

A stylized world map composed of a grid of dots in various shades of gray, with several dots highlighted in red. The title 'Overcoming the Shadow Economy' is centered over the map in a large, bold, blue font.

Overcoming the Shadow Economy

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- There is a growing global consensus that the secrecy-havens—jurisdictions which undermine global standards for corporate and financial transparency—pose a global problem: they facilitate both money laundering and tax avoidance and evasion, contributing to crime and unacceptably high levels of global wealth inequality.
- As economic leaders, the United States and Europe have an obligation to force financial centers to comply with global transparency standards. That they have the instruments to do so has been forcefully shown in the fight against terrorism. That they do not do so in the fight against corruption and tax avoidance and evasion is testimony to the power of the interests of those who benefit from secrecy.
- In a globalized world, if there is any pocket of secrecy, funds will flow through that pocket. That is why the system of transparency has to be global. The US and EU are key in tipping the balance toward transparency, but this will only be the starting point: each country must play its role as a global citizen in order to shut down the shadow economy—and it is especially important that there emerge from the current secrecy havens some leaders to demonstrate that there are alternative models for growth and development.
- Countries should position themselves proactively—not just complying with current minimal standards, but placing their economic development model at the cutting edge of the evolution of those standards. Each country must seriously consider whether it wants to be engaged in a never-ending struggle to catch up to the evolving international standards, or serve as a model, setting standards that others will eventually be forced to emulate.



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Foreword

The Panama Papers provided proof to the world of something that had long been suspected: the secrecy havens—jurisdictions in which global financial flows were hidden in ways that not even those entrusted with enforcing the laws and regulations of countries around the world could detect—were being used by those engaged in a host of nefarious activities, from tax evasion to corruption and even to child pornography. In a real sense, the secrecy havens facilitate these activities, because if the money flows were exposed, it would be easier to identify and prosecute the perpetrators. Though typically the managers of the banks, the lawyers who put together the impenetrable web of corporations and the public officials who pass laws ensuring secrecy may think of themselves as just »doing business« and helping them, their employees, and their country prosper, more properly these secrecy havens could be viewed as co-conspirators in these crimes.

This Report begins where the Panama Papers leave off. While the Panama Papers describe what was going on behind the secrecy, this Report asks what can (and must) be done, both by the international community and by the secrecy havens.

This Report arises from our involvement with a Committee of Independent Experts established by the President of the Republic of Panama in the wake of the Panama Papers scandal of 2016 to assess and recommend legal and institutional reforms to enable the country to play its role as a good global citizen in the fight against tax avoidance and evasion, corruption, and money laundering while simultaneously continuing on the trajectory of sustainable long-term growth.

Over the past decade, Panama has established itself as the logistics hub of the Americas, building on the natural advantages provided by the Panama Canal and geographical location. Panama has become a diversified economy, with the service sector predominating alongside healthy manufacturing and tourism industries. These gains have allowed Panama to cut its poverty rate by eight percent in the past six years through increased investments in universal public education and healthcare.¹ At

1. Between 2008 and 2014, a period including the global financial crisis, Panama managed to reduce poverty from 26.2 percent to 18.7 percent. World Bank, Panama Overview, available at <http://www.worldbank.org/en/country/panama/overview>; See also Government of Panama (2014).

the same time, there have been important legal reforms, which in turn have contributed to Panama's growth and transformation.²

In spite of such progress, Panama has had a hard time living down its history as a »narco-state« under President Noriega in the 1980s. The Panama Papers seem to have reinforced that image even though less than 20 percent of the corporations were in fact Panamanian. History, and the fact that the trove of documents came from a Panamanian law firm practicing in multiple jurisdictions, plus the name of the disclosure, undoubtedly chosen for the memorable alliteration, all contributed to put Panama at the center of attention.

The Committee of Independent Experts sought to understand what further steps the country would need to take to position itself as a good global citizen, enabling it to better fulfill its role as a logistics hub and to attract foreign investment. In the background were also subtle and not so subtle threats, ranging from cutting correspondence relationships with banks in developed countries to a variety of other sanctions threatened by G20 countries. Such sanctions could obviously deal a crippling blow to the long-term growth of the Panamanian economy, and its efforts to develop sustainably, reduce poverty, and create a shared prosperity.

Some in Panama worry that if Panama were to take aggressive actions to curtail secrecy, it might suffer a competitive disadvantage, as others upon whom the spotlight has not shone so brightly continue their current practices. Indeed, among the most blatant secrecy-havens are dependencies of and jurisdictions within the developed countries. Any observer of the global scene recognizes that the world is often unfair, there is a surfeit of hypocrisy, but power matters. Those developed countries that have allowed the continuation of such behaviors recognize the political forces at play

2. While its banking system may not always have been a model of transparency and good regulation, in recent years regulatory reforms have been instituted to address these deficiencies. See Executive Decree No. 55 of 1 February 2012 (amending Executive Decree No. 1 of 3 January 2001, regulating Law 42 of 2 October 2000). Other legislative changes in Panama's legal framework have required custodianship of bearer shares and disclosure of beneficial ownership for newly incorporated entities. See Law No. 18-2015 of 23 April 2015 (amending Law 47-2013 of 6 August 2013); Law No. 23-2015 of 27 April 2015 (requires that financial and legal institutions identify and record beneficial owners/beneficiaries of their clients; in the event that the final beneficiary is found to be a legal person, the law requires that identification process continue until a natural person is identified). Panama has also agreed to automatic exchange of information by 2018.

within their own countries, which are demanding effective action to curb tax evasion and avoidance and money laundering. Panama has to deal with these aspects of *Realpolitik*.

We had hoped that our recommendations would be part of a report outlining reforms for Panama that would not come at significant cost to the country, but instead poise Panama to become a role model for others. However, that was not to be. We had demanded at the beginning of our deliberations that our Report be made public, whatever its findings, after giving the government suitable time for formulating a response. We had left it to the government to decide on how much time they felt was necessary. When the government refused to provide those assurances, we felt we had no choice but to resign. We believed that a report on transparency that was not itself transparent would simply not be credible. We had to lead by example.³

Yet the challenge posed to the Committee—that of determining what is required to end secrecy-havens, which have played such a large role in facilitating tax avoidance and evasion, corruption, narco-trafficking, and other socially repugnant activities by providing a safe haven for the funds garnered by such illicit activities—remains as important today as at the time our Committee began its work. In recent years, globalization has been subject to controversy and criticism with its advocates explaining its benefits and its critics emphasizing its costs. There are, of course, many aspects of globalization. But there is one aspect on which there is a broad agreement: secrecy-havens have no place in a world of positive globalization. They, like the movement of terrorists across borders, are among the darker sides of globalization.

Given the investment of thought and time to this endeavor—of developing an agenda for combating secrecy-havens—we thought it desirable to move forward constructively by issuing this Report. What we seek is to address this global and systemic problem by making recommendations applicable to all countries for overcoming the shadow economy and ultimately, shutting it down.

This Report is written in that spirit.

3. For more information on our involvement, see Stiglitz and Pieth (2016).

I. Introduction

There is a growing global consensus that the secrecy-havens—jurisdictions which undermine global standards for corporate and financial transparency—pose a global problem: they facilitate both money laundering⁴ and tax avoidance and evasion⁵, contributing to crime and unacceptably high levels of global wealth inequality. Over the years, the global problems posed by secrecy and lack of transparency have increased, and, not surprisingly, this growth has been accompanied by growth in attempts to curb it and the resulting abuses of the global corporate and financial system. Citizens are asking, why do offshore financial centers exist at all? Americans want to know, why did one of their presidential candidates in 2012 keep his money in an offshore center? Wasn't there sufficient competency in the United States to manage his wealth? Or were there some tax or other benefits—available to the rich, who could avail themselves of these offshore centers, but not to others. It is not as if there is something special in the sunshine of the Cayman Islands or the other offshore centers that makes money grow faster than elsewhere. If anything, it is the *lack* of sunshine that is the problem.

If there is something wrong with America's or Europe's regulatory regime that requires certain transactions to occur elsewhere, this deficiency should be cured. But if what is going on is simply fiscal and regulatory circumvention, shouldn't the offshore centers simply either be shut down or forced to comply with and assist in the enforcement of national and international tax and regulatory standards? The disclosures by the International Consortium of Investigative Journalists (ICIJ) of massive tax avoidance and other »irregular« activities in onshore and offshore financial centers have only heightened public perception that these secrecy-havens are up to no good—and stepped up pressure to do something.

This raises a whole series of questions, for the international community and for any country wishing to remain an active financial center within that community: What can be done about secrecy and the lack of transparency? What diverse forms does secrecy take? What would a

4. »Money laundering is the processing of (...) criminal proceeds to disguise their illegal origin.« See Glossary of FATF Recommendations, available at <http://www.fatf-gafi.org/faq/moneylaundering>.

5. Tax evasion is defined as reducing tax payable by fraudulent (i.e. illegal) means while tax avoidance is defined as lawful tax liability minimization. (Black's Law Dictionary, 2nd ed., 2001).

globally efficient system of global information transmission and collection look like and what can countries do to avoid complicity with bad actors of the shadow economy? In other words, what does good global citizenship in information look like?

