice more easily. This framework needs, first of all, transparency, which enables countries, policy makers and scientists to identify and verify the results of the policies in different countries. This transparency is already supplied in the current system; all assessment reports by the FATF (also called mutual evaluation reports) of all countries can be found on the internet and are freely accessible for everyone. They can be downloaded from the websites of the FATF[14] or the FATF-style regional bodies. There is no aggregation of data of all the scores of all the countries possible, due to the incomparability of data across countries.

Second, therefore, our framework must be based on scores which are internationally comparable, thus improving the main weakness of the current scores. Third, it must be possible to find the argument of every single score, so that one can find out what the 'best practice' is, and why. Fourth, it must be diplomatically acceptable by all countries, since the fight against money laundering and terrorist financing needs international cooperation and acceptance. so that ideally no country offers loopholes. Fifth, it must have at least a theoretical chance of having some positive effect on the goal envisaged by it. Ferwerda and Bosma (2007) developed a framework of assessing these results, which complies with all the above mentioned five requirements. The basis of their framework are the same FATF assessment reports that are used nowadays by the international community. They allow to attribute internationally comparable scores to all countries. Because the diverse

[13] It is for this reason that the Dutch Ministry of Finance asked access to our database to make this best practice research easier, in December 2007.
[14] www.fatf-gafi.org

recommendations differ a lot and because interpretation of the recommended action(s) can be broad, Ferwerda and Bosma developed six broad categories, which can be applied in general for attributing scores from 0 to 5. Worth mentioning is that some recommendations have a deviant character, which means that in case that the wordings cannot be applied literally, a somewhat freer interpretation of the general index is needed. Below, we show the Ferwerda Bosma general index used for all recommendations as long as there was no overruling criteria applicable.

0 = No policy or action performed
1 = Only some policy or action performed / there has been an attempt or some advice
2 = Still a lot to be done
3 = Some problems or some sectors uncovered
4 = Minor shortcomings / considerations for improvement
5 = Comprehensive implementation

The NA (not available) score, which was possible in the traditional FATF assessment reports, has been excluded from the database here. This makes calculating with the scores less cumbersome and is more usefull for scientific research. Ferwerda and Bosma also created overruling criteria for different recommendations and countries because of their deviant character; these can be found in Ferwerda and Bosma (2007a and 2007b). To give an example: ‘the anti-money laundering regulations do not apply to the whole Kingdom’ is often mentioned in the assessment report of Denmark (June 2006), since they do not apply to Faroe, an autonomous province of Denmark. Ferwerda and Bosma decided to reduce the score of Denmark by one point. The original score .of 5 for Denmark (‘comprehensive implementation) was overruled and became a 4 (´minor shortcomings´’), because the regulations were not implemented in Faroe. After creating this index and the overruling criteria, Ferwerda and Bosma separately started to read the entire mutual evaluation reports of all the different countries (there were 17 countries in their sample). For each country, each of them applied scores to all 40 different recommendations and wrote down exactly which comments and phrases made him opt for that specific score. The next step was to compare their scores mutually and to come to a final conclusion.[15] In this way they created a database

[15] ´Our concluding score was based on a discussion, which means that if one of us came up with a 5 and the other with a 3, this does not mean the final score will be 4, actually it could happen, in a very extreme case, that the final score will be 0´ (Ferwerda and Bosma 2007).

with a final score for each country and each recommendation, including the arguments of why they opted for this score and referring to the source of the arguments in the mutual evaluation reports. Table 6 shows a detailed example of the construction of the database and the overruling process (Ferwerda and Bosma, 2007a and 2007b).

