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ON THE USE AND ABUSE OF STANDARDS FOR LAW: GLOBAL GOVERNANCE AND OFFSHORE FINANCIAL CENTERS*

RICHARD K. GORDON**

Current trends in international legal scholarship have shifted from a paradigm of state actors working within recognized sources of international law to one that includes networks of domestic regulators that develop and implement best practices or standards on a global basis. The new paradigm can be seen in operation in the efforts by onshore jurisdictions (most of which are financial centers themselves) to restrict the activities of offshore financial centers. Onshore jurisdictions enlisted these regulatory networks, as well as key international organizations, such as the Organisation for Economic Co-operation and Development and the International Monetary Fund, to advance new standards for income taxation, prudential regulation, and money laundering in offshore centers. By 2005, offshore centers' compliance with financial, regulatory, and money laundering standards was largely complete, while there was less success with income tax standards. The current financial crisis, however, has spurred renewed efforts, particularly with respect to the latter. An analysis of this experience suggests that the new paradigm should view regulatory networks in the context of a complex system of states and international organizations that possess the qualities of such regulatory networks. A system of global governance that includes both regulatory networks and these international organizations advances fairness and objectivity and, in

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particular, may protect weak states from the coercive power of the stronger.

Let us rather turn to a much-praised strength of the modern person, with the truly awkward question whether, on account of his well-known historical “Objectivity,” he has a right to call himself . . . just, and just to a higher degree than the people of other times. Is it true that this objectivity originates from a heightened need and demand for justice? Or does it . . . merely create the appearance that justice might be its real cause? Does this objectivity perhaps tempt one to a detrimental and too flattering bias . . . ?¹

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1. FRIEDRICH NIETZSCHE, ON THE USE AND ABUSE OF HISTORY FOR LIFE (Ian Johnston trans., May 2008) (1874), <http://records.viu.ca/~johnstoi/Nietzsche/history.htm>.

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INTRODUCTION

Nouriel Roubini, Professor of Economics and International Business at New York University, Kenneth Rogoff, Professor of Economics and Public Policy at Harvard University and former Chief Economist at the International Monetary Fund, and Nariman Behravesh, Chief Economist and Executive Vice President for IHS Global Insight, all agree that the current financial crisis is the worst since the Great Depression.² From the U.S. financial sector, collapse has spread throughout the developed world,³ though curiously, it has affected most of the developing world less.⁴ Governments⁵ and international financial institutions, such as the International Monetary Fund (“IMF” or “the Fund”),⁶ have called for a total review of how national regulatory structures apparently failed so spectacularly. Many have called for a significant overhaul of domestic supervisory systems,⁷ while some have called for the creation of transnational regulators.⁸ Yet, while it was the financial institutions and supervisory systems of the largest financial centers, such as the United States and the United Kingdom, that failed so spectacularly, the governments of these countries have tried to pin at least some of

2. David Pendery, *Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression*, REUTERS, Feb. 27, 2009, <http://www.reuters.com/article/pressRelease/idUS193520+27-Feb-2009+BW20090227>.

3. Deutsche Welle, *Chronology: Financial Crisis Spreads from US to World Markets* (Apr. 10, 2008), <http://www.dw-world.de/dw/article/0,2144,3689713,00.html>.

4. INT’L MONETARY FUND [IMF], *GLOBAL FINANCIAL STABILITY REPORT: NAVIGATING THE FINANCIAL CHALLENGES AHEAD*, at xi (2009), <http://www.imf.org/external/pubs/ft/gfsr/2009/02/pdf/text.pdf>.

5. Timothy Geithner & Lawrence Summers, Op-Ed., *A New Financial Foundation*, WASH. POST, June 15, 2009, at A15; GROUP OF TWENTY, *DECLARATION ON STRENGTHENING THE FINANCIAL SYSTEM* 1–5 (2009), http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf.

6. IMF, *THE RECENT FINANCIAL TURMOIL—INITIAL ASSESSMENT, POLICY LESSONS, AND IMPLICATIONS FOR FUND SURVEILLANCE* 12–14 (2008), <http://www.imf.org/external/np/pp/eng/2008/040908.pdf>.

7. *Id.*

8. Michael Knigge, *Nationalized Banks Are “Only Answer,” Economist Stiglitz Says*, DEUTSCHE WELLE, June 2, 2009, <http://www.dw-world.de/dw/article/0,4005355,00.html>; Patrick Wintour, *We Need International Regulation to Protect Global Economy, Brown Tells World Leaders*, GUARDIAN, Sept. 25, 2008, <http://www.guardian.co.uk/politics/2008/sep/25/gordonbrown.marketturmoil>.

the blame on an old whipping horse: offshore financial centers (“OFCs”).⁹

As absurd as this may sound—trying to shift blame to tiny jurisdictions—it has always been so, or at least from the early 1990s.¹⁰ Government authorities from the United States and a number of other developed countries focused on three financial areas where they claimed OFCs were acting dangerously: income taxation, prudential financial regulation, and anti-money laundering and terrorism financing. By and large, there was no generally accepted international law governing these issues. Rather, onshore jurisdictions looked to something other than law: generally accepted standards or best practices. It was an appeal to follow these standards, not law, that dominated the calls for change in offshore behavior. And while the implementation of coercive or “hard power”¹¹ of states played an essential role in changing the behavior of offshore jurisdictions, it was the “soft power” of persuasion, that the standards were in fact best practices, that may have played the most important role.

The struggle of these onshore jurisdictions to adhere to non-legal standards was an excellent example of the operation of what scholars have termed transnational regulatory networks (“TRNs”)—informal groups of domestic regulators that, over time, create

9. GROUP OF TWENTY, *supra* note 5, at 4–5. There are a number of different ways of defining what constitutes an offshore financial center. One is to use seven criteria: (1) a primary orientation of business toward nonresidents, (2) a favorable regulatory environment, (3) a low- or zero-taxation scheme, (4) a disproportion between the size of the financial sector and the domestic financing needs, (5) a disproportionate dealing in currencies that are not the currency of the jurisdiction where the center is located, (6) banking activity that is primarily *entrepôt* business, and (7) a separation from major regulatory states. Ahmed Zoromé, *Concept of Offshore Financial Centers: In Search of an Operational Definition* 6 (IMF, Working Paper No. 07/87, 2007), available at <http://www.imf.org/external/pubs/ft/wp/2007/wp0787.pdf>. Because this Article is concerned primarily with the Organisation for Economic Co-operation and Development’s (“OECD”) Harmful Tax Practices Project, the IMF’s Offshore Financial Center assessment project, and the Financial Action Task Force’s Non-Cooperating Countries and Territories Project, it will refer to the key traits and lists of jurisdictions used in those programs. See *infra* Appendix.

10. See *infra* Parts II.B.1, C.1.

11. “As defined by Joseph Nye, hard power is ‘command power that can be used to induce others to change their position.’ It works through both carrots and sticks, rewards and threats. Soft power, by contrast, flows from the ability to convince others they want what you want.” Anne-Marie Slaughter, *Sovereignty and Power in a Networked World Order*, 40 STAN. J. INT’L L. 283, 291 (2004) (quoting JOSEPH S. NYE, JR., *THE PARADOX OF AMERICAN POWER: WHY THE WORLD’S ONLY SUPERPOWER CAN’T GO IT ALONE* 9 (2002)) [hereinafter Slaughter, *Sovereignty and Power*]. “Nye first elaborated the concept of soft power in an earlier work.” *Id.* at 291 n.28 (citing JOSEPH S. NYE, JR., *BOUND TO LEAD: THE CHANGING NATURE OF AMERICAN POWER* 188–201 (1990)).

generally accepted regulatory standards.¹² By the middle of the first decade of the twenty-first century, onshore jurisdictions largely succeeded in securing compliance with financial regulatory and money laundering standards, but had less success with their initial goals with respect to income taxation.¹³ How this system developed, and the reasons for its successes and failures, may have much to teach as to how the new engagement with offshore centers should proceed.

In Part I, this Article begins by discussing the current state of legal theory concerning transnational regulatory networks. It then examines some of the problems with that theory, and suggests that, in addition to informal groups of domestic regulators, international organizations with TRN characteristics could play an important role in developing and applying standards or best practices. It contrasts these with organizations lacking key TRN characteristics. Part I proposes that these TRNs, along with states themselves, form a system that creates and applies standards. It suggests that the success or failure of these systems could depend on certain characteristics found in the TRNs and international organizations, characteristics that legitimize both the standard itself and the process by which adherence is assessed. The better the characteristics of a particular system's participants, the better the resulting standards and implementation of those standards.

Part II tests the hypotheses in Part I by analyzing how offshore centers, TRNs, international organizations with TRN characteristics, and onshore jurisdictions addressed the claims that offshore centers failed to comply with certain income tax, financial regulatory, and anti-money laundering standards. Part II.B analyzes how the failure to involve a TRN or international organization with key TRN characteristics hampered the efforts of onshore jurisdictions with respect to income tax. Particularly, it discusses how the absence of a broadly agreed upon income tax standard, and lack of an impartial compliance assessment process, reduced both the legitimacy and effectiveness of those efforts. It concludes by describing how a scaled-back effort adopting some TRN and quasi-TRN components has resulted in some success by onshore jurisdictions. Part II.C continues the analysis by examining how the participation of both a TRN and international organization with TRN characteristics advanced the efforts of onshore jurisdictions with respect to prudential regulation. It discusses how the presence of a broadly agreed upon standard and

12. See *infra* Part I.A.

13. See *infra* Parts II.B.2, C.2, and D.2.

an impartial compliance assessment process created both legitimacy and effectiveness, and how the process served to protect the interests of the offshore jurisdictions. Part II.D continues the analysis by looking at the role of another TRN and the same international organization with respect to money laundering, reaching similar conclusions based on analogous facts.

Part III.A reviews the conclusions of the previous Part and argues that countries, TRNs, and organizations with key TRN characteristics constitute a system that can be seen as an organic whole. It further argues that it was the presence of certain key characteristics within the system that largely determined how the system operated, as well as its successes and failures. The Article argues that the IMF, with its blend of key TRN and certain key non-TRN characteristics, played an important role in legitimating such coordinated action among domestic regulators in the case of financial and anti-money laundering standards. The Article also argues that the IMF played an important role in restraining the application of local power by onshore jurisdictions, thereby helping ensure that OFCs were treated more fairly by the system than they otherwise would have been.

In Part III.B, the Article proposes a modification to the paradigm of the operation of TRNs. Lastly, the Article draws some final conclusions concerning the benefits and drawbacks of standards in guiding international behavior.

I. BACKGROUND

A. *TRNs and Global Governance*

Over the past decade and a half, scholarly inquiry into the source and operation of international law has undergone significant development. The earlier paradigm was one of unitary state actors, working either by themselves or through formal international organizations, within the context of recognized sources of international law (i.e., international conventions, international customary law, general principles of law recognized by “civilized” nations, judicial decisions, and teachings of experts).¹⁴ The focus of inquiry was primarily on the rights and obligations of states (including

14. Annex to U.N. Charter, Statute of the International Court of Justice, art. 38, June 26, 1945, 59 Stat. 1055, T.S. No. 993, 3 Bevens 1179 (1945); *see also* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW §§ 102–03 (1986) (defining various sources of international law and identifying evidence of international law).

those found in the charters of international organizations), the adjudication of breaches in the law, and the imposition of sanctions.¹⁵

The new focus looks beyond these basic parameters.¹⁶ Instead of treating states as unitary actors, scholars have drawn attention to the disaggregation of state sovereignty; states act in the international system, not just through their executives, but through their various domestic governmental institutions, including ministries, courts, legislatures, and regulatory agencies.¹⁷ These various governmental units may communicate with each other through global policy networks and not just through the State (e.g., foreign ministries) or formal international organizations.¹⁸ Throughout, two key factors in the development of international law have been natural law (i.e., what is inherently right or wrong) and positivism (i.e., what is in the self-interest of states).¹⁹

Key players in these developments have been domestic regulatory agencies, including those that supervise the banking, insurance, and securities sectors. These domestic regulators are guided in large part by the application of technical expertise. They share their expertise and other information through semi-formal transnational regulatory networks. The Basel Committee on Banking Supervision (“Basel Committee”)²⁰ and the International Organization of Securities Commissioners (“IOSCO”) are cited as

15. See, e.g., MARK W. JANIS & JOHN E. NOYES, INTERNATIONAL LAW: CASES AND COMMENTARY (3d ed. 2005).

16. David Kennedy, a principal contributor to the new scholarship, has recently outlined the development of new approaches to international legal theory in *The Mystery of Global Governance*, 34 OHIO N.U. L. REV. 827 (2008).

17. Slaughter, *Sovereignty and Power*, *supra* note 11, at 325. Like David Kennedy, Anne-Marie Slaughter is a principal contributor to the new scholarship.

18. See, e.g., David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, 33 TEX. INT’L L.J. 281, 284 (1998) (noting how non-treaty international financial regulatory organizations cooperate to develop transnational rules or standards).

19. David D. Jividen, *Rediscovering International Law Through Dialogue Rather than Diatribe: Reflections on an International Legal Conference in the Aftermath of Operation Iraqi Freedom*, 27 HARV. J.L. & PUB. POL’Y 691, 693–99 (2004).

20. The Basel Committee was established in 1974 by the central bank governors of the G-10: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States. BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT’L SETTLEMENTS, THE HISTORY OF THE BASEL COMMITTEE AND ITS MEMBERSHIP 1 (2009), <http://www.bis.org/bcbs/history.pdf?noframes=1>. According to the Committee’s Web site, “[o]ne important objective of the Committee’s work has been to close gaps in international supervisory coverage in pursuit of two basic principles: that no foreign banking establishment should escape supervision; and that supervision should be adequate.” *Id.* at 1–2.

being among the more influential TRNs.²¹ These informal groups of national regulators have no legal personality, have little or no staff, and have little or no formal system of internal governance. Rather, they consist of officials from national regulators who agree to meet on an occasional basis and to reach agreement by consensus. Other TRNs may coordinate among themselves through semiformal supra-TRNs like the Financial Stability Forum (“FSF”), which includes these TRNs themselves as members.²²

These TRNs, through application of the collective expertise of their members and through the building of consensus, develop best practices or standards to address technical regulatory issues faced by most or all domestic regulators. These standards are then promulgated as technical guidance for all regulators.²³ For example, the Basel Committee is concerned with preserving the safety and soundness of the banking system.²⁴ Composed of a number of domestic banking regulators from the most important banking centers, the Basel Committee’s various standards are designed to promote a public good—a sound banking system—that is of benefit to all.²⁵ And, in a world with an increasingly interconnected financial system where one weak link may jeopardize the entire system, the diffusion of best practices among all regulators benefits each jurisdiction individually. If the Basel Committee’s standards truly address the technical problem of how best to regulate and supervise the banking system, then problems of conflicting principle or ideology, or of national self-interest, should be minimized.²⁶

Of great importance is the fact that acceptance of these best practices or standards is primarily accomplished not through the hard power of sanctions but through more subtle peer pressure or

21. Slaughter, *Sovereignty and Power*, *supra* note 11, at 315.

22. Anne-Marie Slaughter, *Global Government Networks, Global Informational Agencies, and Disaggregated Democracy*, 24 MICH. J. INT’L L. 1041, 1046–47 n.16 (2003) [hereinafter Slaughter, *Global Government Networks*]. Membership in the Financial Stability Forum includes the IMF, a treaty-based international organization. *See id.*; Slaughter, *Sovereignty and Power*, *supra* note 11, at 289 n.26.

23. Rolf H. Weber & Douglas W. Arner, *Toward a New Design for International Financial Regulation*, 29 U. PA. J. INT’L L. 391, 411 (2007).

24. BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT’L SETTLEMENTS, THE NEW BASEL CAPITAL ACCORD: AN EXPLANATORY NOTE 1 (2001) [hereinafter BASEL COMM. ON BANKING SUPERVISION], <http://www.bis.org/publ/bcbsca01.pdf>.

25. *Id.* at 7.

26. This is not to say that the resulting standards would then prove to be wise, in that purely technical failures might still result. The recent crisis affecting the worldwide banking sector suggests that, at a minimum, banking supervisory standards were poorly conceived from a purely technical perspective.

persuasion.²⁷ In other words, “[the system] co-opts people rather than coerces them.”²⁸ TRNs help educate local regulators and convince them that the standards agreed upon are truly best practices. In addition, scholars have argued that the market, reacting to the regulatory best practices, can also provide incentives for performance.²⁹ Many have referred to this shift from traditional international law to less formal standard-building through TRNs as part of a global movement from “government” to “governance.”³⁰

Because transnational regulatory networks bring highly developed expertise to address common problems, the solutions they offer should be less ideologically or politically motivated than those of states acting individually or in like-minded groups. Like turning to organizations of doctors for medical advice or engineers for views on building bridges, turning to banking regulators for views on how to maintain a safe and sound banking system simply makes good sense. Implementing their advice, therefore, should be in the best interests of everyone. While states are motivated to develop policies that are self-serving, TRNs are motivated primarily to develop policies that are truly best practices. And, while states may rely on the hard or coercive power of carrots and sticks to enforce their views, TRNs rely more on soft power, meaning simple persuasion. The emergence of TRNs, therefore, may be of great benefit to the world. TRNs create those standards that succeed in promoting improved behavior without having to create new law.

B. *The Limitations of TRNs*

Scholars of the globalization of regulatory law have, however, noted some problems when standard-setting is shifted from the national to the global level, from local regulators to international

27. Slaughter, *Global Government Networks*, *supra* note 22, at 1061. Of course, even breaches in accepted international law may result only in peer pressure and not formal hard power sanctions.

28. Slaughter, *Sovereignty and Power*, *supra* note 11, at 291 (quoting JOSEPH S. NYE, JR., *THE PARADOX OF AMERICAN POWER: WHY THE WORLD'S ONLY SUPERPOWER CAN'T GO IT ALONE* 9 (2002)) (internal quotation marks omitted).

29. Weber & Arner, *supra* note 23, at 411.

30. See, e.g., Kennedy, *supra* note 16, at 832 (describing the transition to a focus on global governance); Sol Picciotto, *Regulatory Networks and Global Governance* 7 (June 27–29, 2006), available at http://eprints.lancs.ac.uk/232/1/Reg_Networks_&_Glob_Gov.pdf (manuscript of speech given at The Institute of Advanced Legal Studies, University of London, workshop) (detailing the regulation of international financial markets through global governance).

standard-setting bodies.³¹ Chief among these is a potential lack of legitimacy. For instance, accountability of TRNs may be limited, in that bureaucrats operating at the TRN level may not be accountable to individual state governments or to people as a whole.³² Further, it is typically true that not every domestic regulatory authority is represented within a typical TRN. The Basel Committee, for example, includes only the regulatory authorities of twenty-seven countries, most of which are developed or very large.³³ This can cause at least three major problems. First, a lack of representation may result in the interests of member regulatory bodies being promoted over those of non-members. To the extent that national regulators favor the interests of their own states over a hypothetical best practice for the world as a whole, the resulting standards may be tainted by state self-interest.³⁴ This may adversely affect both the perception of the standards as legitimate and the actual quality of the standards themselves. Second, TRNs, like the Basel Committee, do not normally have a mechanism for reviewing any particular standard, outside of the TRN itself (meaning the TRN reviews its own work), which also may affect both the perception of legitimacy and the quality of the standards proposed. Third, TRNs do not normally have neutral or objective ways of monitoring compliance.³⁵ These problems result in flaws in the standards that TRNs create and advance.

These problems may be overcome with a combination of adequate procedural standards and substantive standards.³⁶ Naturally, these procedural and substantive standards may be very difficult to implement in fact. A key problem is that the inherent conflicts among

31. Benedict Kingsbury, Nico Krisch & Richard B. Stewart, *The Emergence of Global Administrative Law*, 68 *LAW & CONTEMP. PROBS.* 15, 16 (2005). Professors Kingsbury, Krisch, and Stewart have developed a project on global administrative law at New York University that is part of the Regulatory Institutions Network, or "RegNet."

32. Pierre-Hugues Verdier, *Transnational Regulatory Networks and Their Limits*, 34 *YALE J. INT'L L.* 113, 115 (2009).

33. The Committee's members come from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. About the Basel Committee, <http://www.bis.org/bcbs/> (last visited Sept. 27, 2009).

34. Verdier, *supra* note 32, at 115.

35. *Id.* at 116.

36. Kingsbury, Krisch & Stewart, *supra* note 31, at 17, 37–42. Procedural standards could include sufficient transparency in the adoption of rules, adequate participation by different state regulatory authorities, reasoned decision making, and effective review of final rules and decisions, while substantive standards could provide that any rules adopted are proportional and rational, employ the least restrictive means to accomplish the desired result, and satisfy legitimate expectations.

different national regulators must be resolved if the TRN is to agree upon one or more best practices. This will lead to concessions and tradeoffs, breaching some or all of the procedural or substantive standards.³⁷

C. *Quasi-TRNs, Organizations with TRN Characteristics, and States Themselves*

This Article has so far addressed the paradigmatic TRN, like the Basel Committee. But, there may be other groups that have some, though not all, TRN characteristics. This Article proposes a taxonomy based on the characteristics of TRNs (and other networks of sub-state units) that distinguish them from states acting alone.

Quasi-TRNs. The first category of groups possessing TRN characteristics includes quasi-TRNs, or those organizations like the Financial Action Task Force (“FATF”) on Money Laundering and Terrorism Financing, that have most, but not all, TRN attributes.³⁸ As with TRNs like the Basel Committee, the FATF has worked to create various standards and best practices. Also like the Basel Committee, the FATF has no legal personality and no formal system of internal governance. While it has a few staff, it relies primarily on the expertise of its members to conduct its work and it reaches agreement by consensus. Unlike the Basel Committee, the members of the FATF are states. However, as a practical matter, states’ members are represented at the FATF by sub-state units, including regulatory authorities (most particularly banking supervisors), as well as law enforcement. While the Basel Committee is less susceptible to state control than the FATF, it retains at least some of the beneficial qualities of serving as a repository of local expertise.

Two types of international treaty organizations with TRN characteristics. The second category includes international treaty organizations, which this Article divides into two types: those with broad membership and those with more restricted membership. The former includes international financial institutions like the IMF,

37. See Verdier, *supra* note 32, at 115–16.

38. Anti-money laundering principles involve both regulatory and non-regulatory (mostly related to criminal justice) matters. See DAVID FOLKERTS-LANDAU ET AL., TOWARD A FRAMEWORK FOR FINANCIAL STABILITY 35 (1998), available at <http://www.imf.org/external/pubs/ft/wefs/toward/index.htm> (follow link for Part VI, Prudential Regulation of Banking). For purposes of simplicity, this Article will refer to TRNs as including matters that are primarily regulatory in nature but that may involve some non-regulatory issues. It will also refer to regulatory issues as matters that may require some legislative response.

World Bank, or regional development banks. While these are accepted as parts of the traditional international legal system, they do share some characteristics of TRNs. Like the Basel Committee, the IMF has created some technical standards, although none in the traditional regulatory areas such as banking, securities, or insurance.³⁹ Unlike the Basel Committee or the Financial Action Task Force, however, the IMF is a treaty organization with state membership, with a large paid professional staff, and with a formal governance structure.⁴⁰ However, states are represented at the IMF through their central banks or finance ministries, and the organization's staff is selected largely because of its technical expertise, including in financial regulatory areas.⁴¹ While the organization itself is controlled by states, staff may still exercise its expertise with some significant freedom from the control of those states.

Organizations like the IMF have non-TRN characteristics that address some of the problems that scholars have identified with TRNs. For example, unlike the Basel Committee, which has a membership limited to only a few national banking regulators, the IMF's membership includes nearly every state,⁴² and its staff includes individuals from nearly every country in the world.⁴³ Such broad membership may allay some legitimacy concerns. In addition, IMF staff might be able to review the standards proposed by TRNs or play a role in monitoring compliance. As will be discussed in Part III.A, these are key roles the IMF has played.

The second type of international treaty organization is dominated by member states more than the first type of treaty organization with TRN characteristics, such as the Organisation for Economic Co-operation and Development ("OECD").⁴⁴ This type

39. See, e.g., IMF Dissemination Standards Bulletin Board, <http://dsbb.imf.org/Applications/web/dsbbhome/> (last visited Sept. 27, 2009) (noting that the special data dissemination standards provide guidance as to how countries should disseminate key economic and financial data).

40. Richard Gordon, *The International Monetary Fund: A Mandate to Fight Money Laundering and the Financing of Terrorism*, in MICHAEL P. SCHARF, *THE LAW OF INTERNATIONAL ORGANIZATIONS* 1093, 1093–95 (2d ed. 2007).

41. *Id.*

42. IMF, Membership, <http://www.imf.org/external/about/members.htm> (last visited Oct. 26, 2009).

43. IMF, THE ROLE OF DIVERSITY IN THE FUND'S HUMAN RESOURCE STRATEGY 5–10 (2003), <http://www.imf.org/external/np/div/2003/052803.pdf>.

44. Org. for Econ. Co-operation & Dev. [OECD], Ratification of the Convention of the OECD [hereinafter OECD, Ratification of the Convention], http://www.oecd.org/document/58/0,3343,en_2649_201185_1889402_1_1_1_1,00.html (last visited Oct. 26, 2009).

will obviously suffer from a number of problems in independence and legitimacy due to its domination by member states. However, even the OECD may exhibit some positive TRN characteristics; for example, the OECD and its members may also tap into significant domestic expertise in the fiscal area.

States themselves. While TRNs may use soft power to convince national regulators as to what constitutes a standard or best practice, those regulators are the ones who may exercise hard power. The acceptance of the standard may be an exercise of soft power, but regulatory sanctions based on that standard are backed by the police power of the state itself. Regulatory power typically applies only to the resident of the state in which the regulator has jurisdiction, but applying such power to its resident can force the resident to stop doing business with states that have not applied the standard. This brings market pressure to bear on the non-complying state to comply. If states whose residents have significant market power are prevented from doing business with the non-complying state, market pressure on the non-complying state will be significant. Thus, the application of hard power is more effective if it is coordinated among states whose residents have a dominating market presence.⁴⁵ Obviously, states acting as themselves embody many of the negative characteristics that TRNs are supposed to replace. Although they are far less associated with the creation and application of technical-based and generally accepted standards, they can nevertheless play their roles in relatively more benign ways that do not conflict with the various goals of creating and implementing generally accepted standards as described above.⁴⁶

45. Another reason that onshore jurisdictions sought a coordinated response may have been to prevent anyone from receiving a competitive advantage by using OFCs to escape domestic tax or regulatory costs. Once the OFC's allegedly noxious activities were shut down, no one's residents could benefit by using them.

46. Another category might include states acting together in informal clubs, such as the G-8 (Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States), University of Toronto Munk Center for International Studies G-8 Research Group, What is the G-8?, http://www.g8.utoronto.ca/what_is_g8.html (last visited Nov. 19, 2009), or the increasingly important G-20 (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, and the United States). Steve Brusk & Ed Henry, *Officials: G-20 to Supplant G-8 as International Economic Council*, CNN.COM, Sept. 24, 2009, <http://www.cnn.com/2009/US/09/24/us.g.twenty.summit/index.html>. When acting in such groups, they often focus on particular technical issues rather than simply on natural law (i.e., principle) or positivism (i.e., state interests). Another possible category would be supra-national, quasi-federalist, multi-state polities like the European Union. Each of these additional categories lie somewhere between states themselves and organizations like the OECD.