Over the past forty years, the world has come to a better understanding of the consequences of lack of transparency. In economics, a whole branch of the field has developed with multiple awards of Nobel Prizes for enhancing our understanding of the consequences of imperfect information. The standard theorems about the efficiency of the market were developed under the assumption of full information; with imperfect information—in particular, with one person having information that others do not, which is what is meant by secrecy and lack of transparency—the economy is not in general efficient.⁶ One party can and often does take advantage of another. That is why all countries have fraud and disclosure laws on consumer product contents, securities, etc., with stiff penalties to ensure that the disclosures are truthful.

Similarly, in politics and government there has been an increasing awareness of the dangers of secrecy. Such secrecy is the basis of most corruption and as the saying goes, »sunshine is the strongest anti-septic.« With transparency, the special arrangements that lead to a government receiving less than it should for assets or paying more for what it procures would not occur.⁷

There are markedly different attitudes towards secrecy and transparency around the world. In Norway, Sweden and Finland, tax returns are regularly published online. Their attitude is: What do people have to hide? If they earn their income honestly, why shouldn't they disclose it? At the other end of the spectrum are countries, such as the Philippines, which view disclosure as an invasion of privacy, punishing those who disclose taxpayer information.⁸

6. This result, overturning Adam Smith's »invisible hand theorem«, was established by Greenwald and Stiglitz (1986).

7. Sometimes, secrecy is used not just for these kinds of nefarious pecuniary activities, but simply to advance political perspectives. Daniel Moynihan, one of America's most influential senators, wrote a powerful book describing the consequences of secrecy, entitled simply *Secrecy*. He argued that it had had the effect of extending and intensifying the Cold War. See Moynihan (1998). There is now a huge literature on the subject. See, e.g., Stiglitz (2001); Stiglitz (2002); Florini (2007).

8. See Republic Act No. 8424 of 11 December 1997 (prohibits disclosure of tax records with a penalty of PHP50,000–PHP100,000 and two to five years imprisonment for Bureau of the Internal Revenue (BIR) employees and PHP2,000 and six months to five years for individuals who cause a disclosure).

If there were not social consequences to decisions concerning transparency and privacy, one could leave it to each individual to decide how much and what to disclose. But there are huge social consequences. Most socially destructive activities—activities that undermine the very functioning of society—occur behind the cloak of secrecy. If ill-gotten gains from crime and especially corruption can be traced and monitored, then the likelihood of apprehending those who engage in these activities is increased. This in turn markedly reduces incentives to engage in these socially destructive activities.

Secrecy also undermines the ability to ensure that everyone is making their contribution. If ours were still a simple agrarian society, with each farmer growing their own food and making their own clothes, one might well argue that there is little need for a state, and thus little cost to the nondisclosure of income information. In an earlier era, much of government spending went to the waging of wars. But in a modern, complex society, we have to raise large amounts of money to make our society function, to promote growth and to ensure that the fruits of that growth are equitably shared. We need, for instance, investments in infrastructure, education, healthcare, basic research, and a host of other common needs. If society is to function well, everyone has to contribute their fair share. But some individuals would like to freeride, to take advantage of the provision of public goods without paying. If that is allowed to occur, the whole social contract can break down.

Globalization has resulted in a global economy, but not a global government. If we had a global government, almost surely, it would enact strong global legislation requiring banks and other financial operators in all countries to conform to certain transparency standards. It would realize the corrosive effect of secrecy, and would do what it could to combat it. In the absence of such a global government, the major players can effectively force others to comply with their standards, simply by threatening to cut off access to their financial system. And in fact, many in the United States have been calling for the government to break off all connections with jurisdictions not conforming to the global standards (even secrecy jurisdictions within their own territories), effectively shutting down all secrecy-havens. There is a widely shared perspective that these havens only exist because the United States and Europe have looked the other way—influenced by their own one percent. These major

players have yet to pull the trigger, partly due to the delay in putting their own houses in order. But in societies with growing inequality, this is increasingly viewed as intolerable. Thus, there is a real possibility that, over time, they will be shut down: current initiatives are but the first step in a far more aggressive encounter.

In a globalized world, if there is any pocket of secrecy, funds will flow through that pocket. That is why the system of transparency has to be global. The US and EU are key in tipping the balance toward transparency, but this will only be the starting point: each country must play its role as a global citizen in order to shut down the shadow economy—and it is especially important that there emerge from the current secrecy havens some leaders to demonstrate that there are alternative models for growth and development.

This Report attempts to address these aspects of secrecy and provide recommendations for overcoming the shadow economy and ultimately, closing it down. Section II explores the global phenomenon of secrecy-havens, the structures through which illicit funds escape detection, and the risks involved in that opacity. Section III describes the ongoing international efforts and emerging standards to reign in the shadow economy. In Section IV, we offer recommendations for all countries for closing the global channels of secrecy, and Section V concludes with a perspective on why such measures are necessary for the survival of globalization.

II. Secrecy, Tax preferences, and the Race to the Bottom

The Panama Papers and other information leaks,⁹ which will no doubt continue, have demonstrated the risks of playing an enabling role in obscuring financial flows. Some of these flows may have a perfectly legal background, but many of them do not. The Panama Papers revealed that the law firms in question¹⁰—operating on

9. Swiss Leaks, Luxembourg Leaks, and now, the Bahamas Leaks detail widespread use of tax and secrecy jurisdiction. See <https://www.icij.org/projects> for full descriptions.

10. Mossack Fonseca began operating more than 40 years ago in the late 1970s, in what has been described as the golden age of offshore companies. It is popularly known in Panama as the law firm that began the offshore accounts services. The firm started out by setting up companies in Panama, taking advantage of its particularly lax corporate laws. However, after the United States invaded Panama (making investors nervous), Mossack Fonseca shifted its main operations to the British Virgin Islands. BVI

a worldwide basis, including in other offshore centers as well as large traditional financial centers—opened and serviced shell companies, trusts, private foundations, and other entities to serve as integral components of so-called »structures« through which money flows. These complex constructions are composed of companies with unknown owners and beneficiaries (hidden behind nominee directors and bearer shares¹¹) with multiple bank accounts in jurisdictions with strong bank secrecy legislation and little likelihood of cooperation with foreign authorities. The structures are organized by fiduciaries, mostly lawyers, who are typically under-regulated, and who use their attorney-client privilege to mask the identity of their clients.

Even if there could be some legitimate uses of certain features offered by tax havens,¹² the Panama Papers have shed light on a number of egregious abuses enabled by these structures: apart from straightforward tax fraud by private persons and companies, another group of cases indicates that officials, ministers, and even heads of state used these structures to cover up conflicts of interest or even graft, corruption, and embezzlement. A third group of cases exposed the use of these structures in laundering proceeds from organized crime. In a particularly disturbing case, one client of the Panamanian law firm was the alleged ringleader of a child prostitution ring in Russia, whose members kidnapped, raped, and sold orphan girls. The ICIJ reported that when the firm discovered accusations of its client's involvement, it determined that it was not legally obligated to report them.¹³ Thus, these structures have enabled and in fact incentivized such heinous abuses of the most vulnerable.

At the same time, these structures are developed and used by respected global corporations to avoid taxation

soon became its biggest jurisdiction of operation. BVI also had the added advantage of a legal system answerable to British courts, offering a great deal of security to investors. In the following years, the firm flourished, and established several international branches making it the fourth largest provider of offshore services in the world. As its operations expanded, so did its reputation, which in turn brought in further business. See Luke Harding, »Mossack Fonseca: inside the firm that helps the super-rich hide their money,« *Guardian*, 08 April 2016 (accessed 12 Oct. 2016).

11. Bearer shares are negotiable instruments that accord ownership in a legal entity to the person who holds the bearer share certificate. See Glossary of FATF Recommendations, available at <http://www.fatf-gafi.org/glossary/a-c/>.

12. See Christine Capilouto, Research note, »A more nuanced argument for tax havens«, 1 Oct., 2016 (on file with the authors).

13. See Obermayer and Obermaier (2016).

on massive wealth, in the trillions of dollars.¹⁴ With the assistance of legal and accounting firms (and sometimes governments, which have provided secret tax rulings authorizing such structures, as revealed by the Luxembourg Leaks, informally referred to as LuxLeaks), multinational corporations shift earnings from the place of economic activity to low- or zero-tax jurisdictions through transfer pricing manipulations and other contrived outbound payments, thereby leaving the place of economic activity to carry the social cost.

In addition, governments often complement use of these structures by providing tax-free special economic zones and preferential tax treatment for incorporated entities, which are subject to little or no tax reporting requirements so long as they do not engage in the domestic economy. The most troubling aspect though, is that all of this is perfectly legal. Yet, without a doubt, such preferential tax treatment is highly problematic as it circumvents enforcement of tax laws by third countries and undermines the social state in the North, development in the South, and investments in infrastructure, technology, education, and thus, growth everywhere.

What, if any, are the social benefits of these complex and opaque arrangements? It is increasingly apparent that there are huge social costs. From a global perspective, this form of competition is destructive. From a tax perspective, such structures do not result in more economic activity, but simply the movement of activity from one location to another—or in some cases, just the *appearance* of the movement of activity from one location to another. Indeed, tax competition leads to higher inequality and poorer public services. Even more troubling is its connection to secrecy: A traditional part of money laundering is shifting illicit profits to secrecy-havens not only to conceal their origins, but also to avoid taxation.