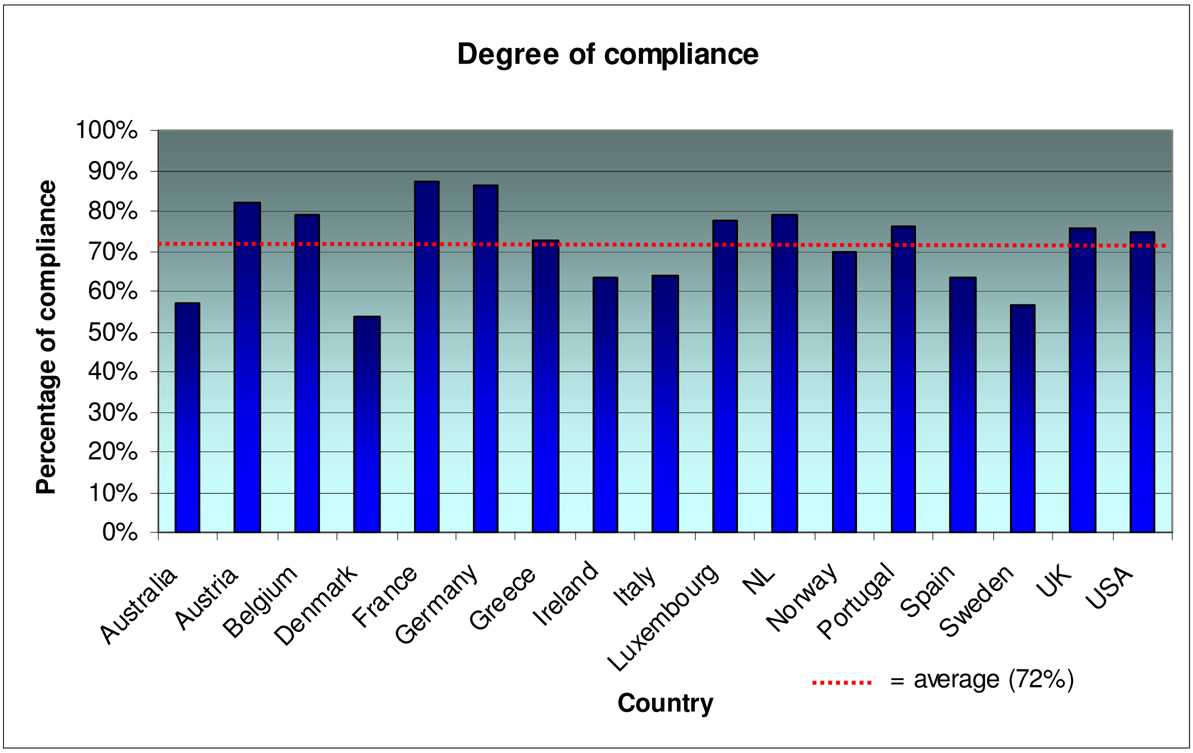
Table 6: The Construction of the Database

Cou	**R**	**J**	**S**	**D**	**F**	**Final score is based on:**
AUS	1	4	5	-1	**4**	(7) Predicate offences include all indictable offences (8) Criminalised at state and territory level and these offences vary in comprehensiveness
AUT	1	4	3	1	**3**	(120) Palermo not implemented and ratified (Table 10 - sentence 3) Raise penalty level for simple ML offences
BEL	1	5	5	0	**5**	(7).Ok
DAN	1	4	4	0	**4**	(Table) Greenland and Faroer not fully consistent, range of predicate offences not adequate
FRA	1	5	5	0	**5**	(149) Palermo + Vienna implemented, Criminalization extensive
GER	1	5	4	1	**5**	(6) Criminalized on basis of Palermo and Vienna
GRE	1	3	2	1	**2**	(140) Expand ML to all serious offences and dual criminality
IRE	1	5	5	0	**5**	(7) Broad ML offence (prosecution + conviction remain low)
ITA	1	5	4	1	**5**	(In text and table no indications for deduction of points have been found)
LUX	1	2	2	0	**2**	(7, Table 2, 22) Palermo not ratified, scope too limited
NL	1	4	4	0	**4**	(113) Palermo not implemented
NOR	1	4	3	1	**4**	(4) Minor enhancements should be made for self laundering and conspiracy

Source: Ferwerda and Bosma 2007. Cou = ISO-coded country name, R.= Recommendation number, J = First score applied by Joras Ferwerda, S = First score applied by Silvester Bosma, F = Final score, (between brackets are the paragraph numbers or table numbers where the argument is found)

The entire table with all the scores attributed according to the process described above, shows immediately which country has the most comprehensive and complete anti-money laundering framework. It also reveals exactly on which of the forty recommendations a country is less compliant and why so. This database can easily be used to create an index of the degree of compliance of all the countries with regard to the forty recommendations, see Figure 1.