D. The Resulting Standard

TRNs, quasi-TRNs, international organizations with TRN characteristics, and states themselves operate in an interrelated fashion. They may not all come into play in every standard system or come into play in the same way with respect to every issue of global governance. Those that do, with respect to a particular regulatory issue, will bring along their different characteristics (along with their different pluses and minuses) to the process. Each will influence each other and, of course, the final result. However, the success or failure of these systems is likely to depend on the presence of beneficial or detrimental characteristics found in the TRNs, quasi-TRNs, international organizations with TRN characteristics, and states themselves. The more positive attributes there are and the fewer detrimental attributes there are, the more likely it will be that the resulting system will work, and work beneficially.

II. THE SYSTEM IN ACTION: OFCS AND INCOME TAXATION,
PRUDENTIAL REGULATION, AND MONEY LAUNDERING

A. Overview

At its heart, the complaint that onshore jurisdictions had with offshore centers was that the latter provided a willing sanctuary for tax evasion, poor financial regulation, and money laundering by onshore residents.⁴⁷ There was, however, no generally accepted international legal framework to address the causes of the alleged damages.

Onshore centers, while conceding the costliness of the taxes and financial regulations they imposed on resident investors, nevertheless justified them as necessary to protect their citizens from the risks inherent in OFCs.⁴⁸ OFCs, on the other hand, realized that by providing onshore residents with a means of avoiding these same taxes and regulations, they could obtain the financial benefits of handling the onshore residents' business. Tax evasion, however, was not the only consequence suffered by onshore centers as a result of OFCs. By allowing onshore residents to circumvent prudential regulations, offshore financial centers threatened the safety and soundness of all financial systems. And, by allowing onshore residents to circumvent anti-money laundering (and later terrorism financing

47. See *infra* Parts II.B.1, C.1, and D.1.

48. See *infra* Parts II.B.1, C.1, and D.1.

policies), OFCs were also enablers of both serious and often violent crime and terrorism both at home and abroad.⁴⁹

While the complaint against these three OFC behaviors developed over a more or less similar time period (from the late 1970s to the present), each did not develop exactly at the same time—and over the period in question they often had a different relative importance.

B. Income Tax

1. The Basic Indictment⁵⁰

There is little question that, at least early on, most offshore centers (as well as some onshore centers)⁵¹ offered onshore residents

49. See *infra* Part II.D.1.

50. This short section is a summary and, in some cases, a reorganization of arguments on tax havens and harmful tax practices. The arguments began very early. The G-7 stated their concern over “[t]ax schemes aimed at attracting financial and other geographically mobile activities [that] can create harmful tax competition between States, carrying risks of distorting trade and investment and [leading] to the erosion of national tax bases.” *Lyon Summit Communiqué: Making a Success of Globalization for the Benefit of All*, U.S. DEP’T OF STATE DISPATCH SUPPLEMENT para. 16 (June 1996), available at http://findarticles.com/p/articles/mi_m1584/is_nSUPP-2_v7/ai_18777690. They were later developed by the OECD in *Harmful Tax Competition: An Emerging Global Issue*. OECD, HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE 19–25 (1998) [hereinafter OECD, HARMFUL TAX COMPETITION], available at <http://www.oecd.org/dataoecd/33/0/1904176.pdf>. See generally Craig Boise, *Regulating Tax Competition in Offshore Centers* (Case Research Paper Series in Legal Studies, Working Paper No. 08-26, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266329 (providing an excellent in-depth discussion of other arguments for and against tax havens).

51. There was an early recognition by the OECD that it was difficult to come up with an objective definition of a “tax haven.” OECD, INTERNATIONAL TAX AVOIDANCE AND EVASION: FOUR RELATED STUDIES 20 (1987). However, the jurisdictions eventually identified by the OECD looked very much like the list of offshore jurisdictions compiled by the IMF, of problem jurisdictions compiled with respect to prudential regulation, and, to a lesser degree, anti-money laundering. Compare OECD, TOWARDS GLOBAL TAX CO-OPERATION: PROGRESS IN IDENTIFYING AND ELIMINATING HARMFUL TAX PRACTICES 17 (2000) [hereinafter OECD, TOWARDS GLOBAL TAX CO-OPERATION], <http://www.oecd.org/dataoecd/9/61/2090192.pdf> (citing thirty-five jurisdictions that meet the OECD tax haven criteria), with Luca Errico & Alberto Musalem, *Offshore Banking: An Analysis of Micro- and Macro-Prudential Issues* 10–11 (IMF, Working Paper No. 99/5, 1999), available at <http://ssrn.com/abstract=880532> (compiling a list of sixty-nine countries and territories that have offshore financial centers capable of being exploited for tax evasion and money laundering purposes), Press Release, Bank for International Settlements, Financial Stability Forum Releases Grouping of Offshore Financial Centers (OFCs) to Assist in Setting Priorities for Assessment (May 26, 2000) [hereinafter Press Release, Bank for International Settlements], available at <http://www.bis.org/press/p000526.htm> (categorizing OFCs into three priority groups based on the quality of legal infrastructures and financial supervision provided by each jurisdiction), and FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING [FATF], FATF REVIEW TO IDENTIFY

an opportunity to evade taxes on income from capital by neither levying tax on income from non-resident capital investments nor reporting such income to resident countries. In effect, these offshore tax havens invited onshore taxpayers to shift their capital investments from onshore financial intermediaries to tax haven-based intermediaries.

The vast majority of capital that flowed to tax havens was not invested locally in either fixed assets like buildings or equipment or in human assets like managers or workers. Tax havens and their economies were quite small and needed only a tiny fraction of the capital that flowed to them for local investment. Instead, the capital was routed to other locations where it could be invested in actual productive assets. The role of the tax haven was to act as a conduit or *entrepôt* on the way to another destination.⁵²

The tax haven provided a place where, as a technical legal matter, income accumulated or where payments were made, while the actual management could be undertaken somewhere else and the actual capital was invested in real productive assets somewhere else. The tax haven mainly provided services like a tax-free environment and secrecy,⁵³ although freedom from non-tax regulation and dependable legal systems were also beneficial to such investors.⁵⁴

In one very simple example, a person subject to residence taxation would open a bank account in the tax haven. Third party payments to the taxpayer would then be diverted to the tax haven bank account. The tax haven would not tax interest income; nor would the taxpayer voluntarily pay tax to the resident jurisdiction on that interest.⁵⁵ The ability of the taxpayer to evade taxes would be greatly reduced if the bank were required to report interest income to

NON-COOPERATIVE COUNTRIES OR TERRITORIES: INCREASING THE WORLDWIDE EFFECTIVENESS OF ANTI-MONEY LAUNDERING MEASURES 2–10 (June 22, 2000), <http://www.fatf-gafi.org/dataoecd/56/43/33921824.pdf> (providing a list of jurisdictions the FATF deems to be “non-cooperative” with detrimental financial practices).

52. See RICHARD A. GORDON, TAX HAVENS AND THEIR USE BY UNITED STATES TAXPAYERS—AN OVERVIEW 32–41 (1981) [hereinafter GORDON, TAX HAVENS AND THEIR USE], available at <http://www.archive.org/details/taxhavenstheirus01gord>.

53. *Id.* at 15, 17.

54. *Id.* at 22–23.

55. Richard A. Gordon did not discuss this issue in his report, TAX HAVENS AND THEIR USE, *supra* note 52, but the point had long been made elsewhere and was therefore already widely known. Also, the amount of evasion involved was considered trivial compared to the use of companies and other offshore vehicles for tax evasion. Telephone Interview with David Brockway, Esq., former Chief of Staff, Joint Comm. on Taxation, U.S. Congress 1983–86 (October 15, 2009). Gordon does discuss a related issue in the context of earnings by companies and other vehicles. See discussion *infra*.

the tax authority.⁵⁶ Such reporting requirements are a key feature of most income tax administrations.⁵⁷

In the event that the payments diverted to the account in the tax haven constituted income, the taxpayer could also fail to declare those as income.⁵⁸ The ability of the taxpayer to evade taxes in this case would be greatly reduced if third party payers were required to report payments and banks were required to report the beneficial ownership of the bank account to the tax authorities.⁵⁹

A taxpayer could also set up a company or a trust in the tax haven and direct payments to that company's bank account rather than to his own. Profits accruing to the company or other legal form could then escape tax in both the tax haven and country of the taxpayer. As a general rule, the U.S. tax regime only taxed dividends paid by a foreign company to a U.S. resident and not the earnings of that company. However, to prevent tax avoidance, rules were adopted to tax, in certain circumstances, the U.S. resident's share of the earnings of such a company when the earnings constituted passive investment income, meaning essentially that the income from the asset could have been paid directly to the U.S. resident without going first through the foreign company.⁶⁰ But without adequate information provided by the tax haven, the Internal Revenue Service would have no way of knowing such income was taxable.⁶¹ Of course, the U.S. resident could also interpose companies between herself and her tax haven bank account to engage in other forms of tax evasion,

56. For example, in the United States, interest paid by a U.S. resident must be reported by the payor to the Internal Revenue Service. I.R.C. § 6049 (2006).

57. Richard K. Gordon, Jr., *Income Tax Compliance and Sanctions in Developing Countries*, in TAXATION IN DEVELOPING COUNTRIES 455, 460-61 (Richard M. Bird & Oliver Oldman eds., 4th ed. 1990) [hereinafter Gordon, *Income Tax Compliance*]; Richard K. Gordon, *Law of Tax Administration and Procedure*, in TAX LAW DESIGN AND DRAFTING 95, 103 (Victor Thuronyi ed., Kluwer Law Int'l 2000) [hereinafter Gordon, *Law of Tax Administration and Procedure*].

58. Again, Richard A. Gordon did not discuss this issue in his report TAX HAVENS AND THEIR USE, *supra* note 52. He does discuss a related issue in the context of payments to companies and other vehicles. *See infra* note 62 and accompanying text.

59. For example, in the United States, many payments representing income must be reported by the resident payor to the Internal Revenue Service, including dividends (I.R.C. § 6042 (2006)), returns of brokers (§ 6045), interest (§ 6049), unemployment compensation (§ 6050B), royalties (§ 6050N), and wages (§ 6051(d)).

60. *See* GORDON, TAX HAVENS AND THEIR USE, *supra* note 52, at 24-25, 50-58.

61. *See id.* at 8-9, 180-82.

such as directing payments constituting would-be taxpayer income to the company instead, as well as other techniques.⁶²

In the absence of adequate information to determine whether a domestic payment to a tax haven-based recipient had in fact come from a domestic taxpayer, the domestic jurisdiction could instead levy a gross fee on that payment approximating the amount that would be due. Levying gross withholding taxes on payments in lieu of taxing recipients is an important tax administration tool.⁶³ In fact, primarily for ease of tax administration, the generally accepted international tax regime has long assumed that certain payments to foreigners that usually represent income to the recipient would be taxed at a gross rate by the jurisdiction of the payer. These would include interest, dividends, royalties, and wages.⁶⁴ Possible double taxation of the same income was eliminated by the receiving jurisdiction by not taxing the foreign income (which is what tax havens did) or by taxing it but giving a credit for the taxes remitted (the general rule and the one adopted by the United States),⁶⁵ or by reducing or eliminating the gross tax through a tax treaty (and/or combining this with the exemption or credit system).⁶⁶ Of course, going the third route means re-opening the tax evasion problem—which is why the system would need enough flow of information to ensure that the paying jurisdiction could tax its residents who were receiving income through the bank account or company or other legal form in the receiving country. This is why the standard-form tax treaties have had articles on exchange of information, which allows one treaty partner to request and receive key information from the other.⁶⁷

As it turned out, by the 1970s, the United States had a large network of tax treaties reducing or eliminating these gross taxes on

62. *See id.* at 26–28, 59–127. Gordon directs the lion's share of attention in his report to these issues, presumably because they constituted the lion's share of revenue losses. *See id.*

63. *See* Gordon, *Income Tax Compliance*, *supra* note 57, at 460–61; Gordon, *Law of Tax Administration and Procedure*, *supra* note 57, at 103, 115.

64. Richard J. Vann, *International Aspects of Income Tax*, in *TAX LAW DESIGN AND DRAFTING*, *supra* note 57, at 718, 721–22, 762–68.

65. MICHAEL J. GRAETZ, *FOUNDATIONS OF INTERNATIONAL INCOME TAXATION* 157 (2003).

66. Vann, *supra* note 64, at 718, 758–59. In 1981, the United States Model Income Tax Treaty posited that the rate of tax on dividends should be reduced from 30 percent to 5 percent in the case of direct investment (ownership of 10 percent or more of the stock of the payor corporation) and to 15 percent in the case of portfolio investment. Interest and royalties should be exempt from gross tax. GORDON, *TAX HAVENS AND THEIR USE*, *supra* note 52, at 148.

67. Vann, *supra* note 64, at 804–07.

payments from U.S. persons to bank accounts in tax havens, but these treaties lacked effective exchange-of-information provisions.⁶⁸ Some of the reasons for having such treaties were historical, based on earlier treaties with the United Kingdom that extended benefits to former U.K. colonies that were now tax havens.⁶⁹ The treaty with the Netherland Antilles, oddly, was tolerated so that overseas investors could invest in the U.S. corporate debt market without having to pay gross tax to the United States,⁷⁰ thereby helping them to evade tax in their home jurisdiction.⁷¹

2. The System in Action

Serious concern over the use of tax havens by U.S. citizens began in 1979 when the Oversight Subcommittee of the U.S. House Ways and Means Committee held hearings focused primarily on Caribbean OFCs.⁷² Two years later, Richard A. Gordon completed a report for the U.S. Treasury entitled *Tax Havens and Their Use by United States Taxpayers*.⁷³ In the three years following the publication of the Gordon Report, the U.S. Congress held a series of additional hearings on tax haven “abuse” (which also included a short discussion of tax havens’ role in money laundering).⁷⁴ The U.S. Treasury focused on preventing tax haven abuse thorough the exchange of taxpayer information. In 1983, President Ronald Reagan signed into law the Caribbean Basin Economic Recovery Act, which provided economic benefits to jurisdictions (many of which were offshore centers) that

68. GORDON, TAX HAVENS AND THEIR USE, *supra* note 52, at 147–49, 207–09.

69. *Id.* at 149.

70. *Id.* at 149–50.

71. Personal communication from a Senate confirmation-level U.S. Treasury official, to author (Oct. 18, 1994).

72. *The Use of Offshore Tax Havens for the Purpose of Evading Income Taxes: Hearings Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 96th Cong. 284–99 (1979). These hearings and subsequent developments are discussed in Bruce Zagaris, *The Procedural Aspects of U.S. Tax Policy Towards Developing Countries: Too Many Sticks and No Carrots?*, 35 GEO. WASH. INT’L L. REV. 331, 333–35 (2003).

73. GORDON, TAX HAVENS AND THEIR USE, *supra* note 52.

74. See generally *Improper Use of Foreign Addresses to Evade U.S. Taxes: Hearing Before the Commerce, Consumer, and Monetary Affairs Subcomm. of the H. Comm. on Gov’t Operations*, 97th Cong. (1982) (discussing measures to stop the illegal use of foreign addresses to evade U.S. taxes); *Tax Evasion Through the Netherlands Antilles and Other Tax Haven Countries: Hearings Before a Subcomm. of the H. Comm. on Gov’t Operations*, 98th Cong. 3 (1983) (focusing on money laundering through the Netherlands Antilles and other Caribbean tax haven territories); *Crime and Secrecy: The Use of Offshore Banks and Companies: Hearings Before the Permanent Subcomm. on Investigations of the S. Comm. on Governmental Affairs*, 98th Cong. 16, 21 (1983) (studying the use of offshore tax shelters to evade U.S. taxes). See Zagaris, *supra* note 72, at 332–35, for a discussion of the chronology of the three hearings.

agreed to an information-exchange agreement with the United States.⁷⁵ More importantly, in 1984, the Tax Reform Act authorized the government to deny a general exemption of withholding tax on portfolio interest paid to any person within a jurisdiction that did not provide the United States sufficient information to prevent evasion of U.S. income tax by U.S. persons.⁷⁶ In addition, the United States refused to enter into new tax treaties with jurisdictions that did not include exchange-of-information agreements.⁷⁷

While some progress was made in information-exchange agreements over the next ten years, most of the key offshore centers did not sign on.⁷⁸ In addition, some offshore centers that did agree to enter into information-exchange agreements were less than forthcoming in implementing those agreements.⁷⁹ Also, there was a fundamental problem with relying solely on requests for information on *particular* U.S. taxpayers to prevent U.S. persons *in general* from using a tax haven to avoid U.S. taxes: the U.S. tax authorities would not, *ab initio*, know what information to request. Presumably, it would be far better from the U.S. point of view if tax havens charged a positive rate of tax and/or if they made it more difficult for U.S. taxpayers using the tax haven as a “residence” to hide the fact that they were in fact U.S. persons.

There were good reasons why offshore centers neither levied income taxes on U.S. residents nor frequently on their own residents. First, because offshore centers were essentially transit points for capital flowing from one onshore jurisdiction to another, little or no income on that capital had an economic source in the offshore center itself.⁸⁰ This meant that there were good theoretical reasons not to tax

75. See Caribbean Basin Economic Recovery Act, Pub. L. No. 98-67, 97 Stat. 384, 395-97 (1983). The Act created I.R.C. § 274(h)(6) to allow tax deductions for conventions in Caribbean countries if those countries entered into exchange-of-information agreements with the United States; see also Zagaris, *supra* note 72, at 332-35 (providing a summary of the Act). See generally Gregory P. Crinion, *Information Gathering on Tax Evasion in Tax Haven Countries*, 20 INT'L L. 1209 (1986) (discussing how the U.S. Treasury uses information gathering through both treaty and non-treaty means to combat tax avoidance and evasion in tax haven countries).

76. See Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494, 648-50 (1984). The new I.R.C. § 871(h)(1) repealed the withholding tax on certain portfolio debt investments of non-residents, while § 871(h)(5) allowed the Secretary of the Treasury to provide that the repeal does not apply in cases of inadequate information exchange.

77. A review of all U.S. tax treaties concluded since 1984 shows that all have exchange-of-information agreements.

78. See Zagaris, *supra* note 72, at 332-37.

79. See *id.* at 335-36.

80. See discussion *supra* at Part II.B.1.

flows of income from capital in the offshore center.⁸¹ Next, because the vast majority of offshore centers were quite small and produced few goods domestically (many were islands with little or no domestic industry), most goods were imported.⁸² Many of these jurisdictions may simply have concluded that it was administratively easier to raise needed government revenue through taxes levied on imports than taxes levied on income.⁸³ There were also reasons based in economic theory to conclude that indirect taxes were preferable to income taxes. In fact, there was already a general consensus among many economists that taxes on income from capital were undesirable due to the disincentive effects on savings.⁸⁴ There were also good reasons why offshore centers may not have wished to act as reporting agents for the U.S. tax authorities. Such reporting would be expensive, particularly given that most offshore centers had no income tax themselves and, therefore, had no pre-existing infrastructure for reporting.⁸⁵ Finally, implementing an income tax and/or reporting income earned by non-residents to their tax authority would have the effect of benefiting foreign jurisdictions without creating a domestic benefit; in fact, the costs born locally, including the loss of business, might be considerable.⁸⁶

Throughout the 1980s, the United States raised the problem of tax haven abuse with other major onshore jurisdictions, a number of which also expressed considerable concern, especially France and, to

81. Officials from a number of offshore centers argued to IMF staff members that because they were neither source nor resident jurisdictions, they had no reason to tax cash flows "passing through us." For an overview of international tax theory, see generally GRAETZ, *supra* note 65 (describing the economic and administrative foundations for taxation of income in source and residence jurisdictions).

82. *Id.* at 378, 390; see Boise, *supra* note 50, at 24.

83. Boise, *supra* note 50, at 25 (discussing how the relatively small size and geographic isolation of OFCs combine to make an income tax a highly inefficient means of obtaining revenue in comparison to duties on imports).

84. See, e.g., Andrew Atkeson et al., *Capital Income Taxes; A Bad Idea*, 23 FED. RES. BANK MINN. Q. REV. 1, 11 (1999), available at <http://www.minneapolisfed.org/research/QR/QR2331.pdf> (concluding that recent research suggests that capital income should not be taxed, despite conventional wisdom to the contrary). There are many other reasons for favoring an income tax, including the ability to tax wealthy persons, who have less marginal utility in each additional currency unit earned, at higher effective rates than less wealthy persons. See Carl S. Shoup, *Taxes and Economic Development*, 25 FINANZARCHIV 385, 388 (1966).

85. Boise, *supra* note 50, at 25.

86. Personal communication from Robert Mathavious, Managing Dir., Fin. Services Comm'n of the British Virgin Islands, in Roadtown, British Virgin Islands, to author (Aug. 16, 2004).

a lesser extent, Germany and the United Kingdom.⁸⁷ During this period, representatives of these countries also raised the issue at meetings of the G-7 (and later G-8, following the addition of the Russian Federation).⁸⁸

The larger onshore jurisdictions then turned to the Organisation for Economic Co-operation and Development. The OECD is an international organization created by treaty that limits membership (largely) to developed countries.⁸⁹ While membership has been increasing, at the time it included the European Union members plus Iceland, Norway, Sweden, the United States, Canada, Japan, and Turkey.⁹⁰ The purposes of the OECD, as expressed in its founding convention, included the promotion of policies designed to achieve economic growth and fiscal stability;⁹¹ the OECD's primary role was to carry out relevant studies and act as a forum where members could "co-operate closely and where appropriate take co-ordinated action."⁹² Much of the OECD's prior work involving taxation focused on developing model double-taxation conventions, including a draft convention on exchange of taxpayer information.⁹³ Once formed, the United States called on the OECD to study the effect of tax havens.⁹⁴

As discussed above in Part I.C, the OECD displayed some TRN-like characteristics; for example, it could call on a great deal of expertise in the tax area from among its members. But, it failed as a TRN on many fronts. The OECD consisted of states themselves, meaning governments and not the regulatory agencies of states comprised its membership.⁹⁵ In other words, it was under the political control of states. At the same time, it suffered from many of the

87. Personal communication from David H. Brockway, Esq., Chief of Staff, Joint Comm. on Taxation, U.S. Congress 1983–86, in Washington, D.C., to author (June 12, 1989). U.K. loyalties were somewhat divided, in that a significant number of the tax havens were also overseas territories of the United Kingdom.

88. *Id.*

89. *See* OECD, Ratification of the Convention, *supra* note 44.

90. *See id.*

91. Convention on the Organisation for Economic Co-operation and Development, arts. 1, 2, Dec. 14, 1960, 12 U.S.T. 1728, 888 U.N.T.S. 179, available at http://www.oecd.org/document/7/0,3343,en_2649_201185_1915847_1_1_1_1,00.html.

92. *Id.* art. 3(c).

93. OECD COMMITTEE ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL 9–15 (2008) [hereinafter OECD, COMMITTEE ON FISCAL AFFAIRS], available at <http://www.oecd.org/dataoecd/14/32/41147804.pdf>.

94. Personal communication from Jeffrey Owen, Former Dir. of the Dep't of Fiscal Affairs, OECD, in Paris, Fr., to author (May 23, 2003).

95. *See* OECD, Ratification of the Convention, *supra* note 44.

drawbacks of such TRNs as the Basel Committee; it was dominated by a relatively small number of wealthy jurisdictions.⁹⁶

In 1987, the OECD published a key study on tax havens that, in many ways, mirrored the conclusions of the Gordon Report.⁹⁷ The OECD study, prepared by staff from member treasury departments and finance ministries (and with participation of outside consultants), also focused on the importance of exchange of information, especially with respect to bank records, and the problems of shell companies whose beneficial owner and controller could not be easily identified.⁹⁸ The study proposed that tax treaty benefits not be extended to jurisdictions that did not provide adequate information exchange, as well as other countermeasures reminiscent of those proposed in the United States in 1984.⁹⁹

Beginning in the mid-1980s (but continuing through the 1990s), the larger onshore jurisdictions attempted to involve the IMF in analyzing and criticizing offshore center income tax policies. Also, as discussed in Part I.C, the IMF had some of the advantages, and avoided some of the disadvantages, of TRNs.¹⁰⁰ While its membership consisted of states, it had a skilled and independent professional civil service as a member which could, at least in theory, bring relatively unbiased technical skills to bear on problems. And unlike TRNs like the Basel Committee or the OECD, its membership was nearly universal.¹⁰¹

There were good reasons for the onshore jurisdictions to wish for IMF involvement. It appeared to have jurisdiction; under the IMF's Articles of Agreement,¹⁰² members are obligated to direct their "economic and financial policies toward the objective of fostering

96. The author attended many meetings of various committees of the OECD as well as conferences sponsored by the OECD from 1990 to 2002. This is his personal conclusion based on hundreds of hours of conversations with OECD staff and ambassadors to the OECD.

97. OECD, *INTERNATIONAL TAX AVOIDANCE AND EVASION: FOUR RELATED STUDIES*, *supra* note 51.

98. *Id.* at 45–46 (noting, incidentally, that this "lack of transparency" also created opportunities for money laundering).

99. *Id.*

100. See the discussion in Part I.C *supra* concerning the IMF's TRN-like characteristics.

101. See IMF, *Membership*, *supra* note 42.

102. Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, 60 Stat. 1401, 2 U.N.T.S. 39 (as amended by the Second Amendment to the Articles of Agreement of the International Monetary Fund, Apr. 30, 1976, 29 U.S.T. 2203, 15 I.L.M. 546) [hereinafter IMF Articles]. The current text of the treaty is available from the IMF Web site at <http://www.imf.org/external/pubs/ft/aa/index.htm>.

orderly economic growth” and underlying economic and financial conditions, which would certainly include tax matters.¹⁰³ The Articles also give the IMF influence and even power. The IMF has the jurisdiction to exercise surveillance over these policies,¹⁰⁴ which they do by writing and discussing (mostly) annual reports on each member’s economy, meaning they could criticize a member’s tax policies.¹⁰⁵ The Articles also allow the Fund to provide financial assistance to member countries in certain circumstances, including that the borrowers follow conditions laid down by the Fund.¹⁰⁶ Those conditions might include changing tax policy. Finally, the Articles allow the Fund to provide technical assistance to members (and others), provided that the assistance is consistent with the purposes of the Fund; in other words, they could help draft tax laws.¹⁰⁷

The Fund, in fact, has a long tradition of attending to tax matters when conducting surveillance, designing conditions for the use of Fund financial resources, and providing technical assistance.¹⁰⁸ Not surprisingly, onshore jurisdictions intimated that they would like the Fund to support anti-tax haven activities through its surveillance, conditionality, and technical assistance.¹⁰⁹

However, with respect to surveillance and conditionality, the IMF (meaning the Executive Board, management, and staff) concluded that its jurisdiction lay uniquely in how a particular member’s¹¹⁰ tax policies affected *its own* economic and fiscal well-being. The issue of the effects of a member’s tax policies on the

103. *Id.* art. IV, § 1(i).