Yet, some countries continue to perceive their competitive advantage as arising partly from low taxation and minimal regulation. The theory is that even if a country does not directly receive fiscal revenues from a business that is persuaded to incorporate there, the economic activity that is generated is of benefit, and some of that will be taxed indirectly. More often than not, however, the costs overwhelmingly outweigh the benefits by

hampering domestic innovation and creating an elite class within the country to guard the interests of those benefiting from the secrecy-havens and any foreign investment that it might generate.

It is important to recognize that the greater the tax preferences, the greater the attraction for money laundering. Therefore, if a country does choose to provide undue tax preferences, fuller transparency, strengthened monitoring, and consistent enforcement are required. If a country chooses to maintain tax preferences, it will have to open all of the books of those taking advantage of the tax preferences to inspection by anyone in the international community, subjecting them to heightened scrutiny, generating more demands for strong enforcement, and placing the country at greater risk of international censure when enforcement proves inadequate. These costs need to be taken into account as a country weighs the benefits and costs of the continuation of such preferential treatment.

But whether a country provides such tax preferences or not, important questions regarding opaque structures in offshore financial centers should be raised: Why is the corporation / trust / foundation incorporated in an offshore financial center? What are the benefits that it receives that it would not have if it were incorporated in one of the countries where its economic activities occur? The response of the international community to the growing legitimate concerns about the costs of secrecy is to demand greater transparency all round—of the finance and corporate sectors, of opaque trusts and foundations, and of those who serve them. Below, we spell out more precisely what transparency entails for entities (companies, trusts, foundations, etc.) incorporated in any jurisdiction: the identity of the beneficial owners, the location of their economic activities, as well as the amounts of global profits and taxes due and paid in each country. The international community's efforts to develop standards which address these concerns are outlined in the next section.

III. International Standards on Financial and Tax Transparency

Since 2009, in the face of the financial crisis and empty public purses, the global fight against tax avoidance, evasion, and financial opacity has gained new ground. Increasingly, the structures of the global financial sys-

14. Tax Justice Network estimates this amount at 21–32 trillion US dollars. See Henry (2012).

tem are perceived to facilitate so-called illicit financial flows (commonly defined as »money illegally earned, transferred, or used that crosses borders«).¹⁵ These flows undermine the rule of law, exacerbate inequality and have a detrimental impact, especially on developing countries, where severe deprivation suffered by the very poor continues to infringe on their human rights (social and economic as well as civil and political rights).¹⁶

We live in an age when the economic, technological, and administrative capacities are in place to effectively tackle extreme poverty. What is needed, however, are reforms in the global system of secrecy-havens to avoid the draining of state budgets, especially of developing countries.¹⁷ At the same time, even developed countries have become aware of the massive amounts of offshore wealth and aggressive tax avoidance that strips public budgets; the corrosive effect that such leakages have on voluntary tax compliance; and the effect that they have on growing inequality, increasingly identified as one of the world's most important problems. Moreover, corruption and other illicit activities that are facilitated by secrecy-havens undermine the very fiber of all societies. In the face of overwhelming democratic demands to address these problems, global coordination has been stepped up to increase both financial and tax transparency.

1) Financial Transparency

The fall of the Berlin Wall and the opening of the East intensified economic globalization, with both positive and negative consequences. International regulation in the areas of anti-money laundering, anti-corruption, and countering the financing of terrorism emerged nearly concurrently. The international community has adopted a sequence of flagship conventions in the area of economic and organized crime, starting with the Vienna Convention on Illicit Trafficking in Drugs of 1988; going on to the United Nations Convention on Transnational Organized Crime (2000) including its additional protocol on human trafficking; the OECD Convention on Bribery of Foreign Public Officials (1997); the United Nations Convention on Anti-Corruption (UNCAC, 2003), and

several more specific agreements on corruption, money laundering, and the financing of terrorism. The common denominator of these international agreements is the prevention of the abuse of the financial sector for illicit purposes.

Overall, international standards on anti-money laundering and anti-corruption are a combination of »hard« and »soft« law, bolstered by tough, politically engaged monitoring mechanisms, refined by business associations and multi-stakeholder groups, and finally translated into in-house regulation. This mix of standards is applied by prosecutors and courts when defining corporate liability for money laundering and corruption.¹⁸ Overall, this type of »co-regulation« system (which initially originated in the human rights area) has been effective in a variety of areas, such as anti-money laundering, combating the financing of terrorism, and anti-corruption.

The identification of beneficial ownership has become a key transparency requirement. Unlike the nominal owner, the beneficial owner is the natural person who actually enjoys the use and title of the property—without actually having to be named as the legal owner.¹⁹ At first sight it may seem obvious to demand—on a worldwide basis—meaningful public registers of companies identifying their beneficial owners. Indeed, the United Kingdom and France have established public registries of company owners.²⁰ Currently, however, the primary obligation of identification of beneficial ownership is placed on financial operators, such as banks, with the obligation to report to regulatory authorities.²¹ We expand on this subject below in Section IV.

18. See Pieth (2007); Pieth (2008a); Pieth (2008b).

19. *Beneficial owner* of an asset or corporate entity refers to the natural person(s) who ultimately owns or controls the asset or corporate entity and/or the natural person on whose behalf a transaction is conducted. It thus includes those who exercise ultimate effective control over an entity or arrangement. See Glossary of FATF Recommendations, available at <http://www.fatf-gafi.org/glossary/a-c/>.

20. As of 6 April 2016 all United Kingdom companies have been required to identify and record their owners/controllers. See Part 21A, Companies Act 2006. The UK has also committed to implement a publicly accessible central register of beneficial owners or »people with significant control«. See Small Business, Enterprise, and Employment Bill, clause 70 and Schedule 3. On 22 July 2016, France instituted public registries of company owners and beneficiaries of trusts and foundations, but has now closed the trust registries after the Constitutional Council ruled that such registries result in a »disproportionate interference with the right to privacy.« Décision n° 2016-591 QPC du 21 Octobre 2016.

21. On 11 July 2016, the United States adopted a Treasury rule (called FinCEN) requiring financial operators to report (to government authorities only) and verify (through documentation only) the beneficial owner(s) of legal entity customers by 11 May 2018. See 81 F.R. 29397.

15. See World Bank, *Illicit Financial Flows*, available at <http://www.world-bank.org/en/topic/financialmarketintegrity/brief/illicit-financial-flows-iffs>.

16. See Sepúlveda (2014).

17. See Pogge and Mehta (2016).

a) Anti-Money Laundering (AML)

The topic of money laundering emerged on the international level with the Vienna Convention of 1988, as part of the arsenal against illicit trafficking in drugs.²² The next year the G7 called a meeting under the auspices of the Financial Action Task Force (*Groupe d'action financière* or FATF²³), then led by the French President Mitterrand and his Minister of Finance. From the »*Sommet de l'Arche*«, the FATF developed its 40 Recommendations to combat money laundering. In a first phase they addressed on the one hand criminalization of drug-related money laundering, confiscation of ill-gotten gains, and the relevant mutual legal and administrative assistance; and on the other hand, the six classic requirements of financial supervision: (1) identification of clients and beneficial owners, (2) increased diligence in unusual transactions, (3) notification of suspicious transactions, (4) relevant documentation, (5) introduction of a compliance function by financial intermediaries, and (6) reporting of large cash transactions.²⁴

The centerpiece of the FATF AML (anti-money laundering) system is identification and verification of the identity of beneficial owners (including corporations, foundations, and trusts).²⁵ Civil society observers, however, are concerned that the standards are not sufficiently high. For instance, they have criticized the high threshold of 25 percent ownership in FATF's beneficial ownership definition (that is, an individual with less than a 25 percent interest does not have to be identified). They also see the provision allowing senior managers to be listed as the beneficial owner where no other person is identified as another »loophole« in the AML system. Instead, they propose that a beneficial owner should be any (»natural«) person with at least one share. In the case of trusts, the identified »beneficial owners« should include any person mentioned in trust documents.²⁶

Closely related is determination of the *origin* of the funds, in particular where transactions and patterns of client behavior do not immediately make sense from a

22. United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988).

23. As will be clear as this report proceeds, work in this area is very acronym intensive. We have identified each acronym the first time it is used.

24. See FATF Recommendations (1990).

25. See FATF Recommendations (2012) 10, 12, 24, and 25.

26. See Knobel and Meinzer (2016a); Knobel and Meinzer (2016b).

professional point of view (the so-called »risk based approach«).²⁷

The FATF has continued to enlarge the scope of its work in three directions: going beyond funds stemming from illegal drug trafficking to all serious predicate²⁸ crimes; including all financial operators in addition to banks; and expanding geographically to include all relevant financial centers. While FATF standards continue to be based on soft law, they are enforced through country peer-reviews and monitoring and, if necessary, trade sanctions against so-called non-cooperative countries and territories.²⁹

From 1990 on, regional bodies, such as the Council of Europe³⁰ and the European Union³¹ translated the Recommendations into traditional international agreements and the standards have concurrently been implemented in national law and regulation, making them also legally binding for the financial industry. The financial industry, banks in particular, followed these developments closely and helped shape the agenda through collective actions, such as the Wolfsberg Group, which developed in-house compliance rules addressing money laundering and corruption risks and incorporating international standards and national laws.³²

b) Countering the Financing of Terrorism

From the 1970s the United Nations drafted various instruments to combat and prevent terrorism. Typically these instruments—triggered by terrorist activities in

27. See supra note 24, Recommendations 1 and 10.

28. A predicate offence is an action that provides resources for another criminal act, for example, tax evasion, illegal logging, trading in contraband, human trafficking, etc. The UN Convention against Transnational Organized Crime (2000) in Article 2(h) defines predicate crime as follows: »Predicate offence« shall mean any offence as a result of which proceeds have been generated that may become the subject of an offence as defined in article 6 of this Convention«. Article 6 regulates money laundering and seeks to apply to the widest range of predicate offences, including corruption.