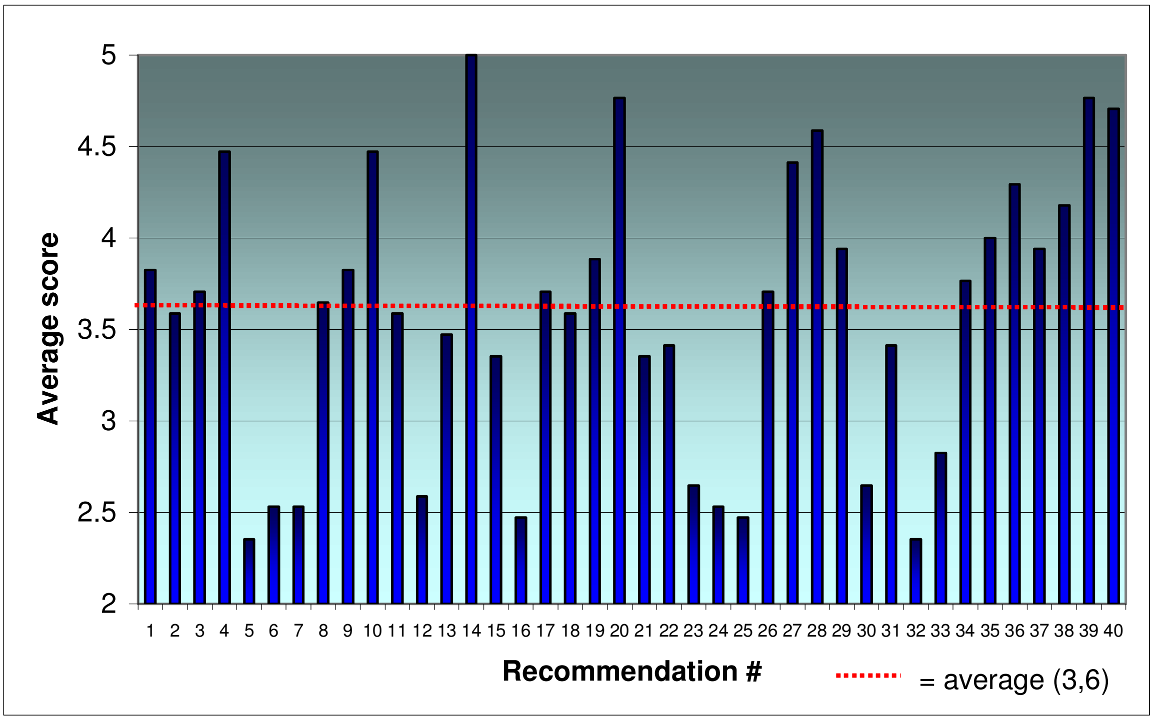
Figure 1. The degree of compliance (in percentages) for all the 17 different countries



Source: Ferwerda and Bosma (2006). The degree of compliance is shown in percentages. The maximum score a country could get was 5 per recommendation. The maximum score is hence 200. France got 174 points, i.e. 87% of the maximum score. (Unger, 2007)

Note that percentage of compliance is calculated by summing up the forty scores for the forty different recommendations and dividing them by the maximum score. This means that we assume that every recommendation has the same importance. This is not per se true, it could be that some recommendations are more important or that a combination of some recommendations is needed for an efficient anti money laundering policy. It could also be that the chain is only as strong as its weakest link and the violence of one specific recommendation could destroy the entire anti money laundering effort. But as a first step it seems reasonable to assume that all recommendations are of the same importance. Weights can be attributed at a later step, once more knowledge about the interaction of the recommendations is known. So, we claim that this database shows whether countries perform well by international comparison in fighting money laundering and whether other countries score better or worse on the same aspect. See Figure 2 on how countries score for the different recommendations.

Figure 2. The average score of all countries on the 40 different recommendations[16]



Source: Ferwerda and Bosma (2006). These are the averages for each individual recommendation. The scale of the scores is 0 – 5, so the average of 5 for recommendation 14 means that all 17 countries of our sample have scored a 5 for this recommendation.