104. *Id.* art. IV, § 3. *See generally* Gordon, *supra* note 40, at 1096–98 (providing an overview of the IMF’s mandate, organization, and activities).

105. *See* IMF Surveillance, A Factsheet (June 2009), <http://www.imf.org/external/np/exr/facts/surv.htm>.

106. *See* IMF Articles, *supra* note 102, art. V, § 3; *see also* IMF, IMF Conditionality, A Factsheet (Sept. 15, 2009), <http://www.imf.org/external/np/exr/facts/conditio.htm> (describing the conditions of the IMF’s lending program).

107. *See* IMF Articles, *supra* note 102, art. V, § 2; *see also* IMF, IMF Technical Assistance, A Factsheet (Sept. 1, 2009), <http://www.imf.org/external/np/exr/facts/tech.htm> (detailing the technical assistance provided by the IMF).

108. There is an enormous amount of material on the Fund’s activities with respect to each of these three areas of activity. Surveillance reports, country reports on the use of Fund resources (including reviews of country performance resulting in disbursement of funds to the borrowing member), and reports on Fund technical assistance are now available on the Fund’s Web site, <http://www.imf.org/external/pubind.htm>.

109. This information comes from the author’s personal participation in the activities of the IMF as a senior staff member during the relevant time period.

110. All but five offshore centers (Andorra, Monaco, Liechtenstein, Tuvalu, and Nauru) are either members of the IMF directly or as an overseas territory, dependency, special administrative area, etc. of a member.

economic or fiscal well-being of *other* members should not be within its jurisdiction, argued François Gianviti, General Counsel and Director of the Legal Department from January 1986 to December 2004.¹¹¹ With respect to tax technical assistance, which at the time was strictly voluntary, the question of external implications of domestic tax policy was generally not raised by IMF staff. Had it been, the effects of such voluntary Fund-to-jurisdiction advice on curbing OFCs' so-called harmful tax practices would still have been, at best, trivial.¹¹²

There are a number of reasons why the Fund as an institution concluded that it had no jurisdiction to become involved in the Harmful Tax Practices Project. Although the actual evidence is sketchy and largely anecdotal, it appears that the political concerns of a number of key Executive Board members were important—though probably not determinative. The IMF Board consists of twenty-four members. The five IMF members with the greatest voting power, the United States, Japan, Germany, the United Kingdom, and France,¹¹³ select an Executive Board member directly, while other IMF members elect Board members from self-organized constituencies.¹¹⁴ The United Kingdom was one of the onshore jurisdictions expressing concern over the harmful tax practices of offshore centers, albeit with less energy and conviction than the United States or France.¹¹⁵ As such, the United Kingdom was primarily representing the concerns of the U.K. Treasury. However, at the IMF, the United Kingdom also represents the interests of the British Overseas Territories and Crown Dependencies because they are, for Fund purposes, part of the United Kingdom.¹¹⁶ Of these, Anguilla, Bermuda, the British Virgin

111. The author drafted a legal opinion which reached this conclusion. While it was endorsed by the General Counsel, it was not publically released.

112. During the early 1990s, Vito Tanzi, the then head of the Fiscal Affairs Department, began to criticize the adverse effects that tax havens had on tax systems of other countries and speculated that those countries could force a change in the tax policies of tax havens by a concerted levying of significant withholding tax on all payments to such havens and levying significant tax on all payments from them. However, such a critique was not integrated into the Fund's surveillance or conditionality. See Vito Tanzi, *Globalization, Tax Competition, and the Future of Tax Systems* (IMF, Working Paper No. 96/141, 1996), available at <http://ssrn.com/abstract=883038>.

113. IMF Articles, *supra* note 102, art. XII, § 3; IMF, IMF Executive Directors and Voting Power [hereinafter IMF, Executive Directors], <http://www.imf.org/external/np/sec/memdir/eds.htm> (last visited Oct. 27, 2009).

114. See IMF, Executive Directors, *supra* note 113.

115. This information comes from the author's personal participation in the activities of the IMF as a senior staff member during the relevant time period.

116. Membership is restricted to countries. See IMF Articles, *supra* note 102, art. II; IMF, Membership, *supra* note 42. The IMF's and United Kingdom's recognition of British

Islands, Cayman Islands, Gibraltar, Guernsey, Isle of Man, Jersey, Montserrat, and the Turks and Caicos Islands were offshore centers that were allegedly engaging in harmful tax practices.¹¹⁷ These U.K. territories and dependencies had jurisdiction over their own domestic tax policies—they were not under the control of the U.K. Treasury.¹¹⁸ This appeared to at least some IMF staff to create a tension between the United Kingdom's more limited domestic interests, as expressed through their concern over harmful tax practices, and the United Kingdom's broader "imperial" interests, as expressed through their need to represent the interests of overseas territories and crown dependencies at the IMF.

Another member of the IMF Board with divided loyalties was Canada. Canada, a G-7 member country since 1976, led an elective IMF Executive Board constituency that included the independent Commonwealth countries of Antigua and Barbuda, Bahamas, Barbados, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines,¹¹⁹ each of which was also an offshore financial center with "suspect" tax practices.¹²⁰ The Canadian Executive Director (who also represented Ireland and Jamaica) was well known to many IMF staff for actively representing the interests of the members of its constituency. In other words, the fact that the IMF's membership was broadly inclusive (unlike the OECD) was probably one reason it did not get involved in curbing tax practices of offshore centers.

Also important was the view of the IMF management and staff, as articulated by the Legal Department in a number of unpublished memoranda, that there was nothing in the IMF Articles of Agreement that created any membership obligation that a member take action to benefit another member at their own expense.¹²¹ This would mean that jurisdictions engaging in allegedly harmful tax practices would only be counseled to adjust those practices if they

Overseas Territories and Crown Dependencies as part of the United Kingdom for purposes of IMF membership is long standing. These facts were made clear to the author while he served as Senior Council in the Legal Department from 1996–2002. For a list of British Overseas Territories and Crown Dependencies, see Foreign and Commonwealth Office (U.K.), Crown Dependencies and Overseas Territories, <http://collections.europarchive.org/tna/20080205132101/www.fco.gov.uk/servlet/Front%3Fpagename=OpenMarket/Xcelerate/ShowPage&c=Page&cid=1044360168291> (last visited Oct. 27, 2009).

117. See OECD, TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 51, at 17, 29.

118. Foreign and Commonwealth Office, Briefing to IMF Staff in Washington, D.C. (Summer 2000).

119. IMF, Executive Directors, *supra* note 113.

120. OECD, TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 51, at 17.

121. See *supra* note 111 and accompanying text.

were harmful to the jurisdiction itself rather than to other members. As this was not the problem, the Fund could not be expected to conclude that the choice of offshore jurisdictions to adopt domestic tax policies that caused harm to other members (by undermining the income tax base of other jurisdictions) breached some kind of Fund obligation. This principle of “no obligation to sacrifice for another member” applied particularly well for tax matters, in that there was no other international law that recognized any principle of international tax comity, i.e., that the courts (and administrative agencies) of one country should enforce the revenue laws of another country except on the basis of reciprocity. In other words, it was probably restraints on the organization’s ability to act on behalf of its wealthiest members (both its organizing principles and its independent staff) that helped keep the IMF from acting against the interests of the OFCs.

Following the election of President Bill Clinton and the reappointment of Donald Lubick to the position of Assistant Secretary of the Treasury for Tax Policy,¹²² the United States began to advance a more aggressive policy to moderate so-called harmful tax practices.¹²³ Concluding that a coordinated approach would be more effective, the United States and France in particular worked with the remaining five members of the G-7 to mobilize the OECD to “develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases” and report back to the G-7 in 1998.¹²⁴

A problem with such a coordinated approach was that a number of OECD jurisdictions were themselves offshore centers guilty of the same behavior. For example, most IMF staff appeared to consider Luxembourg and Switzerland, who had low or no tax on income from capital and relatively strict bank secrecy, offshore centers.¹²⁵ Nevertheless, the OECD as an organization duly issued a report

122. Assistant Secretary Lubick held the same position under President Jimmy Carter. Press Release, U.S. Dep’t of the Treasury, Donald C. Lubick Confirmed as Treasury Assistant Secretary for Tax Policy (Feb. 13, 1998), *available at* <http://www.ustreas.gov/press/releases/rr2225.htm>.

123. Personal communication from Donald Lubick, Assistant Sec’y of the Treasury for Tax Policy, U.S. Dep’t of the Treasury, in Washington, D.C., to author (Summer 1994).

124. OECD, HARMFUL TAX COMPETITION, *supra* note 50, at 7 (quoting the Ministerial Communiqué of May 1996).

125. This information comes from the author’s personal participation in the activities of the IMF during the relevant time period.

entitled *Harmful Tax Competition: An Emerging Global Issue*.¹²⁶ Among other things, the report called for the OECD to develop a list of uncooperative tax havens and “a number of Recommendations for action at the level of national legislation and in tax treaties.”¹²⁷ The report also noted that “[c]ountries should remain free to design their own tax systems as long as they abide by internationally accepted standards in doing so,”¹²⁸ later noting that while there was nothing inherently wrong with countries “that are able to finance their public services with no or nominal income taxes,”¹²⁹ those that “offer themselves as places to be used by non-residents to escape [income] tax in their country of residence” were in breach of accepted standards of behavior.¹³⁰ Nevertheless, in identifying “harmful preferential tax regimes,” meaning breaches of accepted standards, the report listed a number of “key factors”: (1) the regime imposes low or no taxes on the relevant income (from geographically mobile financial and other service activities); (2) the regime is “ring-fenced” from the domestic economy (meaning that there is a domestic income tax, but that non-resident taxpayers are exempt from paying income tax); (3) the regime lacks transparency (e.g., the details of the regime or its application are not apparent or there is inadequate regulatory supervision or financial disclosure); and finally (4) there is no effective exchange of information with respect to the regime.¹³¹

The report discussed how many OECD members had some aspects of harmful preferential regimes and produced a proposal for

126. OECD, HARMFUL TAX COMPETITION, *supra* note 50, at 1. At their 1997 meetings, the G-8 reaffirmed the importance of combating harmful tax competition. FINANCE MINISTERS' REPORT, DENVER ECONOMIC SUMMIT (June 1997), available at <http://www.state.gov/www/issues/economic/summit/finance97.html>. Soon after, the OECD Committee on Fiscal Affairs created the “Special Sessions on Tax Competition” in response to the ministerial communiqué. The Special Sessions prepared the report under the joint chairmanship of France and Japan. The Committee adopted the report at its session on the 20th of January, 1998. See OECD, HARMFUL TAX COMPETITION, *supra* note 50, at 7.

127. OECD, HARMFUL TAX COMPETITION, *supra* note 50, at 50.

128. *Id.* at 15.

129. *Id.* at 20. At the time of the drafting of the report there was much discussion about how the success of the modern welfare state depended on effective taxation of income from capital, and that tax havens, by permitting avoidance or evasion of that tax, were therefore endangering the welfare state. See generally Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573 (2000) (arguing that tax havens allow large amounts of income from capital to go untaxed, depriving countries of revenue and forcing them to rely on forms of taxation less progressive than the income tax, threatening the welfare state).

130. OECD, HARMFUL TAX COMPETITION, *supra* note 50, at 20.

131. *Id.* at 21.

dealing with these members.¹³² It also recommended creating a separate list of possible “tax havens.”¹³³ When the list came out in the 2000 OECD report *Toward Global Tax Co-operation*, no OECD members were on the list.¹³⁴ Not surprisingly, due to the fact that OECD members would not be subject to the harmful tax practices, the project became a major criticism by project opponents.¹³⁵ Simply put, the standards were not designed to be universal. The OECD was acting even less like a traditional TRN.¹³⁶

But a key problem for the OECD was identifying internationally accepted standards of income tax behavior. As the report correctly noted, there was no generally accepted standard that countries impose an income tax, or more specifically, a tax on income from capital.¹³⁷ As argued earlier by at least some officials from OFCs, it was problematic to argue that jurisdictions should be compelled to enforce a tax on the income from capital of their non-residents, especially given no international standard and no international rule of tax comity.¹³⁸ This was the main purpose of TRNs in the first place.

The OECD’s 2000 report appeared to accept some of the arguments raised against the Harmful Tax Practices Project; while the report restated the four “key factors,” it noted at the beginning that the project was “not primarily about collecting taxes” or “promot[ing] the harmonisation of income taxes” or “dictating to any country what should be the appropriate level of tax rates.”¹³⁹ Instead, “the project is about ensuring that the burden of taxation is fairly shared and that tax should not be the dominant factor in making capital allocation

132. *Id.* at 70–71.

133. *Id.* at 71.

134. OECD, TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 51, at 17.

135. See J.C. SHARMAN, HAVENS IN A STORM: THE STRUGGLE FOR GLOBAL TAX REGULATION 44–45 (2006).

136. During the 1990s, the European Union also began the process of addressing the more specific problem of tax evasion on savings income when an individual resident of one E.U. member country held an account in a financial institution in another E.U. member country whose tax authority did not withhold tax on interest paid to the non-resident or report the payment of that interest to the resident jurisdiction’s tax authority. See generally Thomas Perrot, *Legislative Development: EC Draft Directive on the Taxation of Savings: Still a Long (and Bumpy) Road Ahead*, 9 COLUM. J. EUR. L. 475 (2003) (setting the Directive’s objective to deter tax avoidance); Suzanne Walsh, *Taxation of Cross-Border Interest Flows: The Promises and Failures of the European Union Approach*, 37 GEO. WASH. INT’L L. REV. 251 (2005) (discussing the steps developed nations are taking to combat the threat of tax evasion created by “the increased mobility of capital”).

137. OECD, HARMFUL TAX COMPETITION, *supra* note 50, at 16.

138. This information comes from the author’s personal participation in the activities of the IMF during the relevant time period.

139. OECD, TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 51, at 5.

decisions The project will, by promoting a co-operative framework, support the effective fiscal sovereignty of countries over the design of their tax systems.”¹⁴⁰

There are many obvious problems and contradictions in this short statement. The project apparently *is about collecting taxes* in cases where there is no harmonization of tax rates; tax havens, by making it possible to reduce or eliminate tax on income from capital regardless of where the investment is actually located, *actually ensure* that tax is no factor in making capital allocation decisions; and effective implementation of the project *will (they hope) result in* offshore centers and other tax havens changing the design of their tax systems. One can almost pity the OECD. They outline the ideological reason why there is no generally accepted standard, then pretend that they have one that works. This is hardly the way a successful TRN is supposed to work.

Finally, the report also compiled a preliminary list of tax havens from which a list of “uncooperative” tax havens was to be distilled over the next twelve months.¹⁴¹ The report concluded that in order to avoid inclusion on the list of “Uncooperative Tax Havens,” the jurisdiction would have to make a public political commitment to adopt a schedule of progressive changes to eliminate its harmful tax practices (i.e., the four key factors) by the end of 2005.¹⁴² The OECD also laid out a plan for dialogue with so-called “cooperative” jurisdictions.¹⁴³

While the 2000 Report retained the same extensive definition of harmful tax practices,¹⁴⁴ that same year, the OECD released another report focusing in particular on the importance of the exchange of information, especially with respect to gathering information on bank accounts.¹⁴⁵ As discussed above in Part II.B.1, with effective exchanges of information in cases of suspected tax evasion, onshore tax authorities could request and receive information from offshore jurisdictions about bank accounts and other information held by those specific taxpayers.¹⁴⁶ However, those authorities would first have to identify particular taxpayers as possible evaders and fulfill

140. *Id.*

141. *Id.* at 17–18.

142. *Id.* at 17–19.

143. *Id.* at 20–21.

144. OECD, TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 51, at 9.

145. See OECD, IMPROVING ACCESS TO BANK INFORMATION FOR TAX PURPOSES (2000), available at <http://www.oecd.org/dataoecd/3/7/2497487.pdf>.

146. See *supra* notes 57–58, 60, 62, and 68, and accompanying text.

domestic legal requirements for requesting such information.¹⁴⁷ Even if they did, they often would not know what information to request.¹⁴⁸ While far better than nothing, just agreeing to exchanges of information would not solve the problems raised by onshore jurisdictions. Indeed, that was why the attributes of uncooperative jurisdictions went beyond exchange-of-information agreements.

It was also around this time that the Financial Stability Forum (another quasi-TRN, to be discussed at greater length below in Part II.C.2) released its Group III list of jurisdictions that had the most problematic financial supervisory systems.¹⁴⁹ The list included twenty-five offshore centers, including nearly all those on the OECD tax haven list.¹⁵⁰

Not long after the release of the Report, then U.S. Secretary of the Treasury, Lawrence Summers, tried once again to get the IMF involved. He issued a statement to the International Monetary and Finance Committee of the IMF calling “abuse of the global financial system” a “global public bad” and calling on the IMF and the World Bank to prepare a joint report on their roles in protecting the integrity of the financial system against abuse.¹⁵¹ He issued the statement as the IMF was implementing its Financial Sector Assessment Program and Offshore Financial Center Assessment Program.¹⁵² Some IMF senior staff involved assumed that the statement might have been directed, at least in part, toward the possibility of including harmful tax practices as a subject for assessment under those two programs.¹⁵³

While Secretary Summers specifically mentioned money laundering in his statement, staff prepared a background paper examining financial system abuse as broadly defined, including tax

147. OECD, IMPROVING ACCESS TO BANK INFORMATION FOR TAX PURPOSES, *supra* note 145, at 8–9, 19.

148. “As noted, the OECD’s proposed solution has been bilateral tax information exchange agreements requiring exchange of information on request, . . . which is not effective exchange of information.” David Spencer, *Liechtenstein and the Subprime Crisis: Systemic Issues*, J. INT’L TAX’N, Sept. 2008, at 14, 21. For a discussion of the different types of tax evasion opportunities that remain, see generally David Spencer and J.C. Sharman, *International Tax Cooperation*, J. INT’L TAX’N, Dec. 2007, at 34, 35–49.

149. See Press Release, Bank for International Settlements, *supra* note 51.

150. *Id.*

151. Lawrence H. Summers, U.S. Treasury Sec’y, Statement to the International Monetary and Finance Committee (Sept. 24, 2000), *available at* <http://www.imf.org/external/am/2000/imfc/eng/usa.htm>.

152. These issues will be discussed at greater length *infra* in Parts II.C and D.

153. The author was a party to these discussions. Due to sensitivities involved, names and titles of discussants in this section are withheld.

evasion.¹⁵⁴ The paper also discussed the OECD's Harmful Tax Practices Project and its progress.¹⁵⁵ A number of IMF Executive Directors spoke with IMF Management and the staff involved in drafting the background paper and made it clear that they opposed any IMF involvement in the Harmful Tax Practices Project, in part because the Fund should not be involved in any program that was not "voluntary" or that was "coercive,"¹⁵⁶ which, incidentally, are concepts largely contrary to the way in which TRNs are supposed to operate.¹⁵⁷ The next staff paper (co-authored with World Bank staff) deleted any discussion of harmful tax practices and focused exclusively on money laundering.¹⁵⁸

The next OECD report, released in early 2001, included a list of uncooperative jurisdictions (to be updated by the OECD) for the purpose of coordinating the application of the so-called "defensive measures."¹⁵⁹ They were actually quite straightforward. They would disallow normally available deductions, exemptions, allowances, and credits, as well as apply withholding taxes and increase audits, relating to transactions with residents or entities in the uncooperative jurisdictions.¹⁶⁰

While roundly described as the exercise of hard power sanctions and criticized as an improper application of financial force by the powerful against the weak,¹⁶¹ what the OECD termed "countermeasures" turned out to be primarily an exercise of purely domestic sovereignty by OECD members; in fact, the kinds of activities that members of TRNs, meaning domestic regulatory authorities, frequently undertake. This is because the countermeasures would have affected only the tax liabilities of physical or legal persons resident in the onshore domestic jurisdiction

154. IMF, FINANCIAL SYSTEM ABUSE, FINANCIAL CRIME AND MONEY LAUNDERING—BACKGROUND PAPER 3 (2001) [hereinafter IMF, FINANCIAL SYSTEM ABUSE], available at <http://www.imf.org/external/np/ml/2001/eng/021201.pdf>.

155. *Id.* at 19.

156. This information comes from the author's personal participation in the activities of the IMF during the relevant time period.

157. See the discussion about lack of coerciveness in TRN participation *supra* in Part I.A.

158. See IMF AND WORLD BANK, ENHANCING CONTRIBUTIONS TO COMBATING MONEY LAUNDERING: POLICY PAPER 2-9 (2001), available at <http://www.imf.org/external/np/ml/2001/eng/042601.PDF>.

159. OECD, OECD'S PROJECT ON HARMFUL TAX PRACTICES: THE 2001 PROGRESS REPORT 8-9 (2001) [hereinafter OECD, PROJECT ON HARMFUL TAX PRACTICES], available at <http://www.oecd.org/dataoecd/60/28/2664438.pdf>.

160. *Id.* at 13.

161. See *infra* notes 168-71 and accompanying text.

(or the flow of income passing through them to non-residents). None of the measures proposed would have required an OFC to collect taxes and remit them to an onshore jurisdiction; nor did the onshore jurisdictions threaten to withhold financial or other assistance.¹⁶² In effect, local tax authorities would withhold tax benefits from their own residents when they engaged in activities with tax havens. Nevertheless, the OECD was not simply discussing proposed standards that should be accepted by domestic authorities based on persuasion, but was advocating that local authorities enforce those standards by using state (i.e., hard) power.

Nor did the countermeasures breach any generally accepted international obligation. While such an obligation could arise from a double-taxation convention (or possibly a bilateral investment treaty), no such treaties were affected; and even if they were, such treaties permit parties unilaterally to withdraw after a notice period.¹⁶³ One possible problem was that the deductions, exemptions, and credits to be disallowed (or the reduction or elimination of withholding taxes to be foregone) were included in international income tax principles generally accepted by countries with income taxes, and accepted by the major onshore jurisdictions.¹⁶⁴ Assuming a tax on income from capital, there are good reasons for the acceptance of these principles, which have been enshrined in the laws of most OECD countries and in the OECD Model Double Taxation Convention.¹⁶⁵ In effect, the anti-tax haven OECD members were saying, “help us enforce our income taxes on our own people or we will adopt very different tax rules when our taxpayers engage in transactions with your taxpayers.” The threatened countermeasures may have been significant, but they were not illegal under international law or custom. If applied, the countermeasures would increase the tax owed to the onshore jurisdiction.¹⁶⁶ Increasing that

162. OECD, PROJECT ON HARMFUL TAX PRACTICES, *supra* note 159, at 11–13.

163. See OECD, COMMITTEE ON FISCAL AFFAIRS, *supra* note 93, art. 20; U.S. Model Bilateral Investment Treaty, art. 16 (2004), <http://www.state.gov/documents/organization/117601.pdf>. But see George Rawlings, *Taxes and Transnational Treaties: Responsive Regulation and the Reassertion of Offshore Sovereignty*, 29 LAW & POL’Y 51, 51–56 (2007) (describing the shift from a “command-and-control regulatory approach” in dealing with tax havens to a more “responsive regulatory dialogue”).

164. For further discussion, see Benjamin R. Hartman, *Coercing Cooperation from Offshore Centers: Identity and Coincidence of International Obligations Against Money Laundering and Harmful Tax Competition*, 24 B.C. INT’L & COMP. L. REV. 253, 279–81 (2001).

165. See Vann, *supra* note 64, at 718, 719–22, and 725–29.

166. Increasing the withholding tax on dividends or interest paid to a non-resident located in an OFC could, at least in theory, be suffered by the offshore resident. However,

person's taxes would reduce after-tax income, which would reduce the ultimate profitability of that person. That would act as a serious disincentive for that person to conduct business with a person located in a blacklisted jurisdiction, which would, in turn, create competitive pressure on the offshore jurisdiction to change its rules so that it was no longer blacklisted.¹⁶⁷ This would be the exercise of hard power, but one that was applied to the OFC only indirectly, through the onshore resident party and through the operation of the market.

These countermeasures, however, were offered as part of a concerted effort by OECD members to change how OFCs operated. As described above, they came in the form of a standard accepted only by certain members of the OECD (rather than generally accepted), via OECD-initiated assessments (rather than those of neutral parties), and of blacklisting by the OECD (again, rather than by a neutral party), followed by a concerted application of countermeasures by each local state (rather than through persuasion). In many ways this was a textbook example of how TRNs do not operate. This greatly exacerbated the negative reactions that followed.

The OECD program opponents presented the program as a form of bullying which resulted in immediate protests by officials in those offshore jurisdictions. One major complaint was procedural, that the OECD was not a truly representative forum, but one dominated by wealthy onshore jurisdictions that essentially ignored all principles of due process. The Secretary General of the Commonwealth, which includes nearly all of the listed English-speaking tax havens, referred to the OECD as "prosecutor, judge, jury and jailer."¹⁶⁸ Another major complaint was more substantive, that the OECD, by imposing domestic tax policies on small offshore jurisdictions was practicing "economic imperialism" and discriminating against "small states."¹⁶⁹ Predictably, the most vocal and effective complaint was that the

the offshore resident would not be the actual taxpayer, in that tax is withheld at source, i.e., by the onshore resident. In other words, the effect on the offshore resident would only be indirect.

167. See J.C. Sharman & Gregory Rawlings, *National Tax Blacklists: A Comparative Analysis*, J. INT'L TAX'N, Sept. 2006, at 38, 47, 64 (describing the OECD Harmful Tax Competition initiative and discussing criticism of the initiative).

168. Anthony B. van Fossen, *Money Laundering, Global Financial Instability, and Tax Havens in the Pacific Islands*, 15 CONTEMP. PAC. 237, 260 (2003) (quoting Eugene Bingham & John Andrews, *Islands Face Dirty-Money Backlash*, N.Z. HERALD, Mar. 3, 2001, available at http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=174807&pnum=0).

169. *Id.* at 259 (quoting PALAU HORIZON, Aug. 24, 2001), 260 (quoting MONEY LAUNDERING MONITOR, Jan. 2001).