29. See FATF (2000).

30. Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime (ETS No. 141).

31. First EU Money Laundering Directive of 1991 (91/308/EEC); Second EU Money Laundering Directive of 2001 (2001/97/EC); Third EU Money Laundering Directive of 2005 (2005/60/EC).

32. The Wolfsberg Group, eleven of the largest international private banks, started its work by developing general anti-money laundering standards for private banks and went on to adopt an entire series of specialized documents (on the prevention of terrorism, on the risk-based approach, on correspondent banking, and on anti-corruption). Cf. Pieth and Aiolfi (2003); Pieth (2007); Wolfsberg (2000/2002/2012); Wolfsberg (2002a); Wolfsberg (2002b); Wolfsberg (2006).

Germany (*Rote Armee Fraktion*) and Italy (*Brigate Rosse*) and the terrorist activities of Palestinian organizations—were focused on specific forms of threat (e. g. against aviation, oil platforms etc.).³³ In 1999, the United Nations added a convention on the financing of terrorism.³⁴ Shortly afterwards, following 9/11, the international community led by the United States declared all-out »war on terror«, including its financing. Following earlier models of combating drugs and other serious crime, the international community introduced serious restrictions to prevent the use of the financial system for the preparation and financing of terrorist acts. It used the agreements it had developed to combat money laundering and extended the list of predicate offences to money laundering to include the »financing of terrorism«. In addition, the United Nations Security Council developed so-called »smart sanctions«, which target the free movement of capital of suspicious persons.³⁵

c) Anti-Corruption

The development of international anti-corruption standards has followed a very similar pattern: in 1977, after the Watergate scandal, the United States Congress adopted—initially unilaterally—a foreign bribery statute, the *Foreign Corrupt Practices Act* (FCPA).³⁶ After the main competitors signaled their unwillingness to follow suit, the legislation was amended in 1988.³⁷ Post-1990, the United States has worked to internationalize the FCPA through the Organization for Economic Cooperation and Development (OECD).

From 1990 to 1997, the OECD developed two Recommendations and a Convention addressing preventive

and punitive measures against foreign bribery.³⁸ Again the combination of recommendations and hard law was enforced *vis-à-vis* member states largely with a political rather than a legal tool: country monitoring.³⁹ Furthermore, the OECD continued regulation with a mix of its Convention and an updated Recommendation of 2009 as well as even softer forms of guidance notes.⁴⁰ On a member state level, the international standard as developed by the OECD was again translated into national law and regulation.⁴¹ Concurrently, other international organizations, like the Organization of American States, the Council of Europe, the European Union, and the Organization of African Unity—for diverging reasons of their own—picked up the issue of corruption and drafted their own legal instruments.⁴²

Over time, the rationale of the anti-corruption movement gradually expanded from safeguarding fair competition to a development and good governance agenda. In more recent times the anti-corruption and human rights instruments moved closer together. The UNCAC picked up all these elements and developed them into a comprehensive approach, which included replicating the foreign bribery part of the OECD instruments. Country peer-reviews and monitoring were gradually adopted as a means of ensuring implementation by all international organizations.

Concurrent to the emergence of international instruments the multilateral development banks decided that

33. Convention for the Suppression of Unlawful Seizure of Aircraft of 16 December 1970; Convention for the Suppression of Unlawful Acts Against the Safety of Civil Aviation of 23 September 1971; Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, Supplementary to the Convention for the Suppression of Unlawful Seizure of Aircraft 1970 of 24 February 1988; Convention for the Suppression of Unlawful Acts Against the Safety of Maritime Navigation of 10 March 1988 and its Protocol for the Suppression of Unlawful Acts Against the Safety of Fixed Platforms Located on the Continental Shelf of 10 March 1988; International Convention against the Taking of Hostages of 17 December 1997; International Convention for the Suppression of Terrorist Bombings of 15 December 1997.

34. UN International Convention for the Suppression of the Financing of Terrorism (1999).

35. UNSC Res. 1267, 1373; Pieth and Eymann (2009).

36. US Foreign Corrupt Practices Act, Public Law No. 95-213, 91 Stat. 1494.

37. US Omnibus Trade and Competitiveness Act, Public Law No. 100-418, 102 Stat. 1107.

38. Recommendation of the Council of the OECD on Bribery in International Business Transactions (adopted by the Council on 27 May 1994); Revised Recommendation of the Council of the OECD on Combating Bribery in International Business Transactions (adopted by the Council on 23 May 1997); OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (adopted 21 November 1997, signed 17 December 1997).

39. See Bonucci (2014).

40. Recommendation of the Council of the OECD for Further Combating Bribery of Foreign Public Officials in International Business Transactions (adopted by the Council on 26 November 2009); Annex I: Good Practice Guidance on Implementing Specific Articles of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions; Annex II: Good Practice Guidance on Internal Controls, Ethics, and Compliance (adopted 18 February 2010).

41. See e. g., UK Bribery Act 2010 c. 23.

42. Inter-American Convention against Corruption, 29 March 1996; Council of Europe Criminal Law Convention on Corruption, ETS No. 173; in European Union, the Protocol drawn up on the basis of Article K.3 of the Treaty on European Union to the Convention on the protection of the European Communities' financial interests (OJ C 313, 23.10.1996, pp. 1–10), and the Convention drawn up on the basis of Article K.3 (2) (c) of the Treaty on European Union on the fight against corruption involving officials of the European Communities or officials of Member States of the European Union (OJ C 195, 25.6.1997, pp. 1–11; African Union Convention on Preventing and Combating Corruption, 11 July 2003.

combating corruption was within their fiduciary duties, partially in response to mounting evidence of adverse effects of corruption on development.⁴³ They mainstreamed the anti-corruption policies in their operations and introduced sanctions against companies and individuals engaging in fraudulent and corrupt behavior.⁴⁴ Business organizations⁴⁵ and NGOs⁴⁶ also picked up the emerging standards and the so-called »compliance industry« increasingly consolidated the rules. Again, business organizations in the financial sector, most prominently Wolfsberg, drafted anti-corruption guidance,⁴⁷ which was adopted by member banks and translated into in-house standards. Finally, domestic court decisions and settlements (especially in the United States and Germany) integrated the overall standards for defining corporate liability.⁴⁸ Ultimately, countries introduced the common standard in official guidelines and guidance notes.⁴⁹

2) Tax Transparency

a) Information Exchange on Tax Matters

By now, there is a global consensus that greater tax cooperation between countries is needed, including an effective exchange of information between tax administrations. Historically, exchange of information for tax purposes took place through bilateral tax treaties based on the OECD *Model Tax Convention on Income*

and on Capital or the United Nations *Model Convention on Double Taxation Between Developed and Developing Countries*. Both the OECD and UN models serve as reference documents when countries draw up bilateral tax conventions, enabling them to settle the most common problems on a uniform basis. Article 26 under both models provides for exchange of information by the competent authorities of the contracting states. Paragraph 1 of Article 26 allows information to be exchanged in three different ways (individually or in combination): on request, automatically, or spontaneously.⁵⁰

However, information exchange under bilateral tax treaties has not been adequate to stem the leakages from aggressive tax avoidance, which the OECD now estimates to be between 100 and 240 billion US dollars annually.⁵¹ Multinational tax avoidance alone results in revenues losses in the hundreds of billions of dollars, and has been the subject of extensive public discussion since the uncovering of the secret agreements between Ireland and Apple (and remarkably, in this era of transparency, as this Report goes to press, the two continue to refuse to allow the public disclosure of the European Commission ruling against them).⁵² Two decades ago, such leakages were increasingly apparent to world leaders, who through the G7 requested the OECD to address this leakage through a report, entitled *Harmful Tax Competition* (1998). This report began the effort to define »harmful tax practices« and then apply these standards to preferential tax regimes through a Forum on Harmful Tax Practices (FHTP), housed within the OECD. Secondly, the agenda to improve exchange of tax-related information was taken on through a Global Forum on Tax, later renamed the Global Forum on Transparency and Exchange of Information (Global Forum). The *Harmful Tax Competition* report outlined a work agenda to identify preferential tax treatment among OECD countries and created a »blacklist« of tax havens. The report also established criteria for preferential tax laws which were potentially harmful and the FHTP carried the recommendations of the report forward.

43. The World Bank's charter prevents engagement in political activities, and earlier, criticism of governments for corruption had been viewed as political. Supported by results from its research department, under Chief Economist Joseph Stiglitz, the World Bank under President James Wolfensohn began a major anti-corruption campaign, which included identifying corruption-resistant institutional structures and policies.

44. See the World Bank Sanctions Procedures, 15 April 2012; the Sanctions Procedures of the Inter-American Development Bank, 9 June 2015; the Document of the European Bank for Reconstruction and Development, Enforcement Policy and Procedures, 25 April 2014; and the Sanctions Procedures of the African Development Bank Group, 18 November 2014.