Most remarkable in Figure 2 is obviously the average score of 5 (comprehensive implementation) on recommendation 14. This means that all countries (in our research) have a good set of laws so that financial institutions and their employees are protected while doing their job in good faith, and are prohibited from disclosing the fact that a suspicious transaction is reported. Also recommendation 20 has a relatively high average score with 4,76. All countries have a comprehensive implementation of this recommendation[17], except for Norway, which has a score of 4 (minor shortcomings / considerations for improvement) and Spain with its score of 2 (still a lot to be done). While for Norway it is recommended to continue its research techniques, there are no steps taken in Spain to encourage the development of modern techniques, which is what this recommendation is about.

The good news is that none of the recommendations has a real low average score. Relatively the lowest average scores are found for recommendation 5 and 32 with both an average of 2,35 (note that also recommendation 6, 7 and 12, which are based on

[16] The scale of the average score starts at 2 to make differences in the average score better visible.
[17] Recommendation 20: Countries should consider applying the FATF Recommendations to businesses and professions, other than designated non-financial businesses and professions, that pose a money laundering or terrorist financing risk. Countries should further encourage the development of modern and secure techniques of money management that are less vulnerable to money laundering.

recommendation 5, have a relatively low score). A reason for the low scores on these recommendations could be that they are both rather broad. Recommendation 5 is about customer due diligence (which, in short, is know your customer when you are a financial institution) and contains a list of diverse aspects that are important Also recommendation 32 is rather broad, it says that countries should be able to review their complete system of anti-money laundering with the use of statistics for more than ten different domains or aspects.. Since the reports listed the domains that need consideration or improvement, Ferwerda and Bosma (2007) developed a method of subtracting points when domains were criticized. When a recommendation is about many domains or aspects, there is more often a point of criticism to be found compared to tightly formulated recommendations. (Ferwerda and Bosma, 2007, p. 44-45)

Arnone and Padoan (2006) evaluated the method described above, by comparing its results with their figures found when using the scores in the detailed assessments (these are the FATF scores, which are quantified by Arnone and Padoan). Because their figures are based on the detailed assessments, only six of our 17 countries could be compared; for the other countries there were no detailed assessments available. They have figures of only the following countries; Australia, Belgium, France, Ireland, Italy and Sweden.[18] When looking at the aggregated scores of the different countries, the conclusion was: "the results are very similar": In both rankings France and Belgium are the best performers and Australia and Sweden the worst, leaving Ireland and Itlay in the middle. The difference in ranking is that Ireland and Italy are switched in order, just like Australia and Sweden. Although both scales are so close to each other that they almost appear undistinguishable. (Arnone and Padoan, 2006)

When comparing the scores for the different recommendations Arnone and Padoan (2006) found that the top 25% in the Ferwerda Bosma scores are the recommendations 4, 10, 14, 20, 27, 28, 36, 38, 39 and 40. The top 25% in their figures are the recommendations 4, 14, 20, 27, 28, 36, 37, 38, 39 and 40. So nine of the ten best scored recommendations are the same in both databases. The only difference is recommendation 10 that is replaced by recommendation 37.

The worst 25% in the Ferwerda Bosma scores are recommendations 5, 6, 7, 12, 16, 23, 24, 25, 30 and 32. The worst 25% in the Arnone Paoan figures are recommendations 5, 6, 7, 9, 12, 16, 22, 23, 24 and 34. So seven of the ten worst scored recommendations are the same

[18] This was true at the time of the analysis; meanwhile the number increased, and could increase even more in the future.

in both databases. The differences are that recommendation 25, 30 and 32 are replaced by 9, 22 and 34. The fact that both evaluations end up with similar results shows that the Ferwerda and Bosma (2007) index of compliance is quite a good proxy for the much more detailed (but less available and not internationally comparable) assessment reports analyzed by Arnone and Padoan (2006).

What we propose is that this database can be used for the open method of coordination as presented by the Lisbon European Council. It aimes at "establishing, where appropriate, quantitative and qualitative indicators and benchmarks against the best in the world and tailored to the needs of different member states and sectors as a means of comparing best practice." (Presidency Conclusions, point 37, quoted from Radaelli, 2003, p.15)

We are aware of the fact that the reports are still in their infancy. In 2005, the IMF evaluated 23 reports with regard to their overall quality, deficiencies in description/analysis, recommendations and ratings and found 48% of the recommendations and 49% of the ratings with material of serious deficiencies. This means, that there is still a long way to go in order to assess countries anti money laundering activities properly. But the approaches of Arnone and Paoan (2006) and Ferwerda and Bosma (2007) seem interesting for further investigation. They would allow to group and benchmark countries with regard to their anti-money laundering activities.