OECD's "defensive countermeasures" were actually coercive sanctions, in effect the illegitimate application of hard power by the rich and powerful against the small and weak.¹⁷⁰

There was some agreement with this view in the popular press, among economists and think-tanks, and in academia.¹⁷¹ In effect, the offshore centers adopted what turned out to be a powerful rhetorical argument that the larger onshore centers were trying to impose "standards" that were neither internationally accepted nor even applicable to some of their own members.¹⁷²

Finally, the OECD Harmful Tax Practices Project was being carried out almost simultaneously with the Financial Action Task Force's non-cooperating countries and territories initiative, and there was significant overlap between the two blacklists.¹⁷³ One major complaint was that the two issues, tax evasion and the laundering of illegal proceeds, were being conflated and confused by the press and the public so that tax havens were confused with countries that allowed drug kingpins or corrupt dictators to hide their ill-gotten gains.¹⁷⁴

The OECD appeared to be caught somewhat unaware by the fierce nature of the reaction against the Harmful Tax Practices Project and began to change its tactics. While it could not find a TRN or an international organization with TRN characteristics like the IMF to support its initiative, the OECD took steps to make the process more inclusive and less confrontational. Starting in the spring of 2001, the OECD held regional face-to-face meetings with officials from the listed countries in an attempt to negotiate agreements.¹⁷⁵

170. See SHARMAN, *supra* note 135, at 101–48. For further examples, see Vaughn E. James, *Twenty-First Century Pirates of the Caribbean: How the Organization for Economic Cooperation and Development Robbed Fourteen CARICOM Countries of Their Tax and Economic Policy Sovereignty*, 34 U. MIAMI INTER-AM. L. REV. 1, 28–39 (2002) (describing "the CARICOM reaction to OECD lists" and the "economic impact of the OECD listing on CARICOM nations"); Akiko Hishikawa, Note, *The Death of Tax Havens?*, 25 B.C. INT'L & COMP. L. REV. 389, 401–12 (2002) (describing responses to the OECD's designation as tax havens by the designated countries).

171. See, e.g., Hartman, *supra* note 164, at 279–81 (arguing that countermeasures are in fact sanctions to remedy a breach of international obligations, but that because there are no such obligations with respect to tax the sanctions are illegitimate); James, *supra* note 170, at 5 ("[T]he OECD, like pirates who plied the waters of the Caribbean during the sixteenth through nineteenth centuries, has, through its ill-advised anti-harmful tax competition initiative, effectively robbed fourteen CARICOM nations of their sovereign right to determine their tax and economic policies.").

172. SHARMAN, *supra* note 135, at 71, 101–48.

173. See *infra* Appendix.

174. See van Fossen, *supra* note 168, at 260.

175. See *id.* at 259–60.

Also, it was at this time that the replacement of the Clinton administration with the Bush administration resulted in a serious shifting of gears.

Even during the Clinton administration, many conservative Republicans had opposed income taxes in general for ideological reasons while others opposed the OECD's actions as a breach of international sovereignty.¹⁷⁶ There had been little support among Republicans in the House and Senate for the OECD initiative; Richard Armey, the House majority leader, even called the OECD "a global network of tax police."¹⁷⁷ According to some press reports (and private discussions with administration officials), Lawrence Lindsey, then Director of the National Economic Council, and R. Glenn Hubbard, Chairman, President's Council of Economic Advisers (and incidentally Chairman, Economic Policy Committee, Organisation for Economic Co-operation and Development), both adopted views that the availability of tax havens not only helped keep tax rates in the United States down, but they actually helped U.S. companies compete by reducing tax rates.¹⁷⁸ In June 2001, Treasury Secretary Paul O'Neill stated in a meeting at the OECD that the United States could no longer support the initiative, at least the way in which it was now being pressed.¹⁷⁹ Also, as news of this development found its way back to the IMF, Huw Evans, IMF Executive Director for the United Kingdom, concluded that the efforts to involve the Fund in anti-tax haven activities would now be over.

In response, the OECD took several actions. First, the shift in focus hinted at in a 2000 paper on bank secrecy became concrete. Moving beyond the existing OECD model on exchange of information, in 2002, the OECD published a new model covering both civil and criminal taxation matters, known as Tax Information Exchange Agreements ("TIEAs").¹⁸⁰ The OECD also created the Global Forum on Taxation (later retroactively renamed Global Forum on Transparency and Exchange of Information), with a principle goal of advancing the adoption of transparency in the

176. *Id.* at 261–62.

177. *Id.* at 262 (internal quotation marks omitted).

178. See Adam Cohen, *Banking on Secrecy: Terrorists Oppose Scrutiny of Offshore Accounts. And So Do Many U.S. Bankers and Lawmakers*, CNN.COM, Oct. 15, 2001, <http://www.cnn.com/ALLPOLITICS/time/2001/10/22/secrecy.html>.

179. *Id.* This was also reported to the author by a senior civil servant at the OECD.

180. OECD, AGREEMENT ON EXCHANGE OF INFORMATION ON TAX MATTERS (2002), <http://www.oecd.org/dataoecd/15/43/2082215.pdf>; Press Release, OECD, OECD Releases Model Agreement on Exchange of Information in Tax Matters (Apr. 18, 2002), http://www.oecd.org/document/4/0,3343,en_2649_33745_2082244_1_1_1_1,00.html.

ownership and control of companies and trusts and exchange of that information and other information on bank accounts, of which TIEAs were an essential part. From here on, the Global Forum and the Harmful Tax Practices programs moved forward in tandem.

In 2003, Canada hosted a Global Forum meeting bringing together representatives of forty OECD and non-OECD governments.¹⁸¹ Many OFCs participated. They agreed to continue their work on advancing principles of transparency and exchange of information.¹⁸²

The following year, another Global Forum was convened in Berlin.¹⁸³ The meeting sought to create an assessment process to determine how all jurisdictions, including OECD members,¹⁸⁴ were complying with the goal of transparency and information exchange based on the TIEA process,¹⁸⁵ particularly the “financial centers,” which included Andorra, Barbados, Brunei, Liechtenstein, Macao-China, Malaysia (Labuan), and the Marshall Islands, among others.¹⁸⁶ Interestingly, the Forum called for a process with “fairness and integrity” and a “methodology and consistent framework” using an “agreed template.”¹⁸⁷ The Forum also agreed that “the identification and review of significant financial centres should be a dynamic process and that these countries should be invited to participate in the Global Forum.”¹⁸⁸ Finally, it agreed that “the information compiled about all the countries under review would be made available to the full Global Forum for comments and questions prior to finalisation,” and that “[w]here factual disagreements arise, a small group of . . . Participating Partners would be designated following an agreed process to try to resolve the factual disagreement.”¹⁸⁹

It seemed that the OECD learned from its Harmful Tax Practices experience. The new Global Forum adopted a less ambitious goal than the original Harmful Tax Practices set of four

181. Closing Statement by the Co-Chairs, OECD Global Forum on Taxation, Ottawa, (Oct. 16, 2003) http://www.oecd.org/document/0/0,3343,en_2649_33745_16643264_1_1_1_1,00.html.

182. *Id.*

183. Press Release, OECD, Outcome, Conclusion of the Meeting of the OECD Global Forum on Taxation in Berlin (June 3–4, 2004), http://www.oecd.org/document/5/0,3343,en_2649_33745_31967429_1_1_1_1,00.html.

184. OECD, A PROCESS FOR ACHIEVING A GLOBAL LEVEL PLAYING FIELD 2 (June 4, 2004), <http://www.oecd.org/dataoecd/13/0/31967501.pdf>.

185. *Id.*

186. *Id.* at 6 n.7.

187. *Id.* at 6.

188. *Id.*

189. *Id.*

“key factors” in identifying “harmful preferential tax regimes.”¹⁹⁰ The focus now was on information exchange, a principle that even OFCs might well accept as an acceptable standard. After all, many had signed exchange-of-information agreements with countries like the United States.¹⁹¹ Also, such a standard would still leave offshore centers considerable leeway in how to organize their domestic tax structures.

Of particular interest is that the OECD made specific efforts to increase the number of jurisdictions involved in the process, including non-OECD countries and even assessed jurisdictions themselves. Increasing the number of members would help reduce the problem the OECD had in its Harmful Tax Practices—a small and relatively cohesive membership, identified above in Part I.B as a significant limitation in the legitimacy of TRNs. Next, the new program called for an agreed methodology and template for assessment, ensuring more consistency and uniformity among those assessed—another matter addressed in Part I.B. It also called for a review process involving the concerned parties, a third issue addressed above. And finally, there was no specific call for countermeasures. By moving toward a new Global Forum, the OECD was adopting many of the characteristics of successful TRNs. Meanwhile, by 2004 only five offshore centers remained on the OECD list, three of which, Andorra, Liechtenstein, and Monaco, are located in Europe.¹⁹²

The next meeting of the Global Forum was in Melbourne in 2005.¹⁹³ The meeting attracted a significant number of offshore centers, although a number of invited OFCs did not attend.¹⁹⁴ The report of the meeting noted progress in reviewing countries’ adherence to principles of transparency and effective exchange of information.¹⁹⁵ The report also noted that the Global Forum effort was not the same as the Harmful Tax Practices effort, but that “the Report, once completed and as updated periodically, will provide more up-to-date information [than the OECD 2000 Harmful Tax

190. See OECD, HARMFUL TAX COMPETITION, *supra* note 50, at 21.

191. See *supra* notes 67, 75–77 and accompanying text.

192. See OECD, THE OECD’S PROJECT ON HARMFUL TAX PRACTICES: THE 2004 PROGRESS REPORT 14 (2004), <http://www.oecd.org/dataoecd/60/33/30901115.pdf> (listing Andorra, the Principality of Liechtenstein, Liberia, the Principality of Monaco, and the Republic of the Marshall Islands).

193. See OECD, PROGRESS TOWARDS A LEVEL PLAYING FIELD: OUTCOMES OF THE OECD GLOBAL FORUM ON TAXATION, MELBOURNE (Nov. 2005), <http://www.oecd.org/dataoecd/28/55/35670025.pdf>.

194. See *id.* at 9.

195. See *id.* at 3.

Practice list]. This does not reflect any judgment by the Global Forum on the tax or other policies underlying country lists.”¹⁹⁶ In other words, the two efforts were different, and the Forum did not replace Harmful Tax Practices, but those who had been adversely affected by the latter could count on the former to help out.

OFCs rapidly began to enter into TIEA agreements with onshore jurisdictions.¹⁹⁷ By the end of 2002, only six offshore centers and one onshore jurisdiction had not committed to effective exchanges of information.¹⁹⁸ Meanwhile, by 2004 only five offshore centers remained on the OECD list, three of which, Andorra, Liechtenstein, and Monaco, are located in Europe.¹⁹⁹

Nevertheless, the onshore centers did not get what they most wanted in the beginning of the process: the end of no (or low) income taxation or, barring that, the full reporting to onshore centers of all non-resident activities. Because of this, an onshore resident could still easily evade income taxes by setting up a company and bank account in an offshore jurisdiction rather than in a jurisdiction that levied tax. While in cases of suspected tax evasion onshore tax authorities could request, and now receive, information from offshore jurisdictions about those specific taxpayers, those authorities would first have to suspect the evasion. Even if they did, they often would not know what information to request.²⁰⁰ On the other hand, OFCs were not fully satisfied. Complaints of undue pressure to force OFCs to accept burdens they should not have to—spending money to implement tax systems they do not believe in for the benefit of far richer countries—continue.²⁰¹

196. *Id.* at 8.

197. See Press Release, OECD, OECD Reports Progress in Fighting Offshore Tax Evasion, but Says More Efforts Are Needed (Oct. 12, 2007), http://www.oecd.org/document/48/0,3343,en_2649_201185_39482288_1_1_1_1,00.html.

198. See Press Release, OECD, The OECD Issues the List of Unco-operative Tax Havens (Apr. 18, 2002), http://www.oecd.org/document/19/0,3343,en_2649_33745_2082323_1_1_1_1,00.html (listing Andorra, the Principality of Liechtenstein, Liberia, the Principality of Monaco, the Republic of the Marshall Islands, the Republic of Nauru, and the Republic of Vanuatu as the remaining “unco-operative tax havens”).

199. See OECD, THE OECD’S PROJECT ON HARMFUL TAX PRACTICES, *supra* note 192, at 14 (listing Andorra, the Principality of Liechtenstein, Liberia, the Principality of Monaco, and the Republic of the Marshall Islands).

200. “As noted, the OECD’s proposed solution has been bilateral tax information exchange agreements requiring exchange of information *on request* . . . which is not effective exchange of information.” Spencer, *supra* note 148, at 21 (emphasis added). For a discussion of the different types of tax evasion opportunities that remain, see generally Spencer & Sharman, *supra* note 148, at 35–49.

201. Interviews with various IMF staff, IMF Offshore Financial Center Assessment Program (Summer 2007–present).

The income tax standards system began with many detrimental attributes—no real TRN, no real international organization with TRN attributes—and depended largely on the actions of powerful states. It had difficulty producing generally accepted standards and implementing them successfully. It had less than perfect success in protecting the interests of weak states over the strong.

The OECD shifted gears after the outcry raised against the Harmful Tax Practices Project. It created a far more inclusive sub-organization—the Global Forum. The OECD turned away from a standard not widely accepted and adopted a less stringent but more widely acceptable standard. It adopted a system of assessment that was less arbitrary and that included a review process for the countries affected. And finally, it had no blacklist. By adding these components of successful TRNs, the Global Forum process was far more widely accepted.

C. Prudential Regulation

1. The Basic Indictment²⁰²

Onshore jurisdictions claimed that OFCs destabilized the international financial system by failing to implement prudential regulations, which allowed both offshore institutions and onshore institutions that use offshore facilities to avoid onshore regulations, putting them at greater risk of failure. While all prudentially supervised institutions (banks, insurance companies, and securities firms) were of concern to the onshore jurisdictions, banks were the primary focus of onshore attention. According to onshore jurisdictions, because OFCs either did not promulgate adequate prudential regulations or implement them effectively through a program of compliance, an OFC-chartered bank could act in ways that would threaten its own soundness. These could include lending in excess of a prescribed capital minimum and failing to control for default and concentration risk. Another allegation was that, in granting banking licenses, OFC regulators did not vet owners and controllers to see if they were “fit and proper,” which would have made poor management and poor compliance with prudential principles less likely. Together, these poor prudential practices would

202. This short section is a summary and reorganization of arguments presented during the early years of the debate (mid- to late- 1990s) on offshore financial centers and poor financial sector supervision. See Errico & Musalem, *supra* note 51, at 1–7; FINANCIAL STABILITY FORUM, REPORT OF THE WORKING GROUP ON OFFSHORE CENTRES 1–2 (2000), http://www.financialstabilityboard.org/publications/r_0004b.pdf.

lead to a greater likelihood of the bank failing, resulting in losses by creditors, especially depositors. The failure of any bank may lead to the failure of other banks, and even a loss of confidence in the entire banking system.²⁰³ If other onshore banks were creditors, this could adversely affect those banks, resulting in a chain reaction of defaults that could endanger the entire international financial system.

There were a few money laundering issues raised in the financial supervisory context as well. The anti-money laundering measures were not prudential in nature in that they did not have as a goal keeping the bank solvent, but because their implementation in onshore jurisdictions was usually through the financial supervisor or regulator, they had the potential of becoming part of the “poor prudential regulation” indictment.²⁰⁴ The most important of these measures had to do with a requirement to identify the physical person who owned and controlled a particular customer account.²⁰⁵ Of course, such information was also critical for providing tax-related information to the major onshore centers. The regulatory arbitrage provided by offshore centers allowed their financial institutions, or at least financial institutions with an offshore presence, to operate more profitably by reducing the costs of regulation, rendering entirely onshore institutions less profitable and subject to unfair competition.²⁰⁶

2. The System in Action

Domestic bank supervisors had problems supervising domestic banks with branches and subsidiaries located in foreign jurisdictions whenever those foreign establishments were domiciled in jurisdictions with strict bank secrecy.²⁰⁷ Supervisors also had trouble supervising

203. Vincent P. Polizatto, *Prudential Regulation and Banking Supervision: Building an Institutional Framework for Banks 1* (World Bank, Working Paper Series No. 340, 1990), available at http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/1990/01/01/000009265_3960928161430/Rendered/PDF/multi_page.pdf.

204. An informal review in January 2000, of a subset of IMF member countries and offshore jurisdictions by IMF staff confirmed that in the vast majority of cases anti-money laundering rules were implemented through prudential regulatory bodies. The author participated in this review.

205. See OECD, IMPROVING ACCESS TO BANK INFORMATION FOR TAX PURPOSES, *supra* note 145, at 25.

206. Hermann Krull, Assistant General Counsel, South African Reserve Bank (1990–1998, 2002), Statement During a Panel Discussion at the IMF Legal Department (Jan. 14, 2000).

207. This was the reason that the Basel Committee created a working group on supervision of banks' foreign establishments, resulting in the report. See BASEL COMM.,

branches and subsidiaries of foreign banks.²⁰⁸ Briefly, bank supervisors need the *entire* bank's financial information (parent and branches or subsidiaries) to determine if the bank is heeding prudential regulations. In 1975, the Basel Committee on Banking Supervision, a classic TRN, issued a report on the importance of the supervision of banks' foreign establishments in ensuring the safety and soundness of domestic banks,²⁰⁹ which made arguments that were extended in a paper in 1979 favoring consolidated supervision of banks' international activities.²¹⁰ In 1981, the Basel Committee published a report noting that banking secrecy can impede the flow of information needed by supervisors.²¹¹ While the report did not single out offshore centers, it did note that non-members of the Committee, "particularly offshore centers," were in broad agreement.²¹² The report was followed by another exploring ways in which supervisors should share information about the activities of banks and their foreign branches and subsidiaries.²¹³ Of great importance, the Offshore Group of Banking Supervisors ("OGBS"),²¹⁴ a TRN consisting of regulators in offshore centers, generally agreed to the various proposals to ensure the flow of information among supervisors.²¹⁵ Some problems involving the limited membership of the Basel Committee were hence resolved.

The bankruptcy of the Bank of Credit and Commerce International ("BCCI") in 1991 drew attention to the serious problems that could arise when there was no effective consolidated supervision of banks with foreign operations,²¹⁶ especially when an

REPORT TO THE GOVERNORS ON THE SUPERVISION OF BANKS' FOREIGN ESTABLISHMENTS 1 (1975), <http://www.bis.org/publ/bcbs00a.pdf?noframes=1>.

208. *Id.* at 5.

209. *Id.* at 1.

210. See BASEL COMM., CONSOLIDATED SUPERVISION OF BANKS' INTERNATIONAL ACTIVITIES 1 (Mar. 1979), <http://www.bis.org/publ/bcbsc112.pdf>.

211. See BASEL COMM., BANKING SECRECY AND INTERNATIONAL CO-OPERATION IN BANKING SUPERVISION 1 (1981), <http://www.bis.org/publ/bcbs00f.pdf>.

212. *Id.*

213. BASEL COMM., PRINCIPLES FOR THE SUPERVISION OF BANKS' FOREIGN ESTABLISHMENTS § I (1983), <http://www.bis.org/publ/bcbsc312.pdf>.

214. The Offshore Group of Banking Supervisors ("OGBS") includes fourteen offshore centers. See OGBS, Members and Observers, <http://www.ogbs.net/members.htm> (last visited Nov. 21, 2009). Since 1983, a condition of OGBS membership is to support the 1983 Concordat. See OGBS, Conditions of Membership, <http://www.ogbs.net/conditions.htm> (last visited Nov. 21, 2009).

215. See BASEL COMM., INFORMATION FLOWS BETWEEN BANKING SUPERVISORY AUTHORITIES (1990), <http://www.bis.org/publ/bcbsc313.pdf>.

216. At the time it was closed by regulators in the summer of 1991, the Bank of Credit and Commerce ("BCCI") was operating in sixty-nine countries. Duncan E. Alford, *Basle Committee Minimum Standards: International Regulatory Response to the Failure of BCCI*,

offshore center with allegedly lax supervision and “excessive” secrecy like the Cayman Islands was involved.²¹⁷ The following year, the Basel Committee issued a report on minimum standards for the supervision of international banking groups.²¹⁸ The minimum standards include that all international banks be supervised by a home-country authority that performs consolidated supervision, that banks and their foreign branches or subsidiaries receive the prior consent of both home country supervisor and host country supervisor, and that home country supervisors have the authority to receive information necessary to conduct consolidated supervision.²¹⁹ Finally, if these minimum standards are not met, the report suggested that the host country supervisor either prohibit the establishment of foreign branches/subsidiaries or impose restrictive measures on them.²²⁰ In other words, hard power could be exercised against resident banks by local regulators. As with the OECD’s tax “countermeasures,” however, the market would ensure that the foreign jurisdiction would also suffer as a result.

While the report put in place a process of improved cooperation among supervisors from both onshore and offshore jurisdictions, problems remained. In 1995, the Meridien Bank International, which was really two banks with one registered in Luxembourg²²¹ and another, its seventy-four percent owner, licensed in the Bahamas, and with operational control of much of its activities located in London, collapsed and was placed into liquidation by the Bahamian Supreme

26 GEO. WASH. J. INT’L L. & ECON. 241, 258 (1992). The dispersal of subsidiaries and branches in so many countries made it easier for BCCI to avoid consolidated regulatory oversight. *Id.* at 263–64. See generally JOHN KERRY & HANK BROWN, 102D CONG., THE BCCI AFFAIR: A REPORT TO THE COMMITTEE ON FOREIGN RELATIONS (DRAFT) (1992), available at http://www.fas.org/irp/congress/1992_rpt/bcci/ (describing the structure of the BCCI that eventually led to its collapse).

217. According to Senators Kerry and Brown, “the Grand Caymans, did not regulate any bank licensed there. The Caymans lack of regulation was precisely the inducement for banks to charter themselves there.” KERRY & BROWN, *supra* note 216, pt. 12. This allegation was incorrect in that the Caymans did regulate banks and bank branches located there. This information comes from the author’s personal participation in the activities of the IMF as a senior staff member during the relevant time period.

218. See BASEL COMM., MINIMUM STANDARDS FOR THE SUPERVISION OF INTERNATIONAL BANKING GROUPS AND THEIR CROSS-BORDER ESTABLISHMENTS (1992), <http://www.bis.org/publ/bcbsc314.pdf>.

219. *Id.* § II.1–3.

220. *Id.* § II.4.

221. It did no banking business in Luxembourg. This information comes from the author’s personal participation in the activities of the IMF as a senior staff member during the relevant time period.

Court.²²² As with BCCI, regulators and commentators concluded that the use of complicated cross-border corporate structures allowed the bank to escape effective prudential supervision.²²³

There was little doubt that both BCCI and Meridien showed no effective supervision and that supervisors needed to pay better attention to cross-border issues, but it was not clear in either case that offshore centers were to blame for the failure. In both instances supervisory authorities in the United States and the United Kingdom appeared to be at least partially at fault by not taking effective action even after noting clear warning signs that the banks were not complying with existing rules. For example, in the BCCI case, much was made of the role played by politicians and lobbyists in fending off appropriate supervisory action.²²⁴

At the same time, other banking problems unrelated to these specific cross-border supervisory issues were gaining attention. Because the international community's eventual response to these issues played such a crucial role in shaping the treatment of OFCs, this discussion now turns to the series of crises and near-crises in a number of emerging markets. The most prominent crises were in Asia, which had particularly adverse effects on domestic banking systems. These macroeconomic crises were largely caused by large external borrowings and significant balance of payments deficits. Many banks had excessive external exposures and foreign exchange risk that resulted in insolvency; had local supervision been better, some argued, these banks would not have been so vulnerable to economic shocks and would have made recovery after the crises faster and less disruptive.²²⁵

The first of these shocks was the 1994–95 Mexican Peso Crisis. The first significant emerging-market, sovereign debt crisis since the late 1980s,²²⁶ the Peso Crisis resulted in significant financial support to

222. Interview with Herman Krull, former Assistant General Counsel, South African Reserve Bank, in Cleveland, Ohio (Sept. 21, 2008). The bank had an exceptional liquidity crisis, which it was allegedly able to hide from regulators by shifting cash among its many constituent parts.

223. See IMF, TOWARD A FRAMEWORK FOR FINANCIAL STABILITY 47 (1998).

224. KERRY & BROWN, *supra* note 216, pt. 13.

225. See generally Liliana Rojas-Suarez & Steven Reiss Weisbord, *Financial Market Fragilities in Latin America: From Banking Crisis Resolution to Current Policy Challenges* (IMF, Working Paper No. 94/117, 1994) (examining the impact of the strength of the Latin American domestic banking system and domestic supervision in restoring confidence in the financial system after a financial crisis).

226. See JAMES M. BOUGHTON, *SILENT REVOLUTION: THE INTERNATIONAL MONETARY FUND 1979–1989*, at 477–534 (2001) (detailing the sovereign debt crises for various countries during the 1980s).

Mexico from the IMF and the United States.²²⁷ A key analysis by the IMF of the Peso Crisis suggested that macroeconomic variables largely determined the timing of bank failures while it was bank-specific prudential indicators that explained the likelihood of bank failure.²²⁸

By 1995, the two different issues—the lack of effective consolidated supervision of cross-border banking and the ineffective domestic supervision in many countries suffering macroeconomic shocks—became conflated.²²⁹ In 1995, the G-7 announced that much more work was needed in creating and implementing appropriate prudential supervisory standards in all countries.²³⁰ Specifically, they stated that closer international cooperation in the regulation and supervision of financial institutions was “essential to safeguard the financial system and prevent an erosion of prudential standards” and called on finance ministers to “commission studies and analysis from the international organizations responsible for banking and securities regulation and to report on the adequacy of current arrangements”²³¹ In particular, they urged that the IMF and World Bank be involved, but that they “concentrate on their respective core concerns (broadly, macroeconomic policy for the IMF and structural and sectoral policies for the World Bank).”²³² In partial response, a Working Group on Stability in Emerging Market Economies convened under the sponsorship of the Group of 10.²³³

227. Press Release, IMF, IMF Approves US\$17.8 Billion Stand-By Credit for Mexico (Feb. 1, 1995), <http://www.imf.org/external/np/sec/pr/1995/PR9510.HTM> (describing the IMF’s credit line to Mexico for purposes of alleviating the Mexican financial crisis and adding confidence to the international financial system).

228. See generally Brenda González-Hermosillo et al., *Banking System Fragility: Likelihood Versus Timing of Failure—An Application to the Mexican Financial Crisis* (IMF, Working Paper No. 96/142, 1996) (examining the proposition that bank soundness is determined by bank-specific factors and macroeconomic conditions with regard to the Mexican Financial Crisis).

229. These issues became of significant interest to the IMF, which had generally been more concerned with macro rather than micro policy. See, e.g., Morris Goldstein & Philip Turner, *Banking Crises in Emerging Economies: Origins and Policy Options* 9–13, 21–24 (BIS, BIS Economic Paper No. 46, 1996), available at <http://www.bis.org/publ/econ46.pdf?noframes=1>; CARL-JOHAN LINDGREN ET AL., BANK SOUNDNESS AND MACROECONOMIC POLICY 39–46, 123–35 (1996).

230. MINISTRY OF FOREIGN AFFAIRS OF JAPAN, HALIFAX SUMMIT COMMUNIQUÉ, para. 22 (1995), http://www.mofa.go.jp/policy/economy/summit/2000/past_summit/21/e21_a.html.