45. International Chamber of Commerce, Rules of Conduct to Combat Extortion and Bribery.

46. Transparency International Business Principles for Countering Bribery.

47. Wolfsberg (2007); Wolfsberg (2011).

48. This means that companies have to define their particular risk profile and develop and implement tailor-made compliance systems to keep out of trouble. M. Pieth and R. Ivory (2011), Corporate Criminal Liability, Emergence, Convergence, and Risk, Dordrecht et al., 50 et seq., 393 et seq.

49. A Resource Guide to the U.S. Foreign Corrupt Practices Act, 14 November 2012; UK Bribery Act 2010, Guidance about procedures which relevant commercial organisations can put into place to prevent persons associated with them from bribing (section 9 of the Bribery Act 2010).

50. In detail: OECD Model Tax Convention on Income and on Capital, 15 July 2014, Commentary on Article 26, C(26)-9 et seq.

51. <http://www.oecd.org/ctp/policy-brief-beps-2015.pdf>.

52. The European Commission website states: »The public version of this decision [SA38373] is not yet available. It will be displayed as soon as it has been cleansed of any confidential information.« http://ec.europa.eu/competition/elojade/iseff/index.cfm?fuseaction=dsp_result&policy_area_id=3&case_number=38373. For a broader discussion of tax avoidance by multinationals, see the Independent Commission for the Reform of International Corporate Taxation (2015).

By 2000, the FHTP had identified 47 potentially harmful regimes within OECD countries as well as 35 tax haven jurisdictions, but within six years, all but one were taken off and the Global Forum took over the black-listing work. Following the 2009 London Summit of the G20, at which G20 Leaders pledged »to take action against non-cooperative jurisdictions, including tax havens«⁵³ the Global Forum was re-structured with an independent secretariat to monitor the implementation of standards on tax transparency and exchange of information through peer-review mechanisms, country reports, and compliance ratings. The FHTP remained within the OECD and was restricted to address only preferential tax laws and development defensive measures against them.⁵⁴

Around the same time, in 2010, the United States enacted the *Foreign Account Tax Compliance Act* (FATCA)⁵⁵ on a unilateral basis. Under FATCA, foreign financial institutions are obliged to report basic information (name, address, taxpayer identification number, etc.) on accounts held by U.S. taxpayers or by foreign entities owned by U.S. taxpayers to the U.S. Internal Revenue Service, otherwise, account holders are subject to a 30 percent withholding tax penalty (imposed by the foreign financial institutions as stipulated by the FATCA country agreements) on all payments from these foreign accounts.⁵⁶ As of this writing 113 countries have entered into bilateral intergovernmental agreements with the U.S. under FATCA; some provide for reciprocal reporting and some do not.

Although the Convention on Mutual Administrative Assistance in Tax Matters (CMAATM) was first developed by the OECD and Council of Europe in 1988, at the request of the G20, the Convention was amended by Protocol in 2011 to allow for participation by all countries. Two years later, the G20 mandated the OECD to

develop a so-called common reporting standard (CRS) for the automatic exchange of tax information, called the *Common Standard on Reporting and Due Diligence for Financial Account Information* and by 2015, the OECD published the CRS Implementation Handbook.⁵⁷ Although over 85 countries have signed the Multilateral Competent Authority Agreement implementing the CRS (MCAA), the United States has not.⁵⁸

Under the CRS, each reporting financial institution (defined as custodial institutions,⁵⁹ depository institutions,⁶⁰ investment entities,⁶¹ and specified insurance companies⁶²) should provide the following account information:⁶³

- in the case of individuals as account holders: name, address, jurisdiction(s) of residence, Taxpayer Identification Number(s) (TIN), and date and place of birth;
- in the case of entities as account holders: name, address, jurisdiction(s) of residence and TIN(s) of the entity as well as the name, address, jurisdiction(s) of residence, TIN(s), and date and place of birth of the controlling persons;
- account number;
- name and identifying number (if any) of the reporting financial institution;
- account balance or value.

It must be noted that even though the CMAATM, as well as the CRS MCAA implementing the Convention, are multilateral instruments, the actual exchange of information is still activated and conducted bilaterally between the competent authorities of the signatory countries, which commit to confidentiality, speciality,⁶⁴ and reciprocity⁶⁵

53. G20 (2009).

54. OECD (2015).

55. Public Law No. 111-147, 124 Stat.71.

56. Under FATCA agreements, a »participating« FFI has to: »(1) undertake certain identification and due diligence procedures with respect to its accountholders; (2) report annually to the IRS on its accountholders who are U.S. persons or foreign entities with substantial U.S. ownership; and (3) withhold and pay over to the IRS 30-percent of any payments of U.S. source income, as well as gross proceeds from the sale of securities that generate U.S. source income, made to (a) non-participating FFIs, (b) individual account holders failing to provide sufficient information to determine whether or not they are a U.S. person, or (c) foreign entity accountholders failing to provide sufficient information about the identity of its substantial U.S. owners.« IRS, Summary of Key FATCA Provisions, available at <https://www.irs.gov/businesses/corporations/summary-of-key-fatca-provisions>.

57. OECD (2015).

58. See OECD, Automatic Exchange Portal, available at <http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/>.

59. An entity that holds, as a substantial part of its business, financial assets for the account of others.

60. An entity that accepts deposits in the ordinary course of a banking or similar business.

61. An entity that primarily conducts as a business certain activities (trading in money market instruments, portfolio management, financial asset investment and trading) on behalf of other persons.

62. An insurance company that issues a cash value insurance contract or an annuity contract.

63. An account is treated as reportable if it is identified as such pursuant to due diligence procedures that distinguish between preexisting individual accounts of lower and of high value accounts; new individual accounts; preexisting entity accounts; and new entity accounts.

64. I.e., the exchanged information may only be used for tax purposes unless the submitting state explicitly agrees to a different use.

65. I.e., states can only ask for assistance with regard to taxes and in those forms for which they are themselves ready to give assistance.

and file respective notifications through the OECD, which functions as the depository of the information.⁶⁶

In recognition that certain measures of coercion may be needed, the G20 Finance Ministers have further requested the OECD to prepare a blacklist of non-cooperative jurisdictions by the July 2017 G20 Summit, at which point, »defensive measures will be considered.«⁶⁷ In order to be classified cooperative, the OECD has stated that countries, particularly those classified as financial centers, must meet at least two of the three following requirements: a rating of »largely compliant« by the Global Forum; a commitment to *automatic* exchange of information under the common reporting standard by 2018; and participation in the CMAATM or a sufficient bilateral network of information exchange (while the United States has not signed the multilateral agreement, it has a large set intergovernmental agreements under FATCA).

b) Country by Country Reporting

In addition to the movement toward automatic exchange of tax information, the G20 mandated the OECD to lead on reform efforts to »realign taxation with economic substance and value creation« and tackle base erosion and profit-shifting (BEPS). In February 2013, the OECD published the report *Addressing Base Erosion and Profit Shifting* and a few months later developed an *Action Plan on Base Erosion and Profit Shifting*. In just two years, the OECD presented the final BEPS package to the G20 Finance Ministers with detailed reports on each of the 15 Actions and recommendations for coordinated reform of the international tax rules. The BEPS Project achieved consensus on four minimum standards which were endorsed by the G20: model provisions to prevent tax treaty abuse; standardized Country-by-Country Reporting (CbCR); a re-launching of the FHTP peer review process to address harmful tax practices; and an agreement to secure progress on tax dispute resolution through the so-called mutual agreement procedure.

Country-by-country reporting (CbCR) requires countries to automatically exchange tax information on revenues, profits, taxes due/paid, employees, and assets of each entity. In order to implement CbCR, the OECD has devel-

oped the *Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports* (CbC MCAA) as well as a standardized electronic format (CbC XML schema) for the exchange of CbC Reports between jurisdictions. As of this writing, there are 49 signatories to this agreement. The United States has not yet signed; it has yet to enact legislation requiring country-by-country reporting.⁶⁸

BEPS »Associate status« in the OECD's Committee on Fiscal Affairs is being offered to all interested countries willing to commit to both the BEPS standards and BEPS implementation peer review. The »Inclusive Framework« approach will extend the BEPS reform measures on a global basis: Peer reviews on the four minimum standards, including CbCR, will take place by and of the members of the Inclusive Framework, and »relevant jurisdictions« will also be peer reviewed regardless of their involvement in the framework .

The Independent Commission on Reform of International Corporate Taxation (ICRICT), a group of influential economists and development leaders, issued a brief welcoming the BEPS work, but argued that its reform agenda, including the CbCR standards, does not go far enough, and specifically that the CbCR reporting threshold should include all companies (not just those with over 750 million euros in revenues) and that this information should be accessible to the public. The ICRICT recommendations have received strong support across the international community and while regulatory requirements are only just emerging, some proposals for national CbCR laws have required public reporting.⁶⁹

IV. Recommendations

As the previous Section has illustrated, global tolerance for secrecy is rapidly diminishing. The international community has been engaged in an extensive cost-benefit discussion, and whatever the benefits, they are over-

66. OECD (2014).

67. G20 (2016).

68. A newly introduced bill, the Corporate Transparency and Accountability Act of 2016, would require publicly-traded multinationals to disclose information on revenues, profits, taxes, and operations on a country-by-country basis in their reporting to the Securities and Exchange Commission. See H.R. 6126 of 22 September 2016. The bill has now received widespread support, including from the financial industry, but continues to be strongly opposed by the U.S. Chamber of Commerce. See Dougherty (2016); Pearl (2016).