Our approach shares with other soft law approaches and mutual evaluations a major deficiency of no enforcement capacity. However the public opinion and publicity of the reports has apparently an impact on anti-money laundering policy of countries.

7. Conclusion

Blacklisting with regard to money laundering and tax havens seem to have failed. Money laundering blacklisting has failed, because no country remained on the list and it would be very unlikely that money laundering has disappeared. Tax haven listing still prevails and a list is being produced by the OECD. But the list contains only three countries and lacks legitimacy.

1. First reason for failure of the tax haven list is, that the topic of tax competition per se is arbitrary. The entire economic debate on whether tax competition is good or bad, plays a role here. Proponents of tax competition argue that introducing the market principle among nation

states and allowing them to compete for taxes, will lead to optimal tax rates everywhere. People will vote with their feet, as the father of this literature, Tiebout, already claimed in the 1950s. Each person and company will move to that country, which has the adequate bundle of taxes and budget expenditures he or she prefers. Low tax and low expenditure countries will coexist with high tax and high expenditure countries, so the proponents of tax competition claim. Opponents fear unfair competition and a race to the bottom (see e.g. Sinn (2003) and Mc Carthy, van Doorn and Unger (2008) for an overview of the tax competition literature). With money laundering this problem is less so, since there is more agreement on the fact that crime is bad and that fighting crime (and indirectly so through fighting money laundering) is important.

2. Second, the way both lists are done seems arbitrary. The blacklist of the FATF for money laundering only included 23 potential candidates, which had been suggested by members of the FATF, out of which the black sheep were chosen. Other countries were never considered, even not in a later phase. Countries could show compliance with the FATF recommendations by filling in written statements. Only when a certain (not precisely defined!) threshold of (declared!) compliance was not reached they were put on the list. With regard to tax havens the OECD got heavily reproached by offshore centres, that the big countries were not on the list, though they also do tax competition. It was seen as a punishment of small jurisdictions and offshore centres and, by leaving out countries like the US and the UK, as discriminatory and unfair.

3. Third, the effects that blacklisting had are unclear. Blacklisting of money laundering countries has punished some of the countries, but benefited others. So, blacklisting does not fulfill its clear purpose of reducing money laundering and crime. It is also not clear, whether it has increased the compliance of countries. As Rawlings (2007) showed, they might comply only in the books. Blacklisting of tax havens might have even less of a punishment effect, since tax havens are considered less harmful than money laundering countries by the public. To be listed can help countries to become better known as a reliable place to hide one´s tax evaded money.

4. International organizations such as the FATF or the IMF face difficulties with independence when doing blacklisting. In a global world it seems more difficult for international organizations to use the instrument of blacklisting than for private companies.

International organizations stand under the pressure of nation states that mostly also finance them. Blacklisting and ratings by international organizations seem less powerful than when done by private companies. This is similar to what Graz and Noelke (2008) found out about nation states becoming less and less powerful when facing globalization. When the harm comes from outside the nation state, nation states need the help of private global companies that are not bound by limited territorial jurisdictions. Van Waarden (2008, p.84-98) gives the example of Standard and Poors, or of Moody, who rate companies and countries for investors, and their rankings are much more transparent and accepted than when done by international organizations.

5. Does blacklisting even when done by private companies and not by international organizations have the wanted effect? With regard to rating countries for money laundering and for being a tax haven, the question comes up whether private company rating will have the effect wanted by financial authorities and tax competition opponents, namely to reduce laundering, tax evasion and allow for decent tax income. Private company ratings lately do list the effective tax rates (and not only the statutory tax rates) that investors have to pay. The question is whether this has the educative effect of which Gunningham et al (2004) talk. According to them, a disclosure policy can morally educate in two ways. First, it can adequately *warn and educate* the public about the risk of doing business with dishonest financial companies. Second, it can *deter* potential offenders, and *reassure* honest companies that their dishonest competitors are being punished, and thus contribute to compliance.