231. *Id.*

232. *Id.*

233. In addition to Argentina, France, Germany, Hong Kong, Japan, Mexico, the Netherlands, Poland, Singapore, Sweden, the United Kingdom, and the United States, the working group also included Thailand, Korea, and Indonesia. THE WORKING GROUP ON

The IMF and World Bank also set up staff working groups to consider these issues while the Basel Committee continued its efforts to refine standards. In 1996, the Basel Committee, again with full cooperation and participation from the Offshore Group of Banking Supervisors, released another report that addressed a number of practical considerations in implementing the 1992 Report, especially regarding confidentiality of exchanged information.²³⁴ The Basel Committee also accelerated its work on creating a set of generally accepted principles for effective banking supervision; these “Core Principles,” which focused on acceptable standards for prudential regulation of domestic banking, were released late in 1997.²³⁵ In particular, the Core Principles require that supervisors practice consolidated supervision and that they “apply[] appropriate prudential norms to all aspects of the business conducted by their banking organizations worldwide” and that they “require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.”²³⁶ In releasing the Core Principles, the Basel Committee “suggested that the IMF, the World Bank, and other interested organizations use the Core Principles in assisting individual countries to strengthen their supervisory arrangements in connection with work aimed at promoting overall macroeconomic and financial stability.”²³⁷ There was no mention of offshore centers. Similar activities with respect to the creation of best practices or standards were underway for the two other key elements of the regulated financial system, securities markets (including broker-dealers) and insurance, to be

FINANCIAL STABILITY IN EMERGING MARKET ECONOMIES, FINANCIAL STABILITY IN EMERGING MARKET ECONOMIES 1 (1997), <http://www.bis.org/publ/gten02.pdf>.

234. BASEL COMM., THE SUPERVISION OF CROSS-BORDER BANKING 10, 12 (1996), <http://www.bis.org/publ/bcbs27.htm>. Key issues addressed were preserving confidentiality of information obtained by bank supervisors from foreign supervisors and creating standard procedures for the conduct of cross-border inspections by home-country supervisors. *Id.*

235. BASEL COMM., CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION 2 (1997), <http://www.bis.org/publ/bcbs30a.htm>. The Core Principles cover seven principal areas: preconditions for effective banking supervision, licensing and structure, prudential regulations and requirements, methods of banking supervision, information and record-keeping requirements, formal powers of supervisors, and cross-border banking. *Id.* The work on developing the Core Principles was conducted in close cooperation with both the IMF and World Bank, but particularly with the former.

236. *Id.* at 7.

237. *Id.* at 2.

carried out by the International Organization of Securities Commissions (“IOSCO”) and the International Association of Insurance Supervisors (“IAIS”).²³⁸

In April of 1997, the Working Group on Financial Stability²³⁹ issued its report, which urged the creation of “an international consensus on the key elements of a sound financial and regulatory system” by representatives of both developed and developing countries, including the “formulation of norms, principles and practices by international groupings of national authorities with relevant expertise and experience,” such as the Basel Committee, IAIS, and the International Organization of Securities Commissions.²⁴⁰ It also called for the “[p]romotion by multilateral institutions such as the IMF, the World Bank and the regional development banks of the adoption and implementation of sound principles and practices.”²⁴¹ More specifically, the report suggested that, as part of its Article IV surveillance activities, the IMF should “take stock of the progress that countries with clear vulnerabilities have made in the adoption of sound principles and practices developed by the international groupings.”²⁴² The report went on to state that “the IMF and World Bank should develop modalities for sharing their assessments of financial sector strength and the regulatory and supervisory regimes in individual economies,” that IMF conditionality could “include steps to correct shortcomings in the financial sector,” and that the two organizations should provide

238. The history and background on these two organizations are on their Web sites. International Association of Insurance Supervisors [IAIS], <http://www.iaisweb.org/index.cfm?pageID=28> (last visited Sept. 10, 2009); International Organization of Securities Commissions [IOSCO], <http://www.iosco.org/about/index.cfm?section=history> (last visited Sept. 10, 2009). While both the IAIS (IAIS Members, <http://www.iaisweb.org/index.cfm?pageID=31>) and IOSCO (IOSCO Members, http://www.iosco.org/lists/display_members.cfm?memID=1&orderBy=none) have large memberships, as a practical matter, the organizations and their key committees have been dominated by the larger, developed country members. The author personally observed this dynamic while working with members of the organizations as a staff member at the IMF.

239. The Working Group was an ad hoc group consisting of Argentina, France, Germany, Hong Kong, Indonesia, Japan, Korea, Mexico, the Netherlands, Poland, Singapore, Sweden, Thailand, the United Kingdom, and the United States. Representatives of the Basel Committee, the International Accounting Standards Committee, and IOSCO also attended most meetings, as did staff members of the Bank for International Settlements (“BIS”), the European Commission, IMF, the OECD, and the World Bank. THE WORKING GROUP ON FINANCIAL STABILITY IN EMERGING MARKET ECONOMIES, *supra* note 233, at 1.

240. *Id.*

241. *Id.* at 2.

242. *Id.* at 7.

technical assistance as well.²⁴³ In other words, the IMF (and where appropriate, the World Bank) should advance the adoption of banking and other financial-sector principles or best practices in its three main areas of work: surveillance, loan conditionality, and technical assistance. The Basel Committee, a TRN with limited membership, was asking the IMF, an international organization with TRN characteristics but with near universal membership, to participate.

Almost immediately after the report was issued (and just before the Basel Committee issued its Core Principles), the Asian financial crisis struck,²⁴⁴ followed by crises in Russia, Ukraine, and Ecuador.²⁴⁵ A considerable amount has been written on the history, development, causes, and global responses to the series of economic meltdowns that began in Thailand in July 1997.²⁴⁶ There were a number of different views as to what caused Thailand, then South Korea and Indonesia, to move toward a massive default on external (and then internal) obligations. One thing on which virtually all commentators agreed is that the banking systems in each country were not well run; they were under-capitalized and had taken on far too much risk, including exchange rate risk and credit risk.²⁴⁷ They agreed that the key problem causing excess credit risk was excessive connected lending, where banks lent money to connected parties on non-arms-length terms.²⁴⁸ In some instances, these were banks lending money to members of an affiliated corporate group; in others it was banks lending money to relatives or business associates of bank officers or board members.²⁴⁹ In many instances, the banks were controlled by the government, which exerted influence on banks to direct lending to favored borrowers; thus, when the financial crisis hit and investors

243. *Id.*

244. IMF, A Factsheet—The IMF's Response to the Asian Financial Crisis (1999), <http://www.imf.org/External/np/exr/facts/asia.htm>.

245. During this time the author was involved in the crafting of IMF loans and loan programs for each country.

246. According to one analyst, by 1999 more than 16,000 articles, journals, and reviews had already been published on the topic. Michael H. Moskow, *The Asian Financial Crisis*, in *THE ASIAN FINANCIAL CRISIS: ORIGINS, IMPLICATIONS, AND SOLUTIONS* 11, 11 (William C. Hunter et al. eds., 1999).

247. See Roberto Chang, *Origins of the Asian Crisis: Discussion*, in *THE ASIAN FINANCIAL CRISIS: ORIGINS, IMPLICATIONS, AND SOLUTIONS*, *supra* note 246, at 65, 65–68; Michael P. Dooley, *Origins of the Crisis in Asia*, in *THE ASIAN FINANCIAL CRISIS: ORIGINS, IMPLICATIONS, AND SOLUTIONS*, *supra* note 246, at 27, 27–29; William C. Hunter, *The Korean Banking Crisis: Picking up the Pieces*, in *THE ASIAN FINANCIAL CRISIS: ORIGINS, IMPLICATIONS, AND SOLUTIONS*, *supra* note 246, at 127, 127–28.

248. Hunter, *supra* note 247, at 127–28.

249. *Id.*

fled from local currencies, banks were unable to pay their creditors, which were often foreign banks, resulting in illiquidity and insolvency.²⁵⁰ Clearly, the banking systems in these countries had not been adequately supervised.

Another issue related to the causes of the Asian financial crisis was what was termed “contagion,” where a serious loss of investor confidence in one country could spread to other countries as investors lost confidence in similar countries.²⁵¹ Perhaps more importantly, there was significant evidence that bank illiquidity or insolvency in one country could spread to creditor banks in another country, resulting in illiquidity or insolvency in that country.²⁵²

While the problems in these banking systems were not new, they had not been the subject of IMF attention during the annual Article IV consultations, where IMF staff review the economies of member countries. Yet, when the IMF stepped in to provide financing, the problem of poor banking supervision was brought immediately to the fore; bank restructuring, plus new and improved banking regulation, was seen as a key to the reform program.²⁵³ Bill Murden, then a senior official at the U.S. Treasury Department, explained:

[The Working Group on Financial Stability] issued a report in April 1997, in time for the 1997 Denver Summit. The report looked at some of the problems in the financial sectors in emerging markets . . . and recommended a concerted strategy for improving the financial sectors and financial supervision in these economies, including a more in depth role by the IMF and the World Bank Out of that process came some very significant developments, including the Basle Committee’s Core Principles . . . which were released later that fall A year later, [The International Organization of Securities Commissions] issued a similar set of principles. Unfortunately, we did not have time to implement the strategy before the Asia

250. *Id.*

251. Taimur Baig & Ilan Goldfajn, *Financial Market Contagion in the Asian Crisis* 6–7 (IMF, Working Paper No. 98/155, 1998) (showing evidence for contagion by examining the behavior of financial markets).

252. Haizhou Huang & Chenggang Xu, *Financial Institutions, Financial Contagion, and Financial Crises* 14 (IMF, Working Paper No. 00/92, 2000).

253. See Stijn Claessens et al., *Korea’s Financial Sector Reforms*, in *THE ASIAN FINANCIAL CRISIS: ORIGINS, IMPLICATIONS, AND SOLUTIONS*, *supra* note 246, at 167, 173–76. For a brief discussion of the IMF’s bank reform conditionality for Korea, see Andreas F. Lowenfeld, *The International Monetary System and the Erosion of Sovereignty: Essay in Honor of Cynthia Lichtenstein*, 25 B.C. INT’L & COMP. L. REV. 257, 268–69 (2002).

crisis erupted in the summer of 1997 in Thailand and quickly spread to Indonesia and Korea by that fall.²⁵⁴

What Murden did not mention explicitly was that the three countries hit hardest by the Asian financial crisis, Thailand, Indonesia, and Korea, were part of the working group that issued the Report.

Unlike with the OECD's Harmful Tax Practices initiative, the promulgation of prudential banking standards did not require the IMF to conclude that a country should make a sacrifice for the benefit of another; unsound domestic banking systems, management and staff concluded, adversely affected the well being of the country itself, and had potential contagion effects on other countries. With respect to this second issue, there was an additional distinction from the Harmful Tax Practices Project: Article I(i) of the Fund's Articles of Agreement included as one of its purposes "[t]o promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems."²⁵⁵ This had been interpreted broadly to include oversight of the "international financial system," which arguably would include contagion effects from a problem in banks honoring cross-border obligations.²⁵⁶

What happened next was a multi-pronged attempt to find ways to prevent future crises, an effort known broadly as "strengthening the international financial architecture."²⁵⁷ Unlike with the OECD's work on harmful tax competition, this work involved, at least in theory, not only the IMF and World Bank but representatives of developing countries themselves. Among the various prongs was the ongoing work on financial standards—the promulgation of the Basel Core Principles²⁵⁸ (and to a lesser extent the analogous standards of the IAIS²⁵⁹ and the IOSCO²⁶⁰) through the work of the IMF and the

254. William Murden, *Banking Supervision and Government Policy: The Role of Regulators in International Financial Crises*, 4 FORDHAM FIN. SEC. & TAX L. F. 35, 36–37 (1999).

255. IMF ARTICLES, *supra* note 102, art. I(i).

256. *See infra* notes 297–301 and accompanying text.

257. IMF, A Factsheet—The IMF's Response to the Asian Financial Crisis, *supra* note 244.

258. BASEL COMM. ON BANKING SUPERVISION, *supra* note 24, at 2.

259. IAIS, PRINCIPLES FOR THE CONDUCT OF INSURANCE BUSINESS 2 (1999), http://www.iaisweb.org/__temp/Principles_for_conduct_of_insurance_business.pdf.

260. IOSCO, OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION 6 (1998), <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD82.pdf>.

World Bank.²⁶¹ Also, in 1998, the G-22, a group of developed and developing countries (including Korea, Thailand, and Indonesia),²⁶² set up three working groups to examine issues related to strengthening the international financial architecture, one of which focused on strengthening financial systems.²⁶³ In theory at least, the heads of the IMF, the World Bank, the OECD, and the Bank for International Settlements (another treaty organization) attended meetings as observers, but, in practice, the IMF (and, to a lesser extent, the World Bank) staff were most closely involved in the working group's activities.

In the spring of 1999, a new international group, the Financial Stability Forum ("FSF"), was created.²⁶⁴ It included central banks, finance ministries, and financial system supervisory authorities from twelve developed countries, plus the IMF, the World Bank, the Bank for International Settlements ("BIS"),²⁶⁵ the OECD, the Basel Committee, IOSCO, and IAIS, as well as some others.²⁶⁶ Again, IMF and World Bank staff were closely involved in promoting the FSF's research and conclusions.

261. In order to better coordinate the work of the IMF and the World Bank on financial sector issues, the two organizations set up the Financial Sector Liaison Committee, which consisted of senior staff members from the IMF and the World Bank who met periodically to coordinate the financial sector work of the two institutions. It was set up in 1998. IMF, PROGRESS REPORT ON THE WORLD BANK-IMF FINANCIAL SECTOR LIAISON COMMITTEE (FSLC) 1 n.1 (1999), <http://www.imf.org/external/np/mae/fslc/121599.htm>.

262. The G-22 consisted of finance ministers and central bank governors from a broad range of developed and developing countries, including the three most adversely affected by the Asian financial crisis (Korea, Thailand, and Indonesia), and those affected by the 1995 Peso crisis and sovereign insolvencies in former Communist countries, Mexico, and Russia. The others were Argentina, Australia, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Italy, Japan, Malaysia, Poland, Singapore, South Africa, the United Kingdom, and the United States. GROUP OF 22, REPORT OF THE WORKING GROUP ON INTERNATIONAL FINANCIAL CRISES, at i n.1 (1998), <http://www.imf.org/external/np/g22/ifcrep.pdf>.

263. See IMF, Reports on the International Financial Architecture, <http://www.imf.org/external/np/g22/> (last visited Sept. 27, 2009).

264. Financial Stability Board, History, <http://www.financialstabilityboard.org/about/history.htm> (last visited Sept. 27, 2009).

265. "The BIS is an international organization that fosters international monetary and financial cooperation and serves as a bank for central banks." BIS, About BIS, <http://www.bis.org/about/index.htm> (last visited Sept. 27, 2009).

266. The Financial Stability Forum included Australia, Canada, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Singapore, Switzerland, the United States, and the United Kingdom, plus the European Central Bank and three other standard setting organizations related to accounting and payment systems. IMF, A Guide to Committees, Groups, and Clubs, <http://www.imf.org/external/np/exr/facts/groups.htm> (last visited Nov. 9, 2009).

It was clear that the IMF was going to play a key role in adopting and promulgating any new rules of the road for avoiding future financial crises.²⁶⁷ In the late spring of 1998, Michel Camdessus, at that time the Managing Director of the IMF, outlined a key aspect of the approach: a set of standards and codes, including banking supervision, that would be “progressively disseminated by the IMF through its surveillance.”²⁶⁸ Soon after, the Fund published *Toward a Framework for Financial Stability*, which proposed:

The IMF, with its near-universal membership, has an important role to play in . . . the broad dissemination of the work of various organizations, particularly that of the Basle Committee [and] . . . with its broad responsibility to engage in surveillance of member countries’ economic policies . . . can assist in identifying potential vulnerabilities . . . and it can help the authorities in formulating corrective policies.²⁶⁹

The benefits of universal membership were obviously not shared by the Basel Committee,²⁷⁰ and although IOSCO and IAIS had larger membership bases, they too were dominated by their larger members.²⁷¹

The Group of 22’s *Report of the Working Group on Strengthening Financial Systems*, released in the fall of 1998, had few surprises. It announced an “international consensus” on banking and securities supervision, specifically endorsing the Basel Core Principles, including principles on information exchange for supervising internationally active financial groups.²⁷² It also called on the IMF and World Bank to enhance their work in the area, anchored in IMF surveillance.²⁷³ The IMF and World Bank, in coordination

267. This conclusion was obvious, even at the time. See Lawrence L. C. Lee, *The Basle Accords as Soft Law: Strengthening International Banking Supervision*, 39 VA. J. INT’L L. 1, 36–39 (1998) (suggesting that the IMF will play a great role in implementing Basel Core Principles and other Basel accords as a type of “soft” international law).

268. Michel Camdessus, Managing Dir. of the IMF, at the Royal Institute of International Affairs: *Toward a New Financial Architecture for a Globalized World* (May 8, 1998) (transcript available at <http://www.imf.org/external/np/speeches/1998/050898.htm>).

269. IMF, *WORLD ECONOMIC AND FINANCIAL SURVEYS, TOWARD A FRAMEWORK FOR FINANCIAL STABILITY 1* (1998), available at <http://www.imf.org/external/pubs/ft/wefs/toward/pdf/file01.pdf>.

270. See *supra* note 20.

271. See *supra* note 238.

272. GROUP OF 22, *REPORT OF THE WORKING GROUP ON STRENGTHENING FINANCIAL SYSTEMS* 3–4, 47 (1998), <http://www.imf.org/external/np/g22/sfsrep.pdf>.

273. *Id.* at 46–50. The Report was later endorsed by the G-7, although this was a foregone conclusion. University of Toronto Munk Centre for International Studies, G7

with the G-22 and the new Financial Stability Forum, worked to develop a new international effort to encourage the adoption and implementation of financial standards.

This work led to the Financial Sector Assessment Program (“FSAP”), a new program piloted in 1998 and adopted the next year.²⁷⁴ The purpose of the FSAP was to identify strengths and vulnerabilities of a country’s financial sector, in part by assessing its compliance with key international financial standards, such as the Basel Core Principles and related standards on insurance and securities regulations.²⁷⁵ The IMF and World Bank agreed that they should divide assessment work between them based on their areas of competence, with some being exclusively IMF, others exclusively World Bank, and others being of joint responsibility.²⁷⁶ Basel Core Principle assessments were to be the responsibility of the IMF.²⁷⁷ The assessments would be summarized in Reports on the Observance of Standards and Codes (“ROSCs”).²⁷⁸ The purpose of ROSCs was to summarize the extent to which jurisdictions observe certain internationally recognized standards and codes.²⁷⁹

There were a number of key features of the FSAP, most importantly the ROSC program that developed over the first few years. The program’s notable features included that the adoption and assessment of internationally recognized standards remain voluntary²⁸⁰ (meaning persuasion and perhaps market forces but no coercion) and that assessments be independently conducted and consistently applied across countries (meaning there should be

Leaders Statement on the World Economy, http://www.g7.utoronto.ca/finance/g7_103098.html (last visited Sept. 12, 2009).

274. Much of the thinking for the Financial Sector Assessment Program (“FSAP”) had gone on earlier; the pilot program was actually carefully thought out. *See generally* IMF, INTERNATIONAL STANDARDS AND FUND SURVEILLANCE—PROGRESS AND ISSUES (Aug. 16, 1999), <http://imf.org/external/np/rosc/stand.htm> (describing various case studies and research related to strengthening the international financial system).

275. *See* IMF, FINANCIAL SECTOR ASSESSMENT PROGRAM (May 19, 2009) <http://www.imf.org/external/np/fsap/fsap.asp> (explaining in general the use of a FSAP).

276. IMF, INTERNATIONAL STANDARDS AND FUND SURVEILLANCE—PROGRESS AND ISSUES, *supra* note 274, at tbl.1 & para. 70.

277. *Id.* paras. 69–70 (follow link to section IV).

278. *Id.* paras. 5–6 (follow link to section I).

279. *Id.* paras. 5–7. Reports on the Observance of Standards and Codes (“ROSCs”) were initially known as “Reports on the Implementation of Standards and Codes.” *Id.* para. 6. However, the acronym RISC bore unfortunate connotations, resulting in a change of name.

280. *Id.* para. 18.

impartiality).²⁸¹ As Part I.D notes above, these two criteria are among those proposed for a truly successful TRN standard.

Also, there was some debate in the beginning as to whether countries could be required to publish ROSCs, but, as a practical matter, countries that chose to participate in the pilot program did not object to publication.²⁸² Finally, additional technical assistance could then be offered to countries to help address weaknesses identified in the assessment process: a carrot but not a stick.²⁸³ In order for assessments to be as objective as possible, detailed methodologies for assessment were required, and these methodologies for the Basel Core Principles were drafted with the close cooperation of IMF staff.²⁸⁴ In other words, the FASP and ROSC procedures were designed to ensure a uniformly objective compliance assessment process with key features posited as being part of successful standards for TRNs.

While the FSAP and ROSC programs were being devised and piloted, the IMF and the G-7-dominated FSF turned once again to the issue of offshore centers.²⁸⁵ During the Asian crisis and those crises that followed in Russia, Ukraine, and Ecuador, not a single offshore center experienced a significant problem in its regulated financial sector. Nevertheless, both the IMF and FSF managed to find problems with the operations of offshore banking and, at least in part, made valiant efforts to tie these problems to banking problems in the crisis countries.

In early 1999, the Fund issued a staff working paper entitled *Offshore Banking: An Analysis of Micro- and Macro-Prudential Issues*.²⁸⁶ IMF staff interest in offshore banking issues had been prompted in part by the continuing expression of interest from the United States and French Executive Directors (among others), although many staff members involved expressed serious doubts about whether offshore centers posed any real threat to the

281. While IMF management, staff, and Executive Directors often referred to the FSAP and ROSC assessment programs as part of IMF surveillance, from a legal perspective they were actually technical assistance, which under Article V, section 2 is strictly voluntary. See IMF ARTICLES, *supra* note 102, art. V, § 2.

282. See IMF, FINANCIAL SECTOR ASSESSMENT PROGRAM, *supra* note 275.

283. IMF ARTICLES, *supra* note 102, art. V, § 2.

284. IMF, DEVELOPING INTERNATIONAL STANDARDS: PROGRESS REPORT 3 (1999) <http://www.imf.org/external/np/rocs/progrev.pdf>.

285. The concern resulted in another report. See FINANCIAL STABILITY FORUM, REPORT OF THE WORKING GROUP ON OFFSHORE CENTRES 16 (2000), available at http://www.financialstabilityboard.org/publications/r_0004b.pdf.

286. See Errico & Musalem, *supra* note 51.

international financial system.²⁸⁷ Almost bizarrely, the paper concluded that “[o]ffshore banking has most certainly been a factor in the Asian financial crisis [and has] . . . also played a significant, but not catalytic, role in the recent Latin America crises,” even though the body of the paper identifies virtually no role at all.²⁸⁸ The paper went on, however, to discuss in general terms the issues raised by offshore banking. The paper claimed that there are “legitimate” and “dubious” reasons for banks to use OFC facilities; oddly, the paper listed among the former “convenient” fiscal and regulatory regimes that lowering explicit and “implicit” taxation increases net profit margins.²⁸⁹ The paper also noted the ease of incorporation, legal frameworks for protecting the privacy of the principal-agent relationship, and the freedom from exchange controls offered by OFCs.²⁹⁰ Among the illegitimate are bank secrecy (“almost invariably” a selling point), tax avoidance and evasion, and money laundering.²⁹¹

The paper suggested that the “greater leeway for balance sheet management, granted by favorable regulatory frameworks in OFCs, make offshore banks potentially more vulnerable . . . to solvency and foreign exchange risks.”²⁹² And yet, the paper also concluded that “offshore banks are *less likely* to be unprofitable and *more likely* to be profitable than onshore banks.”²⁹³ It also noted that, typically, a much larger percentage of offshore bank investments tend to be in other onshore banks, and that offshore banks are often simply intermediate deposits between offshore and onshore banks.²⁹⁴ In what at least appears to be a desperate effort to find a way to condemn offshore banking from a prudential perspective, the paper concluded that while offshore banks are far more likely to be liquid (since their regulators do not enforce capital standards with the verve of their onshore counterparts) the offshore banks may be more highly leveraged and therefore less solvent, although no risk-weighted data

287. The author was involved in these ongoing discussions throughout the relevant time period.

288. Errico & Musalem, *supra* note 51, at 4. The paper also notes that offshore facilities may have contributed to problems in Thailand and Malaysia, but in those cases the offshore “centers” were within Thailand and Malaysia themselves. *Id.* at 33–34.

289. *Id.* at 6–7, 10.

290. *Id.* at 6.

291. *Id.* at 10.

292. *Id.* at 4.

293. *Id.* at 27 (emphasis added).

294. *Id.* at 14–16.

was available.²⁹⁵ In short, the working paper found little factual material to support the charge that offshore center banks were somehow dangerous, although it nevertheless concluded that they were.

The paper was followed the next year by a report of the FSF's working group on offshore centers. Not surprisingly—given the content of the paper—the FSF report concluded that “OFCs, to date, do not appear to have been a major causal factor in the creation of systemic financial problems.”²⁹⁶ The report did, however, also conclude that OFCs *could* cause contagion problems in the future due to the growth in assets and liabilities of OFC financial institutions (and the inter-bank nature of the market) and the suspected growth in off-balance-sheet activities.²⁹⁷ The report distinguished between OFCs with weak supervision and those with strong supervision and went on to distinguish between prudential concerns and, what they termed, “market integrity concerns,” the latter having a meaning similar to the IMF paper’s “dubious purposes.”²⁹⁸ The Executive Summary report listed the old OFC tax issue of information exchange as a key prudential problem, but it added a far more general concern over a lack of prudential supervision.²⁹⁹ Again, similar to the IMF paper, the FSF report also noted that jurisdictions that followed international standards were at risk of losing business to the lax jurisdictions.³⁰⁰

With respect to market integrity, the report noted that while offshore centers did not pose immediate risks to international financial stability, by hampering international surveillance and law enforcement, they eroded the integrity of international financial markets and, therefore, represented a potential threat to global financial systems.³⁰¹ The report highlighted “the lack of . . . information on beneficial ownership of corporate vehicles . . . [that] can thwart efforts directed against illegal business activities.”³⁰²

Noting the work of the IMF in the FSAP program and in preparing ROSCs, the report called for a similar assessment program

295. *Id.* at 29 & n.41.

296. FINANCIAL STABILITY FORUM, REPORT OF THE WORKING GROUP ON OFFSHORE CENTERS 16 (2000), http://www.financialstabilityboard.org/publications/r_0004b.pdf.

297. *Id.*

298. *Id.* at 2.

299. *Id.* at 1–6.

300. *Id.* at 18.

301. *Id.* at 1.