69. L.225-102-4 du code de commerce, France.

shadowed by the costs. In the early days of the fight against secrecy, attention was focused on banks and the financial sector more broadly. But the Panama Papers illustrated that if we are to address the problems posed by secrecy-havens, we have to do something about the underlying institutional arrangements that facilitate a lack of transparency, as well as the complex web of corporate structures and those that help create and maintain them. Governments are being held accountable to adopt and enforce regulations that prevent opacity; and countries whose governments fail to do so should and will face serious consequences.

If the country itself will not enforce transparency regulations, then the international community should step in to fill the void. And it should do so in a way that encourages other secrecy-havens to undertake tough enforcement. Doing something about any particular site will have limited benefits, unless action is taken against all of the sites.

This world has changed in the last quarter century. Not only has globalization proceeded apace, so has the darker side of globalization—facilitated by secrecy-havens. And as this has occurred, the global community has rightly recognized this as a disease that has to be attacked globally. Politicians in secrecy-havens may have insufficient incentives for tough enforcement, as those within their countries who benefit from secrecy often have undue political influence. Fortunately, politicians within much of the rest of the global community have strong incentives to ensure strict enforcement as it is they, their citizens, and their treasuries, which suffer from the illicit activities that flourish under secrecy.

As economic leaders, the United States and Europe have an obligation to force financial centers to comply with global transparency standards. That they have the instruments to do so has been forcefully shown in the fight against terrorism. That they do not do so in the fight against corruption and tax avoidance and evasion is testimony to the power of the interests of those who benefit from secrecy.

While countries like the United Kingdom and the United States preach about the vices of the offshore centers, within their own borders there are pockets of secrecy where these bad practices continue. But with the overall societal costs so transparently large, there is a growing

demand among the public to end this state of affairs. Therefore, U.S. and European regulators should treat secrecy-havens like the carriers of a dangerous disease. If left unchecked, it can spread like a virulent virus. We know what to do with dangerous contagious diseases: quarantine. And so too for the secrecy-havens: they should be cut off from the global financial and economic system and we have the necessary means at hand:

- We can declare it illegal for any citizen of the »cooperative« countries to have an account in a non-cooperative jurisdiction.
- We can declare it illegal for an individual or a corporation in a cooperative country to be a shareholder, director, or trustee of any trust, corporation, or foundation in a non-cooperative country.
- We can declare it illegal for any bank to have any correspondence relationship or to interact in any way with any financial institution in a non-cooperative jurisdiction.

And the punishment for the violation of these laws should be severe. A bank or other financial institution violating these principles should lose its license to operate; a lawyer or other professional service provider violating these principles should lose their license to practice; a publicly created entity failing to report its tax and beneficial ownership information annually should be de-listed. The fact is that there is an ample supply of good actors; the international community does not need to encourage the bad actors.

Much is at stake: if we cannot show our citizens that globalization can be tempered, that it can be tamed for the benefit of the vast majority, there will be a backlash. And the first order of business in taming globalization is to make sure that the secrecy-havens are shut down. If we cannot do that, how can we expect our citizens to believe that we are able—or willing—to temper globalization.

Most of the recommendations laid out below are aimed at the international community. But there is also one overriding recommendation aimed at the secrecy-havens: Rules and regulations that might have been unthinkable twenty-five years ago are now viewed as just the beginning. It is vital for all countries, and especially small countries with significant financial centers, to stay ahead of the curve by creating a business model for long

term sustainable growth. They cannot continue with a business model based on taking advantage of gaps in global legal and regulatory standards. They cannot continue with a business model attempting to engage in »transparency arbitrage.« The consequences of being cut off from the benefits of globalization, especially in the financial sector, would be devastating for these countries.

Countries should position themselves proactively—not just complying with current minimal standards, but placing their economic development model at the cutting edge of the evolution of those standards. Each country must seriously consider whether it wants to be engaged in a never-ending struggle to catch up to the evolving international standards, or serve as a model, setting standards that others will eventually be forced to emulate. Better today to seek an economy suited to the realities of tomorrow.

This section is divided into two parts: the first lays out a set of broad principles, which are described in greater detail in the second. We need to emphasize, however, that it is not the intention of this Report to present concrete legislative proposals, but rather to show the magnitude of the task before the international community, and to argue that the international community needs to take a *comprehensive* approach, going well beyond those embodied in standard practices today.

1) Principles

1. Secrecy has to be attacked globally—offshore and onshore. There can be no places to hide.
2. The collection and exchange of information related to taxation, ownership, and illicit activities is a shared global responsibility.
3. While the traditional gatekeepers of this information are financial institutions, addressing secrecy effectively will mean tackling the entire industry that facilitates secrecy—including the legal firms that have played a pivotal role in the creation of the web of corporations.
4. Knowledge of beneficial ownership of companies and bank accounts is fundamental, both to ensure taxation and also to prevent and prosecute crime.
5. Tax preferences are a privilege and not a right. Tax free zones provide opportunities for money laundering, and those operating in such zones should be held to a high standard.
6. Corporations, trusts, and foundations are creations of the state—and as such, they have no inalienable rights. They are created to facilitate societal welfare, and to ensure that they do so, they need to be globally regulated—regulated in ways which ensure full knowledge of beneficial ownership and full compliance with all tax laws.
7. Complexity contributes to lack of transparency. Those seeking secrecy understand this, and create complex webs of corporations and trusts, to make it more difficult for enforcement agencies to trace flows of illicit funds and to identify the true beneficiaries of illicit activities. This has two implications: (a) The international community should do what it can to impede the creation and maintenance of these complex webs; and (b) to effectively fight for transparency—to detect true beneficial ownership—requires resources beyond those available to enforcement agencies.
8. Transparency is a global public good, requiring global efforts. To facilitate these efforts, every country must maintain publicly searchable registries of the beneficial owners of each corporation, trust, foundation, or other entity.
9. Financial centers (both onshore and offshore) are creations of globalization—and should not be allowed to engage in regulatory and tax arbitrage. Doing so undermines the positive effects of globalization. If secrecy-havens serve as centers for tax avoidance and evasion or in any way facilitate corruption or illicit activities, they are acting as parasites, and should be cut off from the global financial community.
10. What matters is not just passing laws and regulations, but enforcement. There is urgency: even if the »first best« framework cannot be immediately achieved, there are intermediate steps that can and should be taken. Throughout this Report, we have come down solidly on the side of »tough« sanctions, simply because there are many strong incentives for laxity. Those who benefit from secrecy and lax en-

forcement of the regulations designed to promote transparency will put pressure on governments not to enforce these regulations. The pressure is asymmetric: though societal benefits from transparency may be huge, there is no natural lobby group for transparency, and especially no lobby group with the resources of those lobbying for lax enforcement.

The following recommendations are offered against this backdrop.

2) Recommendations

a) Inclusive International Cooperation on Standard Setting and Implementation

All countries, and especially developing ones, should participate in all relevant multilateral fora where international tax and transparency norms are set and in doing so, should be active advocates of high standards and demonstrate a willingness to adopt higher standards of transparency and to work to see that they are uniformly applied. And these fora should be open to all countries. Even exclusive governing bodies, such as the G20, are coming to understand that they can no longer legitimately exclude developing countries. The pressure to continue this process should remain strong until all stakeholders have an equal vote in decision-making processes as well as equal representation in the bureaucracies which support these fora. Developing countries, in particular, should insert themselves as equal participants in these discussions, and fight for inclusion in not only implementation and enforcement, but also standard-setting. All opportunities for multilateral engagement should be leveraged to build resources and collectively negotiate standards which reflect their national and development priorities—but those development strategies should not be based on tax and regulatory arbitrage.

b) Identification of Beneficial Owners and Public Registries

As indicated above, identifying beneficial owners of accounts and of corporations is key both to enabling automatic information exchange and to preventing money laundering. Creating searchable registers is already the common standard under the FATF Recommendations

and the CRS, even if the detail needs further work in international fora. It is crucial, in our view, however, to progress to publicly searchable registries.

Key to stopping illicit activities is tracing money flows—and as we have noted in Section II, one of the reasons that those engaged in illicit activities create complex webs of corporations and trusts is precisely to block the tracing of money flows. If one knew where the money that was stolen by some dictator was hidden away, one could potentially recover it, and hold accountable those who facilitated the corruption. And reducing the returns to illicit activities will almost surely reduce the extent of such illicit activity.

National governments should establish registries of the names of directors, registered agents, and beneficial owners for all entities incorporated in the country and for all trusts and foundations established within the country. Those taking advantage of the web of corporations to hide illicit activities know that both the resources of enforcement agencies and their commitment to full transparency are limited. Whether government agencies could have processed the mass of information involved in either LuxLeaks or Panama Papers may be debated. Clearly, when they have wanted to, intelligence agencies have processed much larger amounts of data. What is clear is that they have not chosen to do so, or if they have, they have not made the findings public, perhaps because of the embarrassment to government and establishment figures around the world. Open registers allow civil society and media to participate in verifying the adequacy of the information given. Therefore the ultimate goal on identification of beneficial ownership should be to establish meaningful public registers of corporate entities naming the beneficiaries (at least above a certain threshold).

c) Automatic Exchange of Tax Information

Country-by-country tax information involving registries of beneficial owners should be the basis of the automatic exchange of information between tax authorities and other relevant government regulatory and enforcement authorities. The current international agreement implementing this exchange is the *Multilateral Convention on Mutual Administrative Assistance in Tax Matters* and agreements under Article 6 of that Convention.