But, as J.P. Engelen (2007) showed in an empirical study, investors do not seem to care about maleficent behaviour of companies. He analyzed the development of equity prices in reaction to scandals of financial fraudulent behaviour of companies and found out that they did not react significantly. This means that private investors do not punish companies for financial fraudulent behaviour, hence not for money laundering and certainly not for tax evasion.

So, may be the same holds for countries? That there is no public to punish their maleficient behaviour?

6. There seems to be one important difference between the blacklisting of criminals, companies and countries. With regard to companies, in order to 'achieve effective enforcement, a sophisticated triage is essential. Zero tolerance is an impossible goal to achieve bearing the scope of this market, and also quite unnecessary to aim for' (Braithwaite

and Drahos, 2002). The art here lies in selecting such companies from among the offenders that they send out the 'widest possible ripples'. Consumers are ultimately better off with an enforcer who takes severe action against a small number of businesses rather than with a supervisor who pretends to be doing something about every complaint received. So, only few companies should be sanctioned but tough and visible. And these companies can be large and should be known companies in order to send out the 'widest possible ripples'.
The selection of countries for blacklisting must contain also large countries if it wants to have a broad effect and be an effective policy instrument. But due to the high costs of stopping trade or economic relations with big economies, big countries do not have to fear being listed.

8. Diplomatic requirements also necessitate that some sort of fairness and rules are applied, so that countries cannot be selected at will in order to send out the 'widest possible ripples'. The arbitrariness of the selection of countries was exactly the reason why the blacklists for money laundering and tax havens failed.

9. Nevertheless, naming and shaming in a global community does have also some positive effects. It might make countries more willing to cooperate. The FATF sees some positive effect in the fact that no country is left on the money laundering blacklist: all countries have adjusted and improved their regulatory framework to combat money laundering (FATF 2006). The EU Tax and Savings Directive in 2005 is a positive step against tax havens in making countries agree on information exchange on non residents' interest income. Some countries have opted for the alternative of levying a 15% tax on non residents in order to avoid information exchange. And they clearly can be identified as the black sheep of international cooperation. Within the EU these are Austria, Belgium and Luxembourg. And within the rest of Europe these are Liechtenstein, Andorra, Monaco, San Marino, Switzerland, Guernsey, Isle of Man, Jersey, and Gibraltar. This transparency of tax havens within Europe might eventually put these countries under stronger pressure to change their tax regimes.

10.Blacklisting is black or white (a discrete scale) while our proposed compliance database shows the nuances of high or low compliance with the international standards (more a continuous scale). The problem with black/white is shown by Rawlings (2007): after states complied with the standards, these jurisdictions have been marked as 'good governance' (the other end of the scale), which lead, in the end, to reverse (unwanted) effects. The index and measures of compliance proposed in this paper do not contain the flaws of the current blacklists because they are not arbitrary and discriminatory as the blacklists produced by the FATF and OECD (Rawlings and Sharman, 2006, p.40-41 and 64). We established a framework for a formal procedure, which might help to explore the greyzones of money laundering.

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Appendix I. Short description of the different recommendations

Recommendation	Short description of the content / keywords about the content[19]
1	Criminalize ML, on basis of Palermo/Vienna Convention
2	Prove ML, apply to legal persons and penalties
3	Make confiscation of ill-gotten gains possible
4	No secrecy laws
5	Consumer Due Diligence (CDD), know your customer
6	Special CDD for Politically Exposed Persons (PEPs)
7	Special CDD for cross-border correspondent banking
8	Monitor for new developments leading to anonymity
9	Rely on third parties for CDD
10	Record-keeping
11	Special attention to complex, unusually large transactions
12	CDD for Designated Non-Financial Businesses and Persons (DNFBP)
13	Report to Financial Intelligence Unit (FIU)
14	Employees protection and professional secret
15	Financial Institutions (FI) develop internal policy, training and audit
16	R. 13-15 and R. 21 for DNFBPs
17	Sanction possibility for non-compliance
18	Shell banks should be prohibited
19	One central database for currency transactions
20	Recs to all businesses & development techniques money management
21	Special attention business relations transactions with NCCTs
22	Special attention to branches located abroad especially NCCTs
23	Regulation, supervision and licensing FI
24	DNFBPs should be supervised
25	Establish guidelines and feedback
26	Establish a FIU
27	Responsibility and develop new techniques for law enforcement
28	Ability to obtain information by competent authorities
29	Supervisors should have adequate powers
30	Adequate resources for competent authorities
31	Domestically cooperation between FIU, law and supervisors
32	Review effectiveness with statistics
33	Prevent unlawful use legal persons (bearer shares / beneficial owner)

[19] Descriptions and keywords are subjective and should not be used as an official guideline. Rather as a mnemonic device.