302. *Id.* at 2.

for all OFCs, based on a priority list of those with the greatest problems.³⁰³ The report recommended focusing on three areas: (1) cross-border cooperation, information sharing, and confidentiality; (2) supervisory powers and practices; and (3) customer identification and record-keeping.³⁰⁴ Specifically, it suggested that the assessment program include subsets of the Basel Core Principles, IAIS principles, and IOSCO principles (as well as of the Financial Action Task Force anti-money laundering recommendations) all linked to these three areas.³⁰⁵ The report also listed a menu of possible incentives to enhance OFCs' adherence to "international standards," from limiting market access to OFC-based institutions to increasing due diligence for onshore financial institutions when doing business with offshore-based ones to restricting or prohibiting financial transactions with those institutions.³⁰⁶

At the time, many IMF staff reacted with dismay to the report. Many staff agreed with the general conclusion that offshore centers had *not* been a weak link in the world financial system. And, while they agreed that many offshore jurisdictions applied a light supervisory hand, they *did not* believe that the result was a weak banking system; agreeing instead with the IMF paper, they felt that offshore banks were healthy—largely because they did not make risky investments.³⁰⁷ Instead, it appeared that the proposed offshore center assessment program addressed other issues referenced in the report, including the fear that onshore jurisdictions could be losing out to offshore ones in the global competition for banking services. But, of greatest concern was that by focusing on information sharing, customer identification, and transparency of ownership, the Working Group was really concerned about tax, and to a lesser extent, money laundering.³⁰⁸ And, as discussed above, many staff believed that it was illegitimate for the IMF to suggest that one jurisdiction should commit sacrifices to benefit another.³⁰⁹ A number of staff most closely

303. *Id.* at 20–28.

304. *Id.* at 28.

305. *Id.* at 58–68.

306. *Id.* at 32 fig.7.

307. Unless, of course, investing in onshore banks was risky, which—during the current international financial crisis—turned out to be the case. The information contained in this paragraph comes from the author's personal participation in the activities of the IMF as a senior staff member during the relevant time period.

308. Because the papers noted that the offshore banks were often more profitable, and because they could point to no actual instances in which offshore banks contributed to the crisis, these arguments were rather weak.

309. *See supra* notes 111, 121 and accompanying text.

involved in putting together the new offshore center program expressed their belief that the program had little or nothing to do with prudential regulation, which they believed actually was a legitimate subject for IMF involvement. Instead, they wondered if it was all a subterfuge to help the OECD and its member states in the Harmful Tax Practices Project. Given the strong support voiced by the Financial Stability Forum for an offshore center assessment program to complement the FSAP and ROSC programs already in progress, it was no surprise that IMF management moved promptly to propose a pilot assessment program.

The IMF papers on the subject echoed some of the contentions that OFCs may have played some kind of role in recent banking failures and the need to improve cross-border information exchange, customer identification, and transparency of ownership of legal persons.³¹⁰ Interestingly, they also discussed at some length other OFC initiatives, including the OECD tax competition program and the recent anti-money laundering initiative of the FATF involving so-called non-cooperating countries and territories initiative (“NCCT”).³¹¹ Like the tax competition program, the NCCT program³¹² assessed a select group of jurisdictions, most of which were OFCs, and threatened them with “countermeasures” if they did not comply with a set of anti-money laundering standards created by the FATF. One of the staff involved in drafting the IMF background papers noted that discussing the work of the OECD and FATF, including their aggressive threats to levy “countermeasures,” would make it less likely that the Executive Board would endorse any IMF involvement in either tax or anti-money laundering initiatives.³¹³

However, the proposed assessment program differed from the FSF recommendations by suggesting that all jurisdictions should be assessed on the entire set of Basel Core Principles (and relevant Basel Committee reports), in addition to insurance and securities standards where appropriate.³¹⁴ The report also noted that those onshore centers where offshore bank branches/subsidiaries were subjected to

310. IMF, OFFSHORE FINANCIAL CENTERS—THE ROLE OF THE IMF, paras. 5–7 (2000) [hereinafter IMF, ROLE OF THE IMF], <http://www.imf.org/external/np/mae/osshore/2000/eng/role.htm>; IMF, OFFSHORE FINANCIAL CENTERS IMF BACKGROUND PAPER (2000) [hereinafter IMF, BACKGROUND PAPER], <http://www.imf.org/external/np/mae/osshore/2000/eng/back.htm>.

311. IMF, BACKGROUND PAPER, *supra* note 310, § III & tbl.3.

312. See discussion *infra* at notes 401–05, 437 and accompanying text.

313. Conversation with un-named senior staff member, IMF, in Washington, D.C. (Jan. 2000).

314. As proposed in IMF, ROLE OF THE IMF, *supra* note 310, paras. 38, 43–45.

consolidated supervision would also have to be assessed, even noting that there were serious gaps because onshore supervisors often do a poor job.³¹⁵ The proposal accommodated anti-money laundering issues, noting that Basel Core Principle Fifteen included ensuring an effective anti-money laundering program.³¹⁶

Of key importance, the report made no mention of the exercise of hard power—no carrots or sticks. While the report accepted the FSF proposal of three modules, with the first being an assisted self-assessment, the second and third assessments resembled assessments in the FSAP program, that is, strictly voluntary, resulting in ROSCs to be published only with the agreement of the jurisdiction involved.³¹⁷ As with the FSAP program, additional technical assistance could then be offered to help OFCs address weaknesses identified in the assessment process.³¹⁸ The IMF Executive Board agreed, emphasizing the strictly voluntary and cooperative nature of the exercise.³¹⁹

As a result, the FSF's proposal—a selective assessment of Basel Core Principles and anti-money laundering principles with a threat of possible “countermeasures” if the OFC did not measure up—was replaced with a voluntary extension of the Basel Core Principles assessment part of the FSAP and ROSC program to offshore centers. In effect, the FSF (and its sponsors in the major onshore jurisdictions) was hoisted on its own petard. Arguably, the FSF wanted the IMF's OFC program to address what was outside the mandate of the Fund: the competitive advantage of offshore banks. Legitimate, institutional causes, such as fewer regulations, along with unfair issues like tax competition and money laundering, all contributed to a competitive advantage that the OFCs had over their onshore counterparts. In order to make the argument for IMF involvement, the FSF had to claim that the issue stemmed from bad prudential regulation.³²⁰ In effect, the IMF accepted this argument and proposed that it fold

315. IMF, BACKGROUND PAPER, *supra* note 310, § III.

316. Basel Core Principle Fifteen states, “Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict ‘know-your-customer’ rules that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.” BASEL COMM., CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION 6 (1997), <http://www.bis.org/publ/bcbs30a.pdf?noframes=1>. Basel Core Principle assessment of this principle tended to be cursory.

317. IMF, ROLE OF THE IMF, *supra* note 310, para. 37.

318. *Id.* paras. 61–64.

319. News Brief, IMF, IMF Board Reviews Issues Surrounding Work on Offshore Financial Centers (July 26, 2000), <http://www.imf.org/external/np/sec/nb/2000/nb0062.htm>.

320. See discussion *supra* notes 111, 121 and accompanying text.

OFCs into its onshore assessment program, all without adopting the proposals that would have targeted the FSF's real concerns.

By 2006, all offshore centers except one eventually consented to being assessed and to publishing their assessments.³²¹ The reasons for this were varied and no doubt included a significant amount of lobbying, but there were a number of practical reasons as well. IMF staff heard a number of different comments voiced by officials in offshore jurisdictions as to why.³²² Certainly, in some instances, there was a fear that if a particular jurisdiction did not participate it would be assumed to be in serious non-compliance with the Basel Core Principles, which could then be cited by onshore regulators as a reason for restricting banking activities with offshore institutions. In other words, onshore regulators could exercise hard power with domestic banks that would have negative effects on offshore banks. Next, many offshore centers believed that their banks were safe and sound and that a truly impartial assessment by the international civil servants of the IMF would likely give them at least passing marks. They may not have trusted the onshore jurisdictions to be fair, but, unlike with the OECD, they placed faith in the skills and impartiality of IMF staff (or at least they decided that the IMF staff was more impartial than the sub-state regulatory members of the Basel Committee on Banking Supervision). Offshore centers were already the subject of essentially involuntary assessments under the OECD's Harmful Tax Practices Project (and the FATF's NCCT program); they might in some instances have hoped that the cooperative and less biased IMF assessment could be used as a tool to counter the work of the G-7 civil servants who dominated the OECD and the FATF.

As it turned out, overall, offshore centers did quite well in their assessments. By the time of the first OFC progress report to the Executive Board, there had been twelve self-assessments and ten IMF-staff assessments leading to ROSCs for compliance with the Basel Core Principles (and a smaller number of ROSCs for insurance,

321. IMF, OFFSHORE FINANCIAL CENTERS: THE ASSESSMENT PROGRAM—A PROGRESS REPORT 11 tbl.2 (2006), <http://www.imf.org/external/np/pp/eng/2006/020806.pdf>.

322. The author interacted extensively with officials of offshore centers, both on-site and in Washington. In particular, the IMF held regular outreach meetings with offshore officials during this time where those officials were invited to discuss their views. The statements in this paragraph are the author's conclusions based on the statements of those officials.

IAIS, and securities, IOSCO, supervisory principles).³²³ While some of the newer (and poorer) offshore centers fared less well, the older established offshore centers performed better than many onshore centers.³²⁴ The most significant problems lay in the set-up and operations of the supervisors themselves, including the examination process,³²⁵ and, in particular, supervision over credit risk and market risk.³²⁶ However, while the report notes that a lack of effective supervisory implementation may result in problems, the report does not suggest that any of the banking systems assessed were in any way actually weak. Frequent discussions among assessors suggested that none were actually concerned over potential bank failures.³²⁷ Although local bank *examination* of credit and market risk was a problem, banks themselves did not appear to be behaving too riskily, in part because so much of their business was actually intermediation between depositors and other onshore banks, and in part because many of the banks were also the subject of consolidated supervision by onshore jurisdictions.³²⁸ In that regard, staff assessments generally found good cooperation with respect to sharing information with onshore regulators.³²⁹ Of particular interest, staff noted that OFCs so far had a better record of compliance with the Basel Core Principles than did onshore jurisdictions.³³⁰

These first impressions were largely confirmed as the Offshore Financial Center Program continued forward, eventually covering all offshore centers by 2004.³³¹ One significant effect of the assessments was that OFCs did work to improve their prudential supervisory programs, including passing new laws and regulations to bring them into fuller compliance with the Basel Core Principles (especially with

323. IMF, OFFSHORE FINANCIAL CENTER PROGRAM: A PROGRESS REPORT 3, 6 fig.1 (2002) [hereinafter IMF, 2002 PROGRESS REPORT], <http://www.imf.org/external/np/mae/offshore/2002/eng/032802.pdf>.

324. *Id.* at 10.

325. *Id.* at 10–12.

326. *Id.* at 12 tbl.3.

327. The author participated in the drafting of the paper and discussed this issue with the assessors. The unanimous view of those assessors was that none of the banking systems assessed to date were actually weak.

328. As the current financial crisis has shown, this may not have been terribly reassuring, but at least onshore regulators—and their state governments—had no reason to complain that the offshore centers were *riskier*.

329. IMF, 2002 PROGRESS REPORT, *supra* note 323, 17–18.

330. *Id.* at 13 tbl.4. In the table, “Initial Countries” are all onshore jurisdictions. As can be seen, offshore centers have a higher rate of compliance with Basel Core Principles. *Id.*

331. IMF, OFFSHORE FINANCIAL CENTERS: THE ASSESSMENT PROGRAM—AN UPDATE 5 (2004) [hereinafter IMF, 2004 ASSESSMENT PROGRAM UPDATE], <http://www.imf.org/external/np/mfd/2004/eng/031204.pdf>.

respect to the independence of the supervisor, on-site examinations, and a focus on credit and market risk),³³² but it was not at all clear that these improvements materially improved the actual safety and soundness of the various banking systems. In a 2003 review of the program, staff found that OFCs had supervisory deficiencies similar to onshore countries.³³³ The review also found that larger, wealthier OFCs generally meet very high supervisory standards.³³⁴

The review the following year actually found that compliance levels for OFCs were, on average, more favorable than those for other jurisdictions assessed by the IMF in its financial sector work.³³⁵ By early 2005, forty-one of the forty-four OFC jurisdictions had been assessed under the first phase of the OFC program.³³⁶ A review by IMF staff that year found that “[c]ompliance with standards in OFCs is, on average, better than in other jurisdictions assessed under the FSAP, reflecting in part the higher average income levels of the OFCs. Results on cooperation and information sharing principles, which play a key role in cross-border supervision, show a similar pattern.”³³⁷ The second phase was to focus on monitoring compliance through assessment updates every four to five years, with a focus on providing technical assistance to less wealthy jurisdictions to help improve their compliance.³³⁸ Finally, in 2008, the Offshore Center Program merged with the FSAP, treating offshore centers, in essence, like their onshore counterparts.³³⁹

332. IMF, 2002 PROGRESS REPORT, *supra* note 323, at 22–24. “Overall compliance with the Basel Core Principles was generally appropriate to the nature of the business conducted, especially in important jurisdictions where compliance was found to be broadly in line with that in advanced economies.” IMF, OFFSHORE FINANCIAL CENTER PROGRAM: A PROGRESS REPORT 2 (2003) [hereinafter IMF, 2003 PROGRESS REPORT], <http://www.imf.org/external/np/mae/oshore/2003/eng/031403.pdf>.

333. IMF, OFFSHORE FINANCIAL CENTERS, THE ASSESSMENT PROGRAM: A PROGRESS REPORT AND THE FUTURE OF THE PROGRAM 12 (2003), <http://www.imf.org/external/np/mae/oshore/2003/eng/073103.pdf>.

334. *Id.*

335. See IMF, 2004 ASSESSMENT PROGRAM UPDATE, *supra* note 331, at 7, app. II (showing that Basel Core Principles assessed in all jurisdictions had, on average, a lower rate of compliance than in just offshore jurisdictions).

336. IMF, OFFSHORE FINANCIAL CENTERS: THE ASSESSMENT PROGRAM: A PROGRESS REPORT 6–8 (2005), <http://www.imf.org/external/np/pp/eng/2005/022505.pdf>.

337. *Id.* at 3. The review also found deficiencies, including “inadequate onsite inspections, inability to address cooperation on terrorist financing, need to expand mutual legal assistance treaties, and lack of formal agreements to share information.” *Id.*

338. See *id.* at 6–8.

339. See Public Information Notice (PIN) No. 08/82, IMF, IMF Executive Board Integrates the Offshore Financial Center Assessment Program with the FSAP (July 9, 2008), <http://www.imf.org/external/np/sec/pn/2008/pn0882.htm>.

As a result of the IMF's insistence that offshore centers be assessed in a fair, consistent, and uniform manner, it was shown that those centers largely conformed to the universal banking supervision standards. There was no longer any reason to treat them separately. Offshore centers had scored a significant victory. The prudential standards system included many beneficial TRN attributes (and, with the IMF participating, even more legitimacy than just the Basel Committee alone possessed), was far superior to the Harmful Tax Practices Project, and was more legitimate than the Global Forum program. It not only produced generally accepted standards to be applied and implemented impartially, but it protected the interests of weak states over the strong.

D. Money Laundering and Terrorism Financing

1. The Basic Indictment³⁴⁰

Onshore jurisdictions also claimed that OFCs assisted criminals by failing to implement anti-money laundering principles, which allowed criminals more easily to retain the proceeds of their crimes. Among the most important anti-money laundering principles was a requirement that financial institutions “know your customer,” including knowing who controlled the account and whether the source of the funds was likely to be criminal. These principles also required financial institutions to monitor accounts to see if they might indicate criminal proceeds and report to a government agency when they did. Finally, the principles stated that this information should be made available to other jurisdictions.³⁴¹

By not enforcing such rules, onshore centers claimed that criminals were allowed to hide the fact that they owned or controlled an account, either because the accounts were actually anonymous (such as numbered accounts) or because the account holder was a company or other legal arrangement in which the owner and controller was not revealed. Next, the criminal could make deposits of his ill-gotten gains to these accounts, often through a transfer from another bank, without any questions being asked as to the origin of the funds. When the criminal wanted use of the funds, he would

340. This short section is a summary and reorganization of arguments presented during the initial debate (late 1990s) on jurisdictions that were deemed to be “non-cooperative” with respect to anti-money laundering efforts. See FIN. ACTION TASK FORCE [FATF], REPORT ON NON-COOPERATIVE COUNTRIES AND TERRITORIES 1–2 (2000), <http://www.fatf-gafi.org/dataoecd/57/22/33921735.pdf>.

341. *Id.*

implement a transfer to an account in his or her own name, typically in a large onshore jurisdiction. By running criminal proceeds through these effectively anonymous accounts, onshore banks would not be able to discover the origins of the funds, or whether the account was controlled by a criminal laundering the proceeds. Any request for information by another jurisdiction would either be rebuffed because the information was not available or because of laws protecting financial secrecy.³⁴²

Other principles also included having jurisdictions extend cooperation to each other in investigating and prosecuting alleged criminals involved in laundering. Offshore centers, it was alleged, either rebuffed such requests directly or provided such poor cooperation that little assistance was actually given.³⁴³ Following the terrorist attacks of September 11, 2001, onshore jurisdictions extended their criticism to include inadequate cooperation in the “global war on terror.” One requirement of this “war,” adopted as international law by the U.N. Security Council, was to seize accounts owned or controlled by known terrorists and terrorist organizations. The larger onshore jurisdictions also agreed that a failure to implement “know your customer” rules made it impossible to seize the funds of known terrorists.³⁴⁴

2. The System in Action

Sustained global interest in anti-money laundering policies began in the 1980s, primarily in the context of concern over international drug trafficking.³⁴⁵ Because the drug trade (and other illegal activities) generated huge profits, criminals found it necessary to find a way to introduce the cash into the formal financial system so that it could be

342. *Id.*

343. *See id.* at 5.

344. This was a key issue of discussion at the FATF Emergency Session meeting in Washington, D.C., October 29–30, 2001. The author was present during this meeting. The Eight Special Recommendations on Terrorism Financing, adopted by the FATF soon after September 11, 2001, required the freezing of terrorist assets and the implementation of U.N. Security Council resolutions that included specific names of terrorists and terrorist organizations. However, the FATF’s so-called Un-cooperative Countries and Territories process, started nearly two years earlier, was not changed to include terrorism financing in the initiative beyond the request that countries complete a separate terrorism financing questionnaire. FATF, *FATF ACTS AGAINST TERRORIST FINANCING, MONEY LAUNDERING AND NON-COOPERATIVE JURISDICTIONS* 1–3 (Feb. 1, 2002), <http://www.fatf-gafi.org/dataoecd/50/36/33935095.pdf>.

345. Richard K. Gordon, *Anti-Money-Laundering Policies: Selected Legal, Political, and Economic Issues*, in 1 *CURRENT DEVELOPMENTS IN MONETARY AND FINANCIAL LAW* 405, 407 (1999).

moved, spent, or invested without drawing the attention of law enforcement. However, simple deposits or transfers of huge amounts of cash could draw the attention of law enforcement. Criminals, therefore, needed to disguise the illegal origins of the proceeds of crime and/or their ownership of the proceeds. Early anti-money laundering legislation made it a crime for financial institutions knowingly to participate in such activities.³⁴⁶ However, to be truly effective, an anti-money laundering regime needed to be implemented in every jurisdiction where drug money might be laundered and introduced into the international financial system. As a result, a number of the major onshore centers, most notably the United States and France, took the lead in pressing for an international anti-money laundering effort.³⁴⁷

The first major international agreement to enact uniform anti-money laundering laws was the U.N. Convention Against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances (also called the Vienna Convention).³⁴⁸ The Convention required all parties to enact legislation providing for the identification and confiscation of laundered drug money and set out procedures for mutual legal assistance in countering money laundering.³⁴⁹ In 1990, the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (Strasbourg Convention) was adopted,³⁵⁰ and the following year, the first European Directive on the prevention of the use of the financial system for the purpose of money laundering was adopted.³⁵¹

The next major international step to enhance global anti-money laundering efforts came with the creation of the Financial Action Task Force in 1989, following the G-7 Summit in Paris.³⁵² The original Task Force consisted of sixteen OECD countries.³⁵³ The Task Force was inter-governmental in nature, with members represented by sub-state entities like financial supervisors (in this aspect at least it was

346. *See id.* at 405, 407–10.

347. Interview with un-named senior staff member, Fin. Action Task Force, in Washington, D.C. (Sept. 21, 1998).

348. U.N. Convention Against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances, Dec. 20, 1988, 28 I.L.M. 493, 26 U.N.T.S. 3 (1992). The original treaty was adopted in 1988. *Id.*

349. *Id.* arts. 5, 7–11.

350. Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, Nov. 8, 1990, E.T.S. 141.

351. Council Directive 91/308, 1991 O.J. (L 166) 1 (EC).

352. *See* FATF, About the FATF, http://www.fatf-gafi.org/pages/0,3417,en_32250379_32236836_1_1_1_1_1_1_1,00.html (last visited Nov. 9, 2009).

353. *Id.*

like a TRN), as well as criminal investigators and prosecutors.³⁵⁴ While the latter two were not like classic TRN members, at least they were not states. While the FATF had a small secretariat, the work of the FATF was carried on almost entirely by its members. Less than a year later, the FATF published³⁵⁵ its first set of Forty Recommendations (“FATF 40” or “the Recommendations”),³⁵⁶ which were designed to provide a comprehensive plan of action for fighting money laundering and which looked somewhat like an anti-money laundering standard. Drafted primarily by representatives from U.S. sub-state participants, the Recommendations covered the criminalization of money laundering and the freezing and seizing of criminal proceeds, preventive measures for banks such as customer identification and record keeping, transaction monitoring and the filing of suspicious activity reports when a financial institution suspected money laundering, and cross-border cooperation in investigating and prosecuting money laundering.³⁵⁷ In this, the FATF also looked much like a classic TRN, using the expertise of members, but suffering from the detrimental effects of a membership limited primarily to large industrialized countries.³⁵⁸

In 1991, the FATF began its program of yearly self-evaluations of compliance by completing questionnaires, and its mutual evaluation program.³⁵⁹ The mutual evaluations involved on-site assessments of compliance with the Recommendations, undertaken by experts drawn solely from other members.³⁶⁰ The following year, FATF helped set up the Caribbean Financial Action Task Force (“CFATF”), the first FATF-style regional body designed to advance adoption of the FATF 40.³⁶¹ This was followed by the formation of the Asia-Pacific Group on Money Laundering, and the FATF found

354. The author served as an IMF representative at FATF meetings starting in 1998 and continuing through 2004 and observed the operations of the FATF in detail, including engaging in discussion with the FATF secretariat and delegates from sub-state entities.

355. See FATF, *About the FATF*, *supra* note 352.

356. FATF, *FORTY RECOMMENDATIONS* (June 20, 2003), <http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF>.

357. *Id.* at 2, 5–6, 9–11.

358. See discussion of the nature of TRNs *supra* at Part I.C.

359. See FATF, *FINANCIAL ACTION TASK FORCE MONEY LAUNDERING REPORT 1991/1992 ANNUAL REPORT 1* (1992), <http://www.oecd.org/dataoecd/63/39/35752730.pdf>.

360. The author served as an IMF representative at FATF meetings starting in 1998 and continuing through 2004 and observed the operations of the FATF in detail, including engaging in discussion with the FATF secretariat and delegates from sub-state entities.

361. See FATF, *FINANCIAL ACTION TASK FORCE MONEY LAUNDERING REPORT 1992/1993 ANNUAL REPORT 5*, 21 (1992), <http://www.oecd.org/dataoecd/13/61/34325384.pdf>.

the mutual evaluation procedures of the CFATF and the Offshore Group of Banking Supervisors to be in conformity with the FATF's principles.³⁶² While membership in regional bodies required a political commitment to implement the FATF 40 and to undergo mutual evaluations, no treaty obligation was involved and no timetable was set for implementation.³⁶³ The FATF also expanded its membership to include twenty-four members of the OECD plus Hong Kong, Singapore, and representatives of the European Commission and the Gulf Co-operation Council.³⁶⁴ This expansion, both of its own membership and of regional bodies, helped to offset the negative effects of the FATF's original restricted membership.

While the FATF created a set of technical anti-money laundering standards, it sought to implement them with techniques that went beyond simple persuasion. The FATF also worked on developing appropriate "countermeasures" to those jurisdictions that failed to adequately implement anti-money laundering policies.³⁶⁵

In 1996, the FATF revised the Recommendations to extend anti-money laundering preventive measures to non-bank financial institutions.³⁶⁶ In addition, it also agreed to apply "preliminary sanctions against certain [FATF] members" that did not comply with the Recommendations (note that the term "countermeasures" was not used).³⁶⁷ By 1998, the CFATF and the Asia Pacific Group on Money Laundering together included all of the offshore centers in the

362. See FATF, FINANCIAL ACTION TASK FORCE ANNUAL REPORT 1996-1997, paras. 5-6, <http://www.jya.com/fatf96-97.htm>.

363. See Caribbean Financial Action Task Force [CFATF], CFATF Overview <http://www.cfatf-gafic.org/component/content/article/17-main/8-cfatf-overview.html> (last visited Nov. 9, 2009). The "uncommitted" commitment to implement the FATF 40 was discussed at a number of CFATF meetings and later at the Asia-Pacific Group on Money-Laundering ("APG") and the Select Committee of Experts on the Evaluation of Anti-Money-Laundering Measures ("PC-R-EV"), now known as "Moneyval." The author attended meetings of the APG as a representative of the IMF from 1998 to 2004, where he heard such comments. Also during that period, he discussed the issue with delegates from member countries of the CFATF and the PC-R-EV where he heard such comments.

364. FATF, About the FATF, *supra* note 352.

365. The author served as an IMF representative at FATF meetings starting in 1998 and continuing through 2004 and observed the operations of the FATF in detail, including engaging in discussion with the FATF secretariat and delegates from sub-state entities.

366. FATF, THE FORTY RECOMMENDATIONS, pt. c (1996), <http://www.oecd.org/dataoecd/15/51/40262612.pdf>.

367. FATF, FINANCIAL ACTION TASK FORCE ANNUAL REPORT 1996-1997, *supra* note 362 para. 32 (emphasis added).

Caribbean and Asia listed both in the OECD's 2000 tax haven list and in the FATF's Non-cooperating Countries and Territories 2000 list.³⁶⁸

During the early 1990s, FATF members expressed concern about jurisdictions they believed were key weak links in enforcing anti-money laundering rules.³⁶⁹ According to the FATF, at that time many onshore jurisdictions, including almost all poorer or developing countries, had little or no anti-money laundering rules or enforcement. However, it was the role played by some key offshore jurisdictions that was frequently mentioned as the most troublesome. Many of these jurisdictions allegedly provided benefits to launderers that the vast number of poorer and developing countries did not: they were usually "tax havens," they had a first-world financial infrastructure, and a first-world legal system to protect property rights.³⁷⁰ The 1996 FATF 40 included Recommendation 21, which stated that financial institutions should give heightened due diligence to business relations and transactions with persons from jurisdictions that "do not or insufficiently apply [the] Recommendations."³⁷¹ Such heightened due diligence could result in a financial institution refusing to undertake transactions with the person from a non-complying jurisdiction, but the Recommendation was vague on this issue.³⁷² The Recommendation was an invitation, however, for local regulators to use hard power on their domestic institutions to ensure compliance on the part of non-resident institutions, in a manner quite similar to that recommended for both tax and prudential standards enforcement.³⁷³

368. Membership of the CFATF includes every OFC in the Caribbean region. See CFATF, CFATF Overview, *supra* note 363. The membership of the Asia Pacific Group includes every OFC in the Asia region. See Asia/Pacific Group, Overview of Members, <http://www.apgml.org/apg-members/> (last visited Oct. 30, 2009); Appendix, *infra*.