All countries should play an active role in implementing these agreements in domestic law and strengthening domestic institutions for enforcement. Developed countries should play a supporting capacity building role and begin by sharing information on a non-reciprocal basis with developing countries involved in programs to strengthen their capacity to receive, interpret, and safeguard such information.

On the other hand, it is not the duty of any country to determine a foreigner's home income tax obligations. Each country should be responsible for monitoring economic activities that occur within their jurisdiction. If country A cannot tell what economic activity has occurred within its own boundaries, why should we expect any other country to be able to do so? Of course, to ascertain the full import of cross-border activities (e.g. a company in country A may claim to be paying interest to someone in country B) may require cooperation with other countries. And it may be important for country A to know who the beneficial owners of some company or trust in country B are—they may in fact be citizens or residents of country A—and, country B should be able (and obligated) to provide the information to the home country.

d) Information Gathering, Disclosure, and Verification

Information can only be exchanged if it is collected. Failure to collect such information at the domestic level is unacceptable. Here are some of the ways that secrecy havens can improve their information gathering capacities and performance:

In order to penetrate the web of corporations, trusts, and foundations, one decisive step could be to clean out the web, eliminating zombie entities. To do this, corporations and other legal entities, such as trusts, foundations, etc., should pay a fee and file a report on an annual basis. In addition to the benefits of information collection and risk assessment, annual reports and fees reduce the number of »dead« corporations, which can be used as distraction in investigations.⁷⁰ The annual report should include identities of beneficial owners, in

70. By the same token, any trust or foundation should be required to be registered, with a declaration of the beneficial owner(s) and beneficiaries of the trust or foundation and those having effective control.

addition to contingent or potential beneficiaries.⁷¹ The annual report should state all jurisdictions in which the entity has carried on economic activities over the past year, and include the tax returns filed with each jurisdiction in which it has operated. If it has operated but filed no tax return in a particular jurisdiction, it should file an affidavit that it is not subject to taxation in that jurisdiction.

In its annual filing, any corporation, trust, or foundation incorporated in the country should be required to disclose the location of its economic activities; its assets, employees and profits within each jurisdiction in which it operates as well as the taxes it pays in that jurisdiction. Tax returns should be signed off by a senior corporate/foundation officer or settler of a trust⁷² as well as an external certified public accountant attesting to the accuracy of the tax filing. In addition, the annual report should have a signed affidavit from the directors listing the beneficial owners. In the case of trusts, the trustees and settlers should sign an affidavit listing the beneficiaries, including contingent and potential ones. In all cases, there should be certification that they have *personal* knowledge of the ultimate beneficial owners/beneficiaries.⁷³

e) Supervision of Intermediaries

In addition to supervision of banks and business entities, a state must also adequately supervise intermediary service providers, such as the legal industry. We have already noted one basic obligation of a lawyer or any licensed agent registering a corporation or other business entity: to attest to personal knowledge of the ultimate beneficial owners. In addition, the lawyer should have a positive obligation to ensure that there is a genuine

71. For instance, in some trusts, the beneficiary is A, but if A dies, then B becomes the beneficiary. Trustees, settlers and all other relevant persons referred to in the trust documents should also be identified.

72. A settler of a trust is the person who settles or donates property under the trust to another person, called a beneficiary.

73. The annual report should also state whether there has been any change in the activities in which the entity has been engaged in, or any change in directors, nominees, or other relevant individuals with an affidavit that the change has been conducted according to the by-laws of the entity, and that the new directors or nominees are fully aware of the natural person(s) who are ultimate beneficiaries. Additionally if there have been any change in the beneficiaries or trustees of a trust, those changes should be reported along with any payments made in respect to those changes, and include a certification that all taxes on such transfers have been duly paid.

economic motive for the existence of the company, and should be required to state that purpose, along with the intended location of the planned economic activity in the filing of incorporation. It will be noted that lawyers acting as financial intermediaries, fiduciaries, and company incorporators outside the traditional field of legal work do not—according to international standards—enjoy legal privilege. Any lawyer, registered agent, or other actor who knowingly registers a corporation or trust whose primary purpose is to evade or avoid taxes or to engage in money laundering should be subject to suspension, and in the case of multiple offenses, revocation of his/her license to practice law. Registered agents not complying with tax and financial information reporting provisions above should also be subject to adequate sanctions.

f) Real Estate Transactions

Real estate has provided a convenient way for facilitating secrecy and money laundering. Recent news coverage of cash purchases of luxury apartments in New York City and London suggests that perhaps a majority are owned by entities in secrecy-havens.⁷⁴ The United States has belatedly responded by requiring disclosure of beneficial ownership for real estate cash transactions in certain locations.⁷⁵ Such disclosure should be made mandatory—and enforced—for all large real estate cash transactions, and the countries in which the corporations, trusts, etc. are incorporated should require filing of all real estate related cash transactions. In addition, the Criminal Finances Bill recently introduced in the UK House of Commons introduces the concept of »unexplained wealth orders.« These orders will allow agencies tracking financial transactions to force the owner of an asset to explain how they obtained the funds to purchase it. Unexplained wealth orders would also help reveal the owners of real estate.⁷⁶ This two-sided approach may succeed in making headway against the use of real estate for money laundering and other illicit activities.

74. See Story (2016). Land Registry figures show UK real estate worth more than 170 billion pounds is held by more than 30,000 tax haven companies. See Garside (2016).

75. See U.S. Department of the Treasury (2016).

76. See U.K. Parliament, Parliament Business, Criminal Finances Bill 2016–17, available at <http://services.parliament.uk/bills/2016-17/criminal-finances.html>.

The FATF toughened up AML standards regarding cash transactions in 2012. Regarding taxation, it should be the obligation of any lawyer, real estate agent, or broker to report all cash purchases of real estate to tax authorities, listing the amount of the purchase and the name of the beneficial owners of the purchasing entity. Of course, most countries have (or should have) national property registries, with registration required to enforce property rights. Full and public disclosure of the beneficial owners should be a condition for registering ownership.

We have already discussed the obligations imposed on lawyers conducting these and similar transactions. Similarly, any systematic pattern of violations within a legal or brokerage firm should be punished by suspension or permanent revocation of the license of all the lawyers and/or agents within these firms. It is the responsibility of all professionals within the firm to ensure that partners and associates and/or brokers and agents are not engaged in such activities. Again, the resources available to the government for monitoring are limited. Partners can be an important part of the monitoring process.

g) Responsibilities of Corporate Fiduciaries

Today, a single agent may »represent« hundreds if not thousands of corporations. In many countries, there are no limits to the number of boards of directors in which a person may participate, and it may be common for the members of the board of directors to have no real connection to or with the operations or ownership of the company. Therefore, it would not be unusual to find janitors, secretaries, or drivers of a law firm listed as members of the board of directors of a company served by the same law firm which employs them. It should be obvious that it is almost impossible for any single agent—and especially one without adequate support staff—to fulfill his or her responsibilities, assuming of course the entity is a *real* entity.

Thus, nominee directors, or even officers, should only be allowed to serve on a limited number of boards or management positions, as it is impossible to adequately fulfill fiduciary obligations to a multitude of interests. Performance of duties of care and loyalty implicated in fiduciary relationships undertaken by directors, officers, and managers becomes inadequate when engagement is unduly limited.

h) Institutional Capacity, Implementation, and Enforcement

Another foundational requirement concerns institutional capacity. All regulatory institutions which administer the exchange of information and supervise financial institutions and associated service providers (accountants, registered agents, attorneys, etc.) must have suitable personnel meeting the highest professional standards, and must also have adequate independence and budgetary resources to carry out their duties. And it is especially important to ensure that there are no conflicts of interests affecting government employees and public officials tasked with oversight.⁷⁷

Some secrecy-havens have responded to the demand for more transparency by merely passing laws, which are modeled after other seemingly respectable jurisdictions. Yet, some of these jurisdictions, even if they are »onshore,« are themselves secrecy-havens. The thrust of this report is that we have to curb secrecy-havens, whether they are on- or offshore, and it is not a defense to say that the legal framework is no worse than that of other jurisdictions. Furthermore, one should always be careful about »legal transplants.« Even similar laws can have quite different consequences under different legal systems. Finally, and perhaps most importantly, what matters is not just *passing* laws, but enforcing them.

Modelling one country's laws after another is not sufficient by itself, but must be complemented by a strong and impartial judiciary and regulatory institutions to administer and enforce the law. Such laws must also fit within the context of the country's legal system as a whole, as other laws may be needed to complement or support laws enacted to promote transparency—and other laws may have to be repealed. Further, the impact and interaction of laws should be monitored to determine necessary amendments. For instance, in some countries it is illegal to disclose information that is supposed to be secret—even if that disclosure itself would enable the enforcement of anti-corruption laws.

77. Such conflicts of interest may be reduced through the following disclosures before hiring/elections: (1) Disclosure of beneficial owner of any entity, foreign or domestic, especially non-transparent companies, trusts, and/or foundations; (2) Disclosure of any financial support and/or campaign contribution from any participant in the financial services sector; (3) Disclosure of previous professional employment and/or board membership of the industries being regulated.