34	Special CDD to trust offices
35	Become party of en implement specific conventions
36	Provide range of Mutual Legal Assistance (MLA)
37	Dual criminality
38	Response to foreign request to freeze, seize and confiscate
39	Recognize ML as extraditable offence
40	International cooperation with counterparts

Appendix II. ‘The tax havens the OECD forgot’

United States

• Limited Liability Corporation (LLC)
• Not perceived as offshore company
• No US tax liability for non-residents

It is of course the ultimate irony that the United States of America is one of the best tax havens in the world.

The United States, for instance, does not tax interest on bank deposits held by foreigners, nor surprisingly does it impose any reporting requirements with the exception of deposits held by Canadians. (This has been the subject of a three-year battle between lobbyists and the tax man on the Capitol Hill.)

The USA also provides us with an inexpensive corporate vehicle that is not only tax free -- it is a tax non-entity. It is the Limited Liability Corporation, or LLC for short.

A Limited Liability Corporation is a fusion of two distinct business entities: a limited corporation and a partnership. An LLC is similar to a standard corporation in that it provides the protection of limited liability to its owners. What sets the LLC apart from other corporate forms is how it is taxed.

Standard corporations are taxed separately from their owners at corporate tax rates. LLCs, on the other hand, are treated as partnerships (or sole proprietorships) for the purpose of taxation: income is not taxed at the business entity level at all. Instead, individual LLC members are expected to pay tax on whatever share of the LLC's profit is distributed to them. As a consequence, foreign-owned and managed LLCs do not give rise to any US tax liability whatsoever.

American LLCs can be formed by persons of any nationality. One-person LLCs (sole director/owner) are possible.

LLCs are available all over the United States, but Delaware, Wyoming and Nevada are the three favoured states of non-Americans incorporating US LLCs. Delaware has perhaps the most flexible corporate regime of all the US states -- the state has made a business of incorporating companies since early in the 20th century.

Although an LLC must maintain a registered office in the state of incorporation, it can be managed and conduct business anywhere in the world. Of course, it is sensible for an LLC to refrain from doing business with companies or individuals inside the United States if it is to maintain the benefit of non-existent US tax liability.

An LLC can open a bank account anywhere in the world with relative ease; after all, its place of incorporation is the reputable United States and not some high-profile, "suspect" tax haven.

United Kingdom

• Limited Liability Partnership (LLP)
• Not perceived as offshore company
• No UK tax liability for non-residents

The United Kingdom recently saw the arrival of a new form of a business entity: the Limited Liability Partnership (LLP). If certain circumstances are met, the LLP can effectively operate free of any UK tax liability.

For all intents and purposes, the British LLP is comparable to a United States LLC: It is a combination of a standard limited liability company and a partnership.

Just like limited companies, LLPs provide limited liability to members (in contrast to partnerships where partners' liability is unlimited). However, LLPs are still treated as partnerships as far as taxation is concerned: tax is assessed individually on each member after the distribution of the LLP's profits among them. The LLP as such is not taxed at all.

The legislation requires that an LLP has at least two members; they may be of any nationality and need not be UK residents.

In fact, provided that the LLP members are are located outside of the United Kingdom, and no business is carried with or within the UK, the LLP has no liability for UK taxation. Nevertheless, an LLP must file annual accounts with the Registrar of Companies; these must be audited if the annual turnover exceeds GBP 1 million.

Limited Liability Partnerships proved a popular business association for local UK professionals who traditionally organised themselves as standard partnerships (firms of lawyers, accountants and others) and as such had been exposed to unlimited personal liability. For the UK non-resident, a British LLP is a welcomed addition to a collection of non-offshore yet tax-free corporate entities.