369. The author served as an IMF representative at FATF meetings starting in 1998 and continuing through 2004 and observed the operations of the FATF in detail, including engaging in discussion with the FATF secretariat and delegates from sub-state entities.

370. Interview with Rick McDonnell, Head of Secretariat, Fin. Action Task Force, Paris, Fr. (May 12, 2007). The first-world financial structure included branches or subsidiaries of onshore banks or domestic onshore banks that were an accepted part of the international financial system and trust and company service providers to assist in access to the financial system.

371. FATF, THE FORTY RECOMMENDATIONS (1996), *supra* note 366, at 5, Recommendation 21.

372. For further discussion of this issue, see Hartman, *supra* note 164, at 273–78.

373. As there was no formal enforcement mechanism within the FATF, the only way to enforce the FATF 40 was for local regulatory authorities to accept the standard and enforce it domestically. See the discussion of enforcement of TRN-developed standards *supra* in Part I.A.

There are a number of reasons why offshore centers might not have wished to make full implementation of the FATF's recommendations a priority. The primary purpose of anti-money laundering rules is to reduce criminal activity by reducing the ability to enjoy the profits of crime.³⁷⁴ However, the vast majority of criminals and criminal activities were onshore, not off; therefore, implementing such policies was likely to help onshore jurisdictions far more.³⁷⁵ Because implementation of such policies was relatively costly, especially to financial institutions,³⁷⁶ there may have been relatively little "non-altruistic" reasons to expend such cash. Also, because the implementation of anti-money laundering rules required clients of financial institutions to jump through more hoops regarding such matters as identification,³⁷⁷ implementation might have hurt business.

By 1999, key FATF members, led again primarily by the United States and France, determined that diplomatic efforts, plus the threat of implementation of Recommendation 21, had not been enough to encourage these allegedly troublesome jurisdictions to change.³⁷⁸ Taking as their model the OECD's harmful tax competition project,³⁷⁹ FATF delegates began to formulate an analogous anti-money laundering program, putting together the Non-Cooperating Countries and Territories process.³⁸⁰ In doing so, the FATF made a number of crucial decisions.

First, analogous to the Harmful Tax Practices Project and the detrimental issues involved in that system, the FATF delegates chose not to include in its initial review all jurisdictions that failed to follow the FATF 40, but rather those they believed were causing the most

374. See Gordon, *supra* note 345, at 409.

375. See the discussion in Gordon, *supra* note 345, at 413–14. This point was made repeatedly to the author during meetings with officials from OFCs during the period of 2000 to 2004.

376. See Richard K. Gordon, *Trusts or Terrorists? Financial Institutions and the Search for Bad Guys*, 43 WAKE FOREST L. REV. 699, 721–25, 728–29 (2008).

377. See, e.g., FATF, FATF 40 RECOMMENDATIONS 2–3, Recommendation 5 (2003), <http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF>. Recommendation 5 requires financial institutions to identify all clients, including beneficial owners or controllers. *Id.* This includes beneficiaries of trust accounts as well as directors and controlling shareholders of companies. *Id.* This is far more onerous than simply requiring the name and address of the client of record.

378. Interview with un-named high ranking official for a FATF-member country, in Kuala Lumpur, Malaysia (July 2000).

379. The modest FATF Secretariat was physically housed at the OECD's Paris headquarters, which may have lead to the FATF adopting some of OECD ideas during mutual staff coffee or lunch breaks in the OECD mess.

380. Interview in Kuala Lumpur, *supra* note 378.

practical problems.³⁸¹ For this purpose, they put together an ad hoc group to determine which jurisdictions should be included in the initial review.³⁸² The reasons for so doing were obvious, as most countries in the world had yet to adopt and implement the FATF 40; to cover all countries would require too many resources. However, by selecting only a subset of such countries, they left themselves open to criticism. FATF members wound up selecting a relatively large number of jurisdictions for review, including a number of large onshore jurisdictions like the Philippines and Russia.³⁸³ Eventually, FATF examined a total of forty-seven countries or territories in two rounds of reviews.³⁸⁴

Unlike the Harmful Tax Practices Project or even the prudential supervisory program, the FATF already had a standard formally endorsed by virtually all of the jurisdictions they wished to examine: the FATF 40. Although when signing on to the FATF-style regional bodies the jurisdictions had not pledged to implement the FATF 40 by a specific date, at least they had accepted it as the applicable standard against which their anti-money laundering policies should be judged through a mutual evaluation process.³⁸⁵ Nevertheless, the FATF decided neither to apply the full FATF 40 as the standard by which cooperation would be judged nor to rely on the FATF-style regional body mutual evaluations to determine compliance.³⁸⁶ Rather, the FATF chose to create a special set of twenty-five criteria based on a subset of the FATF 40, and to assess compliance with the twenty-five criteria themselves.³⁸⁷ The FATF also contemplated a “certain subjectivity” in assessments.³⁸⁸ This failure to apply the same standard

381. FATF, REPORT ON NON-COOPERATIVE COUNTRIES AND TERRITORIES, *supra* note 340, at 6 (“FATF members have been invited to mention those jurisdictions where, in the recent past, there have been difficulties, with an explanation of the nature of the difficulties that were encountered.”).

382. *See id.* at 6–7.

383. *See* FATF, FATF REVIEW TO IDENTIFY NON-COOPERATING COUNTRIES OR TERRITORIES: INCREASING THE WORLDWIDE EFFECTIVENESS OF ANTI-MONEY LAUNDERING MEASURES 9 (2000), <http://www.fatf-gafi.org/dataoecd/56/43/33921824.pdf>.

384. Interview with Rick McDonnell, *supra* note 370.

385. *Id.*

386. Interview in Kuala Lumpur, *supra* note 378.

387. *See* FATF, REPORT ON NON-COOPERATIVE COUNTRIES AND TERRITORIES, *supra* note 340, at 1–7.

388. “No specific criteria can be considered a litmus test of a particular jurisdiction’s level of co-operation in the international fight against money laundering. Rather, each jurisdiction must be judged by the overall, total effect of its laws and programmes in preventing abuse of the financial sector or impeding efforts of foreign judicial and administrative authorities.” *Id.* at 6.

indicated more detrimental attributes, in that a successful standards system should apply the same standard to all.

Many of the twenty-five criteria focused on the core of the preventive measures in the FATF 40, including inadequate regulation and supervision of financial institutions, inadequate fit and proper test rules for the licensing and creation of financial institutions, inadequate customer identification requirements for financial institutions, excessive secrecy provisions regarding financial institutions, and a lack of an efficient suspicious-transaction reporting system.³⁸⁹ Other criteria focused on law enforcement (lack of a financial intelligence unit) and on international cooperation.³⁹⁰ But others, such as “[i]nadequate commercial law requirements for registration of business and legal entities” and “lack of identification of the beneficial owner(s) of legal and business entities,” were new.³⁹¹ There simply was no single standard for all.

For jurisdictions that were found to be non-cooperative with respect to these criteria, proposed responses could include:

[s]pecific actions . . . by other multi-lateral fora (e.g., the G-7, the OECD, the Basle Committee, IOSCO and the International Financial Institutions) to seek the issuance of public statements or other appropriate action. In particular, the World Bank and the International Monetary Fund, *could examine the consequences of a particular jurisdiction’s failure to take appropriate corrective action*, in connection with their activities.³⁹²

Other proposed responses involved applying Recommendation 21 to financial institutions with respect to heightened due diligence.³⁹³ And finally, again reminiscent of the OECD’s Harmful Tax Practices Project, the Report proposed the application by FATF members (as opposed to financial institutions located within FATF-member jurisdictions), collectively or individually, of “counter-measures,” including “[c]onditioning, restricting, targeting or even prohibiting financial transactions with non-cooperative jurisdictions.”³⁹⁴

389. *Id.* at 2–4.

390. *Id.* at 4–6.

391. *Id.* at 4.

392. *Id.* at 7 (emphasis added).

393. *Id.* at 8.

394. *See id.*

In February of 2000, the FATF published its first review.³⁹⁵ The vast majority of the OFCs listed in the initial forty-seven did not make it to the “uncooperative” list.³⁹⁶ While it was not clear from the report why this was the case, a number of persons who were part of the review process reported that the United Kingdom worked to keep its offshore territories off the list, while Canada also worked to keep off the list a number of territories with which it had close relations and which it represented on the Executive Board of the IMF.³⁹⁷ The Cayman Islands, one of the most important OFCs in terms of total business transacted, did make the list. The report noted that the Caymans had no requirement for customer identification and recordkeeping, the most essential of the anti-money laundering preventive measures, as well as little active bank supervision.³⁹⁸ Other jurisdictions like the Bahamas, Dominica, and the Marshall Islands were listed primarily for not providing information on beneficial ownership of legal persons or arrangements,³⁹⁹ something that most onshore jurisdictions also did not do. A number of other relatively minor OFCs (in terms of total business transacted) were on the list and were also uncooperative tax havens; three of these, the Cook Islands, Nauru, and Niue, also had no customer identification requirement.⁴⁰⁰ A number of others with serious shortcomings, including Russia and Lebanon, were not offshore centers at all.

As noted earlier in Part II.B.2, the NCCT process was proceeding more or less parallel with the OECD’s Harmful Tax Practices Project. Jurisdictions named as NCCTs complained as well, and for many of the same reasons: the defensive “countermeasures” were actually coercive sanctions, or the illegitimate application of power by the rich and powerful against the small and weak.⁴⁰¹ Again, there was some agreement with this view in the popular press as well

395. FATF, *FATF REVIEW TO IDENTIFY NON-COOPERATING COUNTRIES OR TERRITORIES: INCREASING THE WORLDWIDE EFFECTIVENESS OF ANTI-MONEY LAUNDERING MEASURES*, *supra* note 383, at 1.

396. *See infra* Appendix.

397. The author personally observed these discussions during February of 2000.

398. FATF, *FATF REVIEW TO IDENTIFY NON-COOPERATING COUNTRIES OR TERRITORIES: INCREASING THE WORLDWIDE EFFECTIVENESS OF ANTI-MONEY LAUNDERING MEASURES*, *supra* note 383, at 4.

399. *Id.* at 2, 5, 7.

400. The Cook Islands did not require customer identification for offshore banks (defined as banks that do not accept resident customers), *id.* at 4, while Nauru lacked regulations of any kind, *id.* at 8, and Niue had deficiencies in customer identification, *id.*

401. *See supra* notes 169, 170, 172 and accompanying text.

as in academia.⁴⁰² While the FATF 40 was at least arguably a standard accepted by virtually all of the OFCs on the NCCT list via their membership in an FATF-style regional body, the twenty-five criteria by which they were assessed were not.⁴⁰³ This allowed the offshore centers to claim that the larger onshore centers were trying to impose standards that were neither internationally accepted nor applied to some of their own members.⁴⁰⁴ As with the tax competition program, another key complaint was that the process of assessing the jurisdiction's compliance lacked all the hallmarks of due process posited to be found in the most successful standards system; in particular, the assessments were certainly neither uniform nor impartially applied.⁴⁰⁵ Objectivity was noticeably absent.

In 1996, a staff member in the Monetary and Exchange Affairs Department published a paper on the macroeconomic implications of money laundering.⁴⁰⁶ In the paper, he argued that laundering created inaccuracies in macroeconomic data, investment decisions based on ease of laundering rather than on rate of return, erosion of confidence in financial markets, tax evasion, and finally an increase in underlying criminal activities (i.e., predicate offenses) that would result in the promotion of private economic benefits over social welfare.⁴⁰⁷

In response, the IMF Legal Department disputed each of these views, suggesting that if a problem existed it was that *anti*-laundering policies resulted in inaccurate macroeconomic data, skewed investment decisions, erosion of confidence in markets, and tax

402. See, e.g., Hartman, *supra* note 164, at 263–64 (arguing that countermeasures are in fact sanctions as a remedy for a breach of international obligations, but that because there are no such obligations with respect to tax, the sanctions are illegitimate); James, *supra* note 170, at 5 (“[T]he OECD, like pirates who plied the waters of the Caribbean during the sixteenth through nineteenth centuries, has, through its ill-advised anti-harmful tax competition initiative, effectively robbed fourteen CARICOM nations of their sovereign right to determine their tax and economic policies.”).

403. This was because the standard had been created solely by the FATF and its members, meeting without consultation with outsiders. See *supra* notes 387–91 and accompanying text.

404. See SHARMAN, *supra* note 135, at 71, 86–93.

405. See *id.* at 75, 86–88; see also John Burgess, *15 Nations Cited as Havens for Possible Money Crimes*, WASH. POST, June 23, 2000, at E3 (quoting the Cayman Islands' government in criticizing their placement on the FATF list as “made without due process”).

406. PETER QUIRK, INTERNATIONAL MONETARY FUND, *MACROECONOMIC IMPLICATIONS OF MONEY LAUNDERING* (1996).

407. *Id.* at 2, 18–19, 27–28.

evasion.⁴⁰⁸ As for the argument that crime is bad, the article noted that while this is obviously true, relying upon this argument would lead logically to a position that all anti-crime efforts were within the IMF's mandate. This position would be self-evidently unworkable.⁴⁰⁹ Informal discussions among the Legal Department and Executive Board offices, management, and senior staff at other IMF Departments confirmed a strong general inclination for the IMF to avoid money laundering issues because they were primarily related to criminal enforcement and, therefore, beyond the Fund's mandate and expertise.⁴¹⁰

Nevertheless, in part to placate the American and French governments, the IMF agreed to send staff members as observers to FATF and FATF-style regional bodies. As the FSAP/ROSC program was being developed, the United States established a slightly different tack. In early 2000, U.S. Treasury Secretary Lawrence Summers sent a letter to the International Monetary and Financial Committee⁴¹¹ at the Fund and the Development Committee at the World Bank,⁴¹² urging the two to "step up" their efforts to combat money laundering.⁴¹³ Noting the recent "increased engagement . . . on financial sector issues and assessments," Secretary Summers urged the IMF and World Bank to include money laundering measures in financial sector reform programs.⁴¹⁴ In particular, the United States lobbied to include the FATF 40 as a standard to be assessed under

408. Gordon, *supra* note 345, at 410–14. Although published as an opinion by a senior lawyer in the Legal Department, it was done so with the encouragement of the IMF's then General Counsel.

409. *Id.* at 414–17.

410. The author served as a senior staff member at the IMF during this time and participated in these discussions.

411. The International Monetary and Financial Committee ("IMFC") is composed of twenty-four IMF governors, ministers, or others of comparable rank. *See* IMF, A Guide to Committees, Groups, and Clubs, *supra* note 266. The Committee advises the IMF's Board of Governors. *Id.* Each member country that appoints, and each group of member countries that elects, an Executive Director appoints a member of the IMFC. *Id.*

412. The Development Committee's formal title is the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries. It is composed of twenty-four World Bank governors, finance, or development ministers or others of comparable rank. It advises IMF and the World Bank Board of Governors on development issues. Each World Bank member country that appoints, and each group of member countries that elects, a World Bank Executive Director appoints a member of the IMFC. *See* Dev. Comm., About the Development Committee, <http://go.worldbank.org/XC5NCJDH40> (last visited Sept. 12, 2009).

413. Lawrence H. Summers, U.S. Treasury Sec'y, Statement to the Development Committee of the World Bank and the International Monetary Fund (Apr. 17, 2000), <http://imf.org/external/spring/2000/dc/usa.htm>.

414. *Id.*

the FSAP/ROSC and OFC programs.⁴¹⁵ There apparently were a number of reasons the United States wished for the IMF and World Bank to add anti-money laundering to the FSAP program. One was that it would bring added attention to money laundering issues. However, another was that the IMF, with its near universal membership and independent staff, would add legitimacy to an assessment practice that was lacking in the NCCT process.⁴¹⁶

The reaction from most other Executive Directors, management, and staff was again largely negative. Two staff reports were drafted and discussed at the Executive Board meeting that largely rejected the idea, but suggested instead that the existing assessment of the anti-money laundering principles in the various supervisory principles (Basel Core Principles, IOSCO, and IAIS) be enhanced and that the IMF and World Bank work more closely with the FATF in ensuring compliance with these principles.⁴¹⁷ The staff reports also suggested that the World Bank and IMF might recognize the FATF 40 as the anti-money laundering world standard, but that it would be up to the FATF and FATF-style regional bodies to assess compliance.⁴¹⁸ The Board went along, noting in particular that the IMF should not become involved in “law enforcement.”⁴¹⁹

A key concern expressed by all the non-OECD Executive Directors at this time (and privately by a few OECD Directors) was that the FATF NCCT process was, in their opinion, anything but voluntary and cooperative in nature, and, therefore, anathema to both the Fund and the Bank’s culture and tradition in general and to the Financial Sector Assessment and Offshore Financial Sector programs specifically.⁴²⁰ They did not want the two international financial institutions to be seen to support in any way the NCCT

415. See, e.g., IMF, FINANCIAL SYSTEM ABUSE, *supra* note 154, at 17 (“We believe country programs and loan operations should incorporate, as appropriate, preconditions and performance criteria designed to help countries make real and measurable progress in combating money laundering. ROSCs offer a flexible process for incorporating assessments of countries’ observance of the FATF Forty Recommendations as another separate module.”).

416. The author discussed these issues with a number of senior U.S. authorities.

417. IMF & WORLD BANK, ENHANCING CONTRIBUTIONS TO COMBATING MONEY LAUNDERING: POLICY PAPER 14, box 1 (2001), available at <http://www.imf.org/external/np/ml/2001/eng/042601.pdf>.

418. *Id.* at 15–16.

419. Public Information Notice (PIN) No. 01/41, IMF, IMF Executive Board Discusses Money Laundering (Apr. 29, 2001), <http://www.imf.org/external/np/sec/pn/2001/PN0141.htm>.

420. See *id.* (“[S]everal Directors noted that recognizing the FATF 40 Recommendations did not constitute an endorsement of the non-voluntary and non-cooperative manner in which the FATF applies the Recommendations.”).

process and contemplated ways in which the IMF and World Bank might work to soften or eliminate the entire NCCT program.⁴²¹

In spite of criticism, the NCCT process continued without the support of the two international financial institutions. In June of 2000, the Bahamas, the Cayman Islands, and Liechtenstein had been removed from the list, while a number of onshore jurisdictions, including Egypt, Guatemala, Hungary, Indonesia, Myanmar, and Nigeria, were added.⁴²² While the addition of these onshore jurisdictions somewhat muted the complaints that the NCCT process involved a ganging up of the powerful over the weakest, it also added voices of countries with significantly larger populations and political influence to the criticism of the process.

The change in U.S. administrations, so important in re-framing the United States' advocacy for the Harmful Tax Practices Project, may have affected U.S. support for anti-money laundering activities. At the IMF, it was rumored that the new officials involved in formulating U.S. policy toward tax havens believed that much of the U.S. policy on anti-money laundering was actually a subterfuge for closing down tax havens. The reason, it was rumored, was that the most important of the twenty-five non-cooperating country criteria were linked to piercing bank secrecy and sharing information, which were also central to uncovering U.S. persons who use tax havens to avoid or evade income tax.

At this point, the efforts of the major onshore jurisdictions to involve the IMF (and to a lesser extent the World Bank) in their harmful tax practices and NCCT projects had largely failed beyond an enhanced emphasis on Basel Core Principle Fifteen, which required

421. In the Executive Board's discussion of the role of the IMF in anti-money laundering efforts,

Directors also stressed that the FATF process needs to be made consistent with the ROSC process—that is, the FATF standard needs to be applied uniformly, cooperatively, and on a voluntary basis—and that once this is done, the FATF could be invited to participate in the preparation of a ROSC module on money laundering. They called on the staffs of the Fund and the World Bank to contribute to the ongoing revision of the FATF 40 Recommendations and to discuss with the FATF the principles underlying the ROSC procedures and come back to the Board with a report and proposals.

Id.

422. FATF, REVIEW TO IDENTIFY NON-COOPERATIVE COUNTRIES OR TERRITORIES: INCREASING THE WORLDWIDE EFFECTIVENESS OF ANTI-MONEY LAUNDERING MEASURES 3-4 (June 22, 2001), <http://www.fatf-gafi.org/dataoecd/56/41/33922055.pdf>.

banks to have effective anti-money laundering programs.⁴²³ While the IMF's project to assess OFC's compliance with the Basel Core Principles (and occasionally the securities, IOSCO, and insurance, IAIS, principles) was proceeding, most offshore centers were actually receiving very good assessments.⁴²⁴

Any remaining effort to derail plans for significant IMF and World Bank involvement in promoting compliance with anti-money laundering principles was rendered almost entirely irrelevant by the September 11, 2001, terrorist attacks on the United States. Although the attacks were carried out inexpensively, the U.S. Treasury Department began immediately to push other members of the FATF to include terrorism financing as a central part of its mandate. On October 29 and 30, 2001, the FATF, meeting in an extraordinary plenary session in Washington, adopted eight new recommendations on terrorist financing.⁴²⁵ Soon after, the IMF Managing Director created a special task force to consider how to intensify IMF involvement in anti-money laundering and anti-terrorism financing projects.⁴²⁶ On November 5, 2001, the Task Force issued a report recommending that the IMF and World Bank endorse the FATF 40 plus the eight new Special Recommendations ("FATF 40 + 8") and begin to include the assessment of compliance with the FATF 40 + 8 into the FSAP and OFC program.⁴²⁷ In addition, the report recommended that anti-money laundering and terrorism financing ROSCs be prepared once the already adopted rules for ROSC assessments could be achieved.⁴²⁸ The Task Force managed to find the previously missing mandate for activity in this area in the IMF's role in overseeing the international financial system.⁴²⁹ Intellectually, this was a stretch, but politically, the results were unavoidable: the IMF's management and Executive Board simply could not say no in the charged atmosphere that was the immediate aftermath of the terrorist attacks. In fact, the Task Force report states quite explicitly

423. For full text of this Principle, see BASEL COMM., PRINCIPLES FOR THE SUPERVISION OF BANKS' FOREIGN ESTABLISHMENTS, *supra* note 213.

424. Interview with Rick McDonnell, *supra* note 370.

425. The author served as a senior staff member at the IMF during this time and participated in these discussions.

426. The author of this Article was a member of the Task Force.

427. IMF, INTENSIFIED FUND INVOLVEMENT IN ANTI-MONEY LAUNDERING WORK AND COMBATING THE FINANCING OF TERRORISM 14–15 (2001) [hereinafter IMF, INTENSIFIED FUND INVOLVEMENT], <https://www.imf.org/external/np/mae/aml/2001/eng/110501.pdf>.

428. *Id.* at 16.

429. *Id.* at 5–6.

that the IMF's involvement should be based not on its mandate but on the fact that

[t]he Fund is a collaborative institution with near universal membership, which lends the Fund legitimacy and acceptance, and makes it a natural forum for sharing information and developing common approaches to issues. These strengths also make the Fund a vehicle for actively promoting desirable policies and standards in member countries.⁴³⁰

The report also noted that the IMF already had experience in assessing compliance with other standards.⁴³¹ In other words, the Task Force suggested that the IMF had as attributes many of the positive factors that lead to good standards systems.

While the Task Force members were drafting the report, some Executive Directors made clear that they wanted not only for all offshore center assessments to include money laundering assessments, but that the offshore program be accelerated.⁴³² There was some resistance to this on the part of many members of the Task Force, who felt that the events of September 11, 2001, had nothing to do with offshore centers and that resources could better be used elsewhere. Nevertheless, in the end, the Task Force report proposed increasing the target number of OFC assessments from ten to twenty per year so that two-thirds of the forty-two OFCs on the Financial Stability Forum's list would be assessed by the end of 2002.⁴³³ The Executive Board agreed.⁴³⁴

The report noted a number of other issues, including that in order for assessments of compliance to be as objective and uniform as possible, the new anti-money laundering and terrorism financing standard—FATF 40 + 8—needed an assessment methodology; without such a methodology, which already existed for Basel Core Principles assessments, there could be no objectivity.⁴³⁵ The report also suggested that the IMF and World Bank should not be involved in assessing compliance with criminal law matters and raised the

430. *Id.* at 10.

431. *Id.* at 10–11.

432. The author served as a senior staff member at the IMF during this time and participated in these discussions.

433. IMF, INTENSIFIED FUND INVOLVEMENT, *supra* note 427, at 15.

434. Public Information Notice (PIN) No. 01/120, IMF, IMF Board Discusses the Fund's Intensified Involvement in Anti-Money Laundering and Combating the Financing of Terrorism (Nov. 16, 2001) [hereinafter IMF Board Discussion], <https://www.imf.org/external/np/sec/pn/2001/pn01120.htm>.

435. IMF, INTENSIFIED FUND INVOLVEMENT, *supra* note 427, at 12. The meaning of these two paragraphs was understood as such by the authors of the paper.

question of how the activities of the IMF and World Bank would intersect with that of the FATF and FATF-style regional bodies.⁴³⁶ Finally, the report discussed the NCCT process, which clearly breached the rules of the game for producing acceptable ROSCs: the NCCT process was not voluntary, not objectively applied across countries (e.g., there was no methodology for assessment), and was assessed using pass-fail ratings.⁴³⁷ In short, it flunked many of the attributes of a good standard system identified in Part I above.

Although they did not explicitly mention the NCCT process, the Executive Board agreed that these issues had to be resolved before anti-money laundering ROSCs could be prepared and, in particular, that the process be “compatible with the uniform, voluntary, and cooperative nature of the ROSC exercise.”⁴³⁸

At this point, an intense series of discussions began among key FATF members and senior staff with respect to the continuation of the NCCT process. In effect, management at the IMF and World Bank concluded that the Executive Board would not endorse an anti-money laundering and terrorism financing ROSC while the FATF continued the NCCT process, while key FATF members insisted that the NCCT process was working and should be allowed to continue. Another issue was the assessment methodology document, which was needed if assessments were to be uniform and objective. The FATF agreed to complete the document and referred the job to the U.S. delegation, but their initial version was little more than a restatement of the FATF 40 + 8. As a result, IMF and World Bank staff agreed to complete the methodology with IMF staff taking the lead. The result was a highly detailed set of criteria that one staff member noted would “make it very hard for the FATF to be easy on themselves and hard on others.”⁴³⁹ IMF staff began to use the draft methodology to make anti-money laundering assessments in the OFC program, but not to publish ROSCs.

By April, the Fund’s International Monetary and Financial Committee,⁴⁴⁰ chaired by the United Kingdom, called on the Fund to complete the anti-money laundering/combating financing of terrorism (“AML/CFT”) methodology “and the development of assessment

436. *Id.* at 12, 28, 34.

437. *Id.* at 27.