There is also the need to address circumvention of the intent of regulations, and anti-abuse provisions in legislation can go a long way in providing the means for regulatory authorities to circumscribe such circumvention. For example, attestation clauses and »know your client« obligations must require direct and personal knowledge.⁷⁸

i) Whistleblower Protection

Finally, all countries should have strong whistleblower protections for public and private employees in regulated sectors.⁷⁹ Instead of being protected, however, whistleblowers are often prosecuted: former PwC employee Antoine Deltoure is now appealing a one-year prison sentence and a 1,500 euros fine for leaking secret tax rulings made by Luxembourg, which enabled over 340 companies to set up complex company structures to avoid corporate income tax globally. Whistleblowers have not only exposed massive tax avoidance by respected global corporations, but have also exposed the identities of individual owners of hundreds of thousands of shell companies, foundations, and trusts set up through thousands of intermediaries all over the world to evade taxes, launder money, and hide wealth. »If You See Something, Say Something« should not just be reserved for public security, but should apply to all cases of secrecy where the public interest is at stake.

j) Freedom of Information Act

A strong Freedom of Information Act (FOIA) is at the heart of transparency and citizen engagement. The gatekeeper of enforcement is the judiciary, and judges possess the power to block or inordinately delay release of information, or authorize heavy redaction. Therefore, FOIA legislation should include clear criteria for release of information with limited and time-bound judicial discretion.

k) Review Processes

The global economy is dynamic and evolving, as are global standards. The private sector is innovative in creating new ways to obfuscate and prevent transparency.

78. See, e.g., US Bank Secrecy Act, 31 U.S.C. 1051 et seq. and regulations under 31 C.F.R. 1020.220, 1023.220, 1024.220, and 1026.220.

79. See Wolfe, et al. (2014).

Therefore constant monitoring of the implementation of international and domestic standards is crucial. This can be done in different ways.

According to one approach, a government may establish an Independent Standards Review Commission to review both legislation and enforcement, to ascertain whether there are gaps between country practices and global best practices and norms. Membership should be structured to avoid potential conflicts of interest and, to assure independence from local pressure groups, should be comprised of a mix of in-country and out-of-country experts. An annual public report should identify gaps between international standards and current legislation, and gaps between what the international standards are likely to be in the coming years and current legislation. In the area of enforcement, the Commission should review the structure, resources, and performance of all relevant regulatory bodies.

The Standards Review Commission should also be complemented by an Independent Resources Review Commission, again composed of a mix of in-country and out-of-country experts, vetted for conflicts of interest. The Independent Resources Commission should provide an annual public assessment of gaps in skills and other resources impeding effective regulation, supervision, and enforcement, with a particular focus on institutions of higher education training professionals in legal, accounting, and auditing affairs; and propose a timeline of actions to address and remedy these resource deficiencies.

Country reviews by international organizations could also be intensified with input by NGOs and academia worldwide.

1) Tax Preferences

As discussed in Part II of this Report, tax preferences, in the form of exemptions and incentives targeted to attract foreign investment, not only bring limited benefits in terms of promotion of long term sustainable growth, they also place domestic firms at a competitive disadvantage. More perniciously, tax preferences also combine with secrecy to enable and encourage tax avoidance and evasion on a massive scale, and in many instances play a role in attracting money laundering operations. Tax exemptions and incentives on profits from activities within special economic zones should be subject to tight

scrutiny, establishing whether the profits booked within those zones are commensurate with the level of actual economic activities that have occurred, as indicated by employment and capital.

Furthermore, companies receiving tax exemptions and incentives should receive them only where they are not used to shift recorded profits from other jurisdictions: the incentive to claim that profits have been earned in a low tax jurisdiction, even when they have not, is too tempting for many firms to resist. Any firm that has been found to have engaged in systematic profit shifting (whether associated with money laundering or not) should lose the benefits of its tax preference, and such loss of tax preference should be extended to any firm, trust, or foundation with substantial overlap of beneficial ownership or directorship. Additionally, no tax preferences should be extended to any firm whose beneficial owner has been associated with money laundering or previously convicted of tax evasion.

In this regard, an Independent Tax Review Commission should evaluate whether the social and economic benefits of tax preferences (for example, in terms of job creation and indirect tax revenues generated through the activities stimulated) are worth the costs (for example, through diversion of domestic economic activity; the associated loss of tax revenues; and exposure of the country to the risks of association with tax avoidance, evasion, and money laundering). This Review Commission should publish all tax preferences as budget expenditures in an annual public report along with the social and economic benefits from such preferences.

3) Exceptions

As we engaged in discussions with those in secrecy-havens over the costs and benefits of secrecy, the defences of personal security, the individual's right of privacy, and commercial confidentiality protections were repeatedly asserted. First of all, these concerns have been exaggerated and there are means by which these »exceptions« can be handled.

In regard to personal security, one of the arguments put forward is that lifting secrecy will divulge details concerning wealth, making individuals prey to kidnapping. But an individual's lifestyle is a far more significant signal

concerning their wealth: living in a multimillion dollar home signals that an individual is very well off.

Moreover, an individual's right to privacy is not absolute and must defer when basic human rights are compromised by a global secrecy network that enables human trafficking, government corruption, and the financing of terrorism. Indeed, in some cases, secrecy has itself undermined national security.⁸⁰

In regard to commercial privacy, corporations may argue that such transparency violates their basic rights, but as mentioned in Principle #6, corporations have no inalienable rights. They are not automatically endowed with human rights as individuals are. Corporations are creations of the state, and as such, the state has the right to endow them with whatever rights and responsibilities it believes serves societal interests, such as limited liability, patent protections, etc., and in each case, there is a cost benefit analysis.

It is also important to note that none of the arguments for secrecy hold up in the case of disclosure to regulatory and law enforcement authorities. One of the specious arguments put forward is that disclosure to certain governments will lead to leakage; but a condition for the automatic exchange of information is that the agencies with whom the information is being exchanged have the capacity to keep the information confidential.

Finally, the global community has the right to impose restrictions on any country seeking to participate in the benefits of financial globalization—if what they do has adverse effects on other countries. Secrecy imposes harm on the entire global community. Thus, each country, and the global community, has both the right and the obligation to curtail secrecy. The recommendations in this section, and elsewhere in this report, are all made with these perspectives in mind.

V. What Is at Stake in the Fight Against Secrecy?

This Report has discussed why secrecy has such an adverse effect and what can be done to shut down tax and secrecy-havens around the world. In these concluding remarks, we seek to put this Report into a broader


perspective of the ongoing debate about globalization. There is obviously a great deal of discontent with globalization, not only in developing countries, but also increasingly in developed ones. It has become increasingly clear that while there may have been benefits to economic growth from globalization, at least in many countries, distributive effects have outweighed growth effects for large segments of the population: there are many individuals who see themselves not just relatively worse off, but absolutely so.

While the benefits of globalization have been multi-faceted, including moving more than half a billion people out of poverty during the past half century and the global spread of ideas and values such as human rights, it is also clear that globalization has had its darker side: just as good things move more easily across borders, so do bad things—like terrorism. Additionally, globalization has not only contributed to the growth of inequality, it has actually impaired the ability of governments to address it: those who seek to avoid declaring ownership or paying their fair share of taxes can more easily move to some jurisdiction to hide their wealth or avoid taxation.

This Report and reports by the Independent Commission on the Reform of International Corporate Taxation (ICRICT) have highlighted two of the more unsavoury aspects of globalization. The ICRICT Declaration showed how transfer pricing in the existing corporate tax system provides an easy framework within which multinationals can avoid taxation, and fuels a race to the bottom as different countries compete to attract business not in a positive and healthy way—by, for instance, providing a more educated labour force, better infrastructure, or a superior legal framework—but rather by lowering taxes.

Unfortunately, irresponsible governments have shown a willingness to avail themselves of this framework; countries like Ireland showed that for a pittance—a small increase in incorporation fees and a few jobs—they were willing to rob their so-called EU partners of billions of euros in tax revenues. Many Irish citizens found the stance of their government morally repugnant and many of Apple's shareholders rightly understand that the most important aspect of corporate responsibility is paying your fair share of taxes. While there may be disagreements about what that fair share is, Apple's effective tax rate of 0.005 percent crossed the moral boundary.

80. See *supra* note 7.



This Report focuses on something even more corrosive of the global community: the secrecy-havens, which provide ample opportunity not just for facilitating tax avoidance and evasion, but also money laundering—thus facilitating all manner of corruption and socially destructive and morally repugnant activities.

These negative impacts of globalization qualitatively differ from other oft-criticized aspects, like trade and financial globalization: there is no benefit to offset the immense social costs. In a global community, the secrecy-havens have provided a place for bad actors to hide both their illegal activity and their money from detection. Of course, we know that these activities are going on. But if we are to stop them, we have to know who is doing what, and we have to take away the huge financial incentives for those engaging in them. The secrecy-havens enable criminals to enjoy the fruits of their bad behaviour and thus, continue all the more. And the secrecy-havens make it virtually impossible to penetrate the web of bad actors. When we find out who is the owner of a bank account into which illicit funds have been deposited, it turns out to be a company incorporated in another secrecy haven, and law enforcement and investigative journalists alike face a dead end.

A major lesson emerges: in our global economy, transparency is only as strong as the weakest link—as the least transparent member of the global community. There are two major implications: Secrecy has to be tackled *globally* and there has to be *zero tolerance* for any deviation from the established global norms.



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