438. IMF Board Discussion, *supra* note 434.

439. The author of this Article was a principal author of the methodology. This view was widely held among staff.

440. For additional information on the IMFC, see IMF, A Guide to Committees, Groups, and Clubs, *supra* note 266.

procedures compatible with the uniform, voluntary, and cooperative nature of the ROSC process.”⁴⁴¹

In June of 2002, the FATF released its next non-cooperating countries report; fifteen jurisdictions were still listed, just under half of which were offshore centers, and none of which was particularly important in terms of percentage of total offshore business in the world⁴⁴²: the Cook Islands, Dominica, Grenada, Marshall Islands, Nauru, Niue, St. Vincent, and the Grenadines.⁴⁴³ However, a number of the remaining onshore jurisdictions (including Egypt, Indonesia, Nigeria, the Philippines, Russia, and Ukraine) had relatively large economies compared to those of the smaller offshore centers and, therefore, could be influential with the IMF Board.

The next staff paper proposed a pilot program of anti-money laundering assessments based on the new methodology to be undertaken by the IMF and World Bank and the FATF and FATF-style regional bodies.⁴⁴⁴ However, given the International Monetary and Financial Committee’s statement, the authors insisted on standing up to the United States and France and insisted that all assessments embrace a process that was:

uniform, including using the same methodology for all assessments (the FATF’s NCCT process uses a different methodology from those of mutual evaluations), *voluntary* (the FATF NCCT process is mandatory and can result in the imposition of sanctions) and *cooperative*, including not using a pass-fail approach (the FATF NCCT process labels jurisdictions either “cooperative” or “non-cooperative”) and giving the jurisdiction the opportunity to publish a right of reply alongside the ROSC (the FATF NCCT process does not allow such a right of reply).⁴⁴⁵

441. Press Release No. 02/22, IMF, Communiqué of the Int’l Monetary and Fin. Comm. of the Board of Governors of the IMF (Apr. 20, 2002), <http://www.imf.org/external/np/sec/pr/2002/pr0222.htm>.

442. Interview with un-named senior staff member from a FATF-member country, in Washington, D.C. (June 2002).

443. FATF, REVIEW TO IDENTIFY NON-COOPERATING COUNTRIES AND TERRITORIES 4 (June 2002), available at <http://www.fatf-gafi.org/dataoecd/4/32/33922320.pdf>.

444. IMF & WORLD BANK, ANTI-MONEY LAUNDERING AND COMBATING FINANCING OF TERRORISM (AML/CFT) MATERIALS CONCERNING STAFF PROGRESS TOWARD THE DEVELOPMENT OF A COMPREHENSIVE AML/CFT METHODOLOGY AND ASSESSMENT PROCESS: JOINT PROGRESS REPORT ON THE WORK OF THE IMF AND WORLD BANK 10 (2002), <http://www.imf.org/external/np/mae/aml/2002/eng/061102.pdf>.

445. *Id.* at 10 n.5.

The FATF flatly refused to give up the current NCCT round.⁴⁴⁶ Thus followed another round of discussions with Executive Directors. A majority of those opposed to the NCCT process still favored accepting the FATF's offer; they felt that it was the best they could get, and that having impartial IMF assessment of NCCT countries would act as a significant counterbalance to the "partial" and "unfair" NCCT assessments. Most of these Executive Directors did not represent jurisdictions on the NCCT list. Others representing constituencies that had been assessed through the NCCT process expressed concerns that such benefits would be outweighed by the legitimacy that an IMF/World Bank-endorsed FATF Report on the Observance of Standards and Codes would confer on the FATF and, therefore, on the NCCT process.

In the end, the Board was split, adopting by a majority a twelve-month pilot of anti-money laundering assessments and accompanying ROSCs. Under this pilot, the IMF and the World Bank were to complete some ROSCs while the FATF and FATF-style regional bodies were to continue to assess their own members.⁴⁴⁷ However, the Board insisted that FATF first agree to undertaking its mutual evaluations of its own members in a manner consistent with the ROSC process (including endorsing the new methodology and its use in undertaking FATF or FATF-style regional bodies and IMF and World Bank assessments) and that it agree "not [to] undertake a further round of the [NCCT] initiative, at least during the period of the 12-month pilot project."⁴⁴⁸

However, a number of Directors expressed their disapproval, saying that those conditions did not go far enough. They said that "reports on observance associated with FATF-led assessments [should] not be designated ROSCs unless the FATF undertook a blanket commitment not to undertake any further country assessments without the consent of the country, and acknowledge that it would accept the results of any Fund/Bank-led assessments."⁴⁴⁹

As the pilot program went forward, by the end of 2002, the eight offshore centers assessed, which included the formerly listed Liechtenstein, did quite well, with only Vanuatu showing a few remaining significant problems with respect to the quality of

446. The author was a party to these negotiations.

447. See Public Information Notice (PIN) No. 02/87, IMF, IMF Advances Efforts to Combat Money Laundering and Terrorist Finance (Aug. 8, 2002), <http://www.imf.org/external/np/sec/pn/2002/pn0287.htm>.

448. *Id.*

449. *Id.*

supervision in the offshore banking sector and non-bank financial institutions.⁴⁵⁰ The assessments merely showcased how effective jurisdictions were in implementing their anti-money laundering programs, in most cases noting great improvement in recent years.⁴⁵¹

However, the remaining OFCs on the FATF NCCT list did not request an immediate assessment. The following year, the Cook Islands requested and received an assessment from the IMF,⁴⁵² with the staff report stating that the authorities “have strengthened the AML/CFT legal and institutional framework mainly in response to the FATF’s listing of the Cook Islands as a non-cooperative” but that “the efforts remain uneven,” noting that the FATF had not removed

450. See IMF, ANGUILLA—OVERSEAS TERRITORY OF THE UNITED KINGDOM: ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR VOLUME I—REVIEW OF FINANCIAL SECTOR REGULATION AND SUPERVISION 24–32 (2003) [hereinafter IMF, ANGUILLA], <http://www.imf.org/external/pubs/ft/scr/2003/cr03370.pdf>; IMF, GUERNSEY—CROWN DEPENDENCY OF THE UNITED KINGDOM: ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR VOLUME I—REVIEW OF FINANCIAL SECTOR REGULATION AND SUPERVISION 27–33 (2003) [hereinafter IMF, GUERNSEY], <http://www.imf.org/external/pubs/ft/scr/2003/cr03364.pdf>; IMF, ISLE OF MAN—CROWN DEPENDENCY OF THE UNITED KINGDOM: ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR VOLUME I—REVIEW OF FINANCIAL SECTOR REGULATION AND SUPERVISION 21–27 (2003) [hereinafter IMF, ISLE OF MAN], <http://www.imf.org/external/pubs/ft/scr/2003/cr03366.pdf>; IMF, JERSEY—CROWN DEPENDENCY OF THE UNITED KINGDOM: ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR VOLUME I—REVIEW OF FINANCIAL SECTOR REGULATION AND SUPERVISION 29–33 (2003) [hereinafter IMF, JERSEY], <http://www.imf.org/external/pubs/ft/scr/2003/cr03368.pdf>; IMF, LIECHTENSTEIN: ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR VOLUME I—REVIEW OF FINANCIAL SECTOR REGULATION AND SUPERVISION 33–39 (2003) [hereinafter IMF, LIECHTENSTEIN], <http://www.imf.org/external/pubs/ft/scr/2003/cr03289.pdf>; IMF, MONACO: ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR VOLUME I—REVIEW OF FINANCIAL SECTOR REGULATION AND SUPERVISION 28–39 (2003) [hereinafter IMF, MONACO], <http://www.imf.org/external/pubs/ft/scr/2003/cr03262.pdf>; IMF, MONTERRAT—OVERSEAS TERRITORY OF THE UNITED KINGDOM: ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR—REVIEW OF FINANCIAL SECTOR REGULATION AND SUPERVISION 20–27 (2003) [hereinafter IMF, MONTERRAT], <http://www.imf.org/external/pubs/ft/scr/2003/cr03371.pdf>; IMF, VANUATU: ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR VOLUME I—REVIEW OF FINANCIAL SECTOR REGULATION AND SUPERVISION 61–67 (2003) [hereinafter IMF, VANUATU], <http://www.imf.org/external/pubs/ft/scr/2003/cr03253.pdf>.

451. See IMF, ANGUILLA, *supra* note 450, at 6; IMF, GUERNSEY, *supra* note 450, at 6; IMF, ISLE OF MAN, *supra* note 450, at 7; IMF, JERSEY, *supra* note 450, at 7; IMF, LIECHTENSTEIN, *supra* note 450, at 17, 35; IMF, MONACO, *supra* note 450, at 6; IMF, MONTERRAT, *supra* note 450, at 6, 20.

452. They were also assessed as part of a mutual evaluation by the Asian FATF-style regional body.

the jurisdiction from the list.⁴⁵³ While the IMF provided free technical assistance to the Cook Islands,⁴⁵⁴ they remained on the NCCT list until 2005.⁴⁵⁵ If one theory was that involving the IMF in assessing anti-money laundering compliance would help get OFCs off the NCCT list, it did not appear to be playing out.

There was an unanticipated effect on the onshore jurisdictions resulting from the involvement of the IMF in the anti-money laundering project. In agreeing to allow the FATF and FATF-style regional bodies to produce ROSCs, the IMF and World Bank insisted that they ensure uniformity through review of the former's assessments.⁴⁵⁶ This did not go entirely well for the FATF and FATF-style regional bodies, where a major review

found a high degree of variability in the quality and consistency of reports prepared by [the FATF and FATF-style regional bodies] as well as within the same assessor group. While a large majority of reports were of high- or medium quality with respect to key components of the assessments, the treatment of ratings gave rise to greater problems. A number of initiatives have been taken or are underway to improve the quality and consistency of assessments by all assessor bodies, including: the standardization of documentation, the strengthening of peer/internal reviews, and the intensification of assessor training.⁴⁵⁷

According to a law enforcement official from an FATF member, one result of this review was that if “the introduction of the methodology document killed some of the ‘I’ll scratch your back if you scratch mine’ attitude; this quality review will kill off more.”⁴⁵⁸

The IMF staff's review of the OFC program in 2003 generally gave OFCs high marks in anti-money laundering as well as banking supervision, noting that they “compare[d] favorably” with onshore

453. IMF, COOK ISLANDS: ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR VOLUME I—REVIEW OF FINANCIAL SECTOR REGULATION AND SUPERVISION 8, 32 (2004), <http://www.imf.org/external/pubs/ft/scr/2004/cr04413.pdf>.

454. *See id.* at 12 (referencing gains produced by “work undertaken by an IMF [technical assistance] mission in 2002 and other donors”).

455. FATF, ANNUAL AND OVERALL REVIEW OF NON-COOPERATIVE COUNTRIES AND TERRITORIES 1 (2005), <http://www.fatf-gafi.org/dataoecd/41/26/34988035.pdf>.

456. *See* IMF & WORLD BANK, ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM: REVIEW OF THE QUALITY AND CONSISTENCY OF ASSESSMENT REPORTS AND THE EFFECTIVENESS OF COORDINATION 3 (2006), <http://www.imf.org/external/np/pp/eng/2006/041806r.pdf>.

457. *See id.* (emphasis omitted).

458. Comment by a senior IMF staff member to the author immediately following the publication of the report.

jurisdictions of similar wealth.⁴⁵⁹ The review again found no serious systemic risk. The review the following year actually found that compliance levels for OFCs for money laundering were, as with banking supervision, more favorable than for other jurisdictions.⁴⁶⁰ As discussed in Part II.C above, in 2008, the offshore financial assessment program was merged with the FSAP program, treating offshore centers like their onshore counterparts.⁴⁶¹

As a result of the IMF's insistence that offshore centers be assessed in a fair, consistent, and uniform manner, it was shown that those centers largely conformed to the universal anti-money laundering and terrorism financing standards. Offshore centers had scored another significant victory.

With the NCCT process, the anti-money laundering standards system started out with many detrimental attributes. Even so, the fact that the FATF had some positive TRN characteristics (such as participation of some local regulatory bodies and the absence of pure state control of membership), plus the fact that the FATF-style bodies included many more members, did help in creating a far more generally accepted standard than did the OECD with respect to its Harmful Tax Practices Project. However, once the system was changed from the NCCT to uniform assessment of the same standards by the IMF (and other quasi-TRNs under IMF oversight), the system assumed far more beneficial than detrimental attributes. Once again, participation of the IMF, an international organization with TRN attributes, made the difference. It not only produced generally accepted standards applied and implemented impartially, but also it helped protect the interests of weak states over the strong.

III. SUCCESSES AND FAILURES: THE SYSTEM AND TRN CHARACTERISTICS

A. *Deconstructing the System*

While onshore centers achieved much of what they claimed they wanted with respect to each of the three areas of complaint, the processes and results were different. The first system, the Harmful Tax Practices Project, was widely criticized. The second, the Global

459. See IMF, 2003 PROGRESS REPORT, *supra* note 332, at 10–14 (describing the results of both banking and money laundering assessments).

460. IMF, 2004 ASSESSMENT PROGRAM UPDATE, *supra* note 331, at 7, 22–25 app. II.

461. Public Information Notice (PIN) No. 08/82, IMF, Executive Board Integrates the Offshore Financial Center Assessment Program with the FSAP (July 9, 2008), <http://www.imf.org/external/np/sec/pn/2008/pn0882.htm>.

Forum, is far less unpopular. Offshore centers, by agreeing to provide taxpayer information to onshore centers, should wind up being less easy locations for onshore residents to commit tax evasion. That being said, the onshore jurisdictions are by no means fully satisfied; offshore centers will still make income tax evasion somewhat easier for determined tax-evading onshore residents. However, the resulting income tax standards, limited to transparency and sharing of information, are largely agreed upon and the system implementing these standards is far less controversial. With respect to prudential regulation, the story was quite different. Offshore centers not only adopted and implemented the generally accepted financial regulatory standards of onshore jurisdictions, they did (overall) a better job at implementing them than did onshore jurisdictions. There is little complaint from anyone over the standards themselves or the system of implementation. Much the same can be said of anti-money laundering and terrorism financing standards, at least after the completion of the non-cooperating countries and territories process.

1. Income Taxation

With respect to the original Harmful Tax Practices Project, there was no real transnational regulatory network and no generally accepted standard.⁴⁶² Onshore centers sought to use the OECD to develop a generally accepted standard and to assess compliance with that standard.⁴⁶³ Onshore centers no doubt would have preferred that offshore centers accept the standard through peer pressure or persuasion. As it turned out, the offshore centers (as well as other jurisdictions) were not convinced that the standard actually was a best practice; they neither accepted that income taxation was the best way to raise revenue nor believed that they should give up all of the benefits of offering tax avoidance or evasion possibilities to onshore residents.⁴⁶⁴ They also did not accept that the OECD's assessment process was legitimate. The OECD members' fall-back position was to use the hard power of coordinated action by their local tax authorities against their own residents who did business with offshore centers. This resulted in an even more significant outcry against the alleged illegitimacy of the entire OECD process.

The first departure from the paradigm TRN process was the absence of a generally accepted standard. There were not only good

462. *See supra* notes 136–38 and accompanying text.

463. *See supra* notes 94, 124 and accompanying text.

464. *See supra* notes 80–86, 172 and accompanying text.

economic arguments against the income tax in general; there were, at least from the perspective of offshore jurisdictions, very good arguments as to why they should not adopt an income tax, including that other taxes, such as import duties, were more appropriate for their particular economies.⁴⁶⁵ As the IMF noted, there was no international obligation for one member to adopt policies that were injurious to themselves to benefit other members.⁴⁶⁶ With no genuine agreement on a standard, it was difficult to impose one. One can argue that the onshore centers tried to use the OECD to help legitimize the “standard” by formally adopting it the way a TRN might, but the effort largely failed. Unlike TRNs, such as the Basel Committee, the OECD was not a group of technical experts but rather a club of states.⁴⁶⁷ To make matters even worse, the OECD shared the undesirable TRN quality of being a select club, consisting only of wealthy onshore jurisdictions.⁴⁶⁸ Onshore jurisdictions turned to the IMF to remedy some of these deficiencies, but the IMF refused to participate—again because staff did not accept the underlying argument that the proposed standards were really best practices appropriate for all jurisdictions.⁴⁶⁹ Next, the compliance assessment process was also conducted by the OECD, further depressing the perception of legitimacy. At the end of this process, the only tool available to the onshore jurisdictions to reach compliance was the hard power of onshore regulatory authorities.⁴⁷⁰ Though somewhat successful, the income tax standards system was turning out to be by far the least satisfactory of the three.

The shift by the OECD from the problematic paradigm of the Harmful Tax Practices Project to the Global Forum on Transparency cured many of these defects. It created a far more inclusive sub-organization—the Global Forum—and adopted another standard, one that was less stringent but more acceptable to offshore jurisdictions (as well as others).⁴⁷¹ The OECD (as the Forum) adopted a system of assessment that, by being less arbitrary and including a review process for the countries affected, adopted many of the positive features of the most successful TRNs.⁴⁷² While participation of the IMF (if transparency and exchange of

465. See *supra* notes 80–86 and accompanying text.

466. See *supra* note 121 and accompanying text.

467. See *supra* note 95 and accompanying text.

468. See *supra* note 96 and accompanying text.

469. See *supra* notes 100–01, 110–11, 156–57 and accompanying text.

470. See *supra* notes 159–62 and accompanying text.

471. See *supra* notes 181–82, 197–98 and accompanying text.

472. See *supra* notes 183–89 and accompanying text.

information in tax matters were ever deemed to be a part of its mandate) might have added even more protection, at least the Global Forum's standard and assessment procedures were moving in the right direction both to add to the legitimacy of the process and to protect the legitimate interests of OFCs.

2. Prudential Regulation

With respect to prudential regulation, starting in the mid-1970s, there was a real transnational regulatory network—the Basel Committee—and a generally accepted (though evolving) standard. Unlike the absence of an income tax, poor prudential regulation in one jurisdiction actually could cause problems for all jurisdictions, including offshore centers. There was a potential legitimacy deficiency with respect to the standard adopted in that the Basel Committee consisted of only a small number of onshore regulators. However, the later acceptance of the standard by the Offshore Group of Banking Supervisors (which included many offshore centers) largely remedied that deficiency.⁴⁷³

Following the Asian Financial Crisis, when onshore centers sought to cast blame for banking and other financial failures on offshore centers, onshore countries enlisted the IMF to add legitimacy to the process.⁴⁷⁴ The IMF added a few positive TRN-like aspects, but more importantly (given the participation of the Basel Committee), corrected some typical TRN deficiencies. Most states were members of the IMF, resulting in broader representation (sometimes indirectly and imperfectly, such as with British Caribbean jurisdictions).⁴⁷⁵ IMF staff acted with relative independence from member states and had significant independent technical knowledge.⁴⁷⁶ The IMF provided a review of the standards and a way of assessing compliance with those standards separate from the Basel Committee or any member states. In particular, the assessment process was designed to be as objective as possible, providing significant procedural protections for complying jurisdictions.⁴⁷⁷ The process determined that OFCs were largely in compliance with the standard, making it much more difficult for onshore jurisdictions to implement (via their regulators) “countermeasures” against residents

473. See *supra* notes 214–15 and accompanying text.

474. See *supra* notes 254, 258, 267–71 and accompanying text.

475. See *supra* notes 116–19 and accompanying text.

476. See *supra* note 40 and accompanying text.

477. See *supra* notes 267–69, 274–84 and accompanying text.

doing business with offshore centers.⁴⁷⁸ To the extent that onshore jurisdictions were trying to use the Basel Core Principles as a backdoor to forcing greater compliance with the failed income tax “standards,” this also failed.

3. Anti-Money Laundering and Terrorism Financing

With respect to anti-money laundering and terrorism financing, the system evolved as a kind of combination of the previous two. The G-7 began the FATF as a kind of TRN. While the FATF was technically a state membership task force, states largely were represented by domestic regulatory authorities as well as by domestic law enforcement.⁴⁷⁹ The anti-money laundering standards (and later anti-terrorism financing standards) developed by domestic authorities and endorsed by the FATF were generally accepted as best practices by offshore centers via the OGBS and the CFATF and later other relevant FATF-style regional bodies.⁴⁸⁰ Unlike domestic bank failures, however, domestic money laundering was far less of a threat to offshore centers in that criminals were committing their crimes onshore. Perhaps as a result, many offshore centers were less interested in suffering the direct and indirect costs (including losing banking clients who were relying on bank secrecy to evade domestic income taxation) of enforcing the standards.⁴⁸¹ As with the OECD’s Harmful Tax Practices Project, the FATF responded with its Non-Cooperating Countries and Territories project. However, offshore centers again objected to the assessment process as illegitimate,⁴⁸² in part because the assessments did not use the FATF 40 as the standard and because the methodology for assessment was particularly subjective.⁴⁸³

Again, the IMF was enlisted, perhaps in part to add legitimacy to the process.⁴⁸⁴ The IMF added a key procedural benefit by creating a detailed assessment methodology, resulting in a far more objective assessment process.⁴⁸⁵ Also, by agreeing to participate, the FATF had to agree to abandon the NCCT process.⁴⁸⁶

478. *See supra* notes 321–39 and accompanying text.

479. *See supra* notes 38, 352–58 and accompanying text.

480. *See supra* notes 360–62 and accompanying text.

481. *See supra* notes 374–77 and accompanying text.

482. *See supra* notes 378–80 and accompanying text.

483. *See supra* notes 385–88, 401–05 and accompanying text.

484. *See supra* notes 415–17, 430 and accompanying text.

485. *See supra* notes 438–39 and accompanying text.

486. *See supra* notes 445–49 and accompanying text.

As with its assessment of OFCs' compliance with Basel Core Principles, the IMF determined that OFCs were largely in compliance with the anti-money laundering and terrorism financing standard, making it much more difficult for onshore jurisdictions to implement countermeasures.⁴⁸⁷

This Article began with a quotation suggesting that powerful governments may once again strike out against OFCs, this time blaming them for the current financial crisis. But perhaps past experience has actually tamed the response. The G-20 (itself a more inclusive group than the G-8 at the time of the Asian financial crisis) statement in April of 2009 specifically resolved to "take action against non-cooperative jurisdictions, including tax havens."⁴⁸⁸ However, assessments of OFCs' prudential and anti-money laundering practices were firmly in the hands of TRNs and the IMF, which have shown in the past their ability to act fairly in assessing well-accepted standards. The G-20 did state that "[w]e stand ready to deploy sanctions to protect our public finances and financial systems."⁴⁸⁹ But to that effect, they mention only that "[t]he era of banking secrecy is over. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of tax information."⁴⁹⁰ But the Global Forum, with its well-accepted standards on transparency and improved assessment process, would be less fearsome to OFCs than the original form of the Harmful Tax Practice Project.

B. Some Proposed Modifications to TRN and Standards Theory

The experience of offshore centers with proposed global standards in income taxation, prudential regulation, and anti-money laundering generally confirms the important role played by transnational regulatory networks. States not only acted alone in the international system but through their various domestic governmental institutions, including tax and financial regulatory agencies (and, where relevant, legislatures and law enforcement). The Basel Committee on Banking Supervision played a particularly important role. The Basel Committee, through application of the collective expertise of its members and through the building of consensus and

487. See *supra* notes 451–55 and accompanying text.

488. GROUP OF 20, THE GLOBAL PLAN FOR RECOVERY & REFORM, para. 15 (Apr. 2, 2009), <http://www.g20.org/Documents/final-communique.pdf>.

489. *Id.*

490. *Id.*

other “soft power” methods, worked successfully to convince all regulators that their Basel Core Principles were in fact best practices. Also, as predicted by theory, the Basel Committee still had some legitimacy issues, including its limited membership and the fact that there was no other TRN independent of the Basel group with sufficient expertise to review the standards or to undertake objective assessments of compliance.

The OFCs’ experience also validates the proposed theory that certain non-TRNs with TRN characteristics can combine with TRNs to create a far more legitimate and effective system for creating and spreading the effect of global standards. The IMF was able to play this role by supplying some of the helpful features missing from the Basel Committee. The IMF had a near universal membership. The fact that IMF members were states and not local expert regulators was mitigated by the relative independence of a highly expert staff. The IMF supplied both an independent review of the standards and a relatively neutral and subjective method for assessment of compliance. Thus, an organization with beneficial TRN and non-TRN characteristics may help mitigate the predicated deficiencies of a TRN; together they may advance the adoption of best practices creating the most effective and beneficial standards system.

The combination of the Basel Committee and IMF also helped protect offshore centers from the predations of onshore centers. Because of the transparent legitimacy of the system, onshore regulators were constrained from acting against resident financial institutions that did business with financial institutions in offshore centers. Thus, the combination of an organization with beneficial TRN and non-TRN characteristics may protect relatively weak states from the self-interested actions of the strong, creating a better standards system.

The OECD and FATF had a more difficult time, demonstrating the problems of operating without the legitimacy of a TRN and/or an organization with TRN (and certain non-TRN) characteristics. With respect to the Harmful Tax Practices Project, the OECD did not have enough positive TRN characteristics to achieve legitimacy. By moving to the Global Forum on Transparency, it did. The FATF did not have quite enough positive TRN characteristics to achieve enough legitimacy. It was, however, able to involve the IMF, whose beneficial TRN and non-TRN characteristics helped once again to create a legitimate system of review and assessment, advancing best practices and protecting weak states from the actions of the strong. Thus, a system that combines the most beneficial TRN and non-TRN

characteristics among participating organizations results in the most effective and beneficial standards system.

The OFC experience suggests two additional observations. Outside observers accept that the substantive standards of TRNs are accepted as best practices because observers (largely) agree that they are best. Had the IMF agreed to adopt the OECD's standards, it would have been through political influence of member states or some other means that would render meaningless its beneficial TRN (and beneficial non-TRN) characteristics.

CONCLUSION

The title of this Article is "On the Use and Abuse of Standards for Law." With respect to the OFC experience with prudential regulation and anti-money laundering rules, the use of standards for "law" (using the word "law" here to mean a rule that is, practically speaking, not optional), standards are well "used." The combination of the Basel Committee/FATF and the IMF, with the former using relatively independent expertise to create the standards and the latter using more representative, if less expert, skill to review and assess compliance, resulted in a (relatively) positive result, both in terms of substance and procedural fairness. The hard power of local regulators was guided, and restrained, by the process. The process is relatively free from the often problematic origins of traditional international law, guided as it is by states' views of principle or ideology (both of which may not be guided by technical expertise applied to solve technical problems) and state self-interest (which can overwhelm both technical considerations and the interests of weak states).

This Article views the larger onshore centers' attempt to use the OECD to create and enforce income tax rules as an attempt to abuse standards as law. In fact, the OECD did not succeed in creating and implementing a generally accepted standard that satisfied all parties and that protected the legitimate interests of the weak against the strong. While OECD members were able to force much of the OECD's agenda on OFCs through the coordinated threat of imposing the hard power of domestic tax authorities, the apparent lack of the system's full legitimacy worked to reduce its effectiveness. Brute force has always been available to powerful states to force change on weaker states; the attempt to create an income tax standard did not change that fact, though it may very well have mitigated its effectiveness. The OECD's partial retreat into the Global Forum and its less heinous standard and fairer method of assessment is perhaps proof of this.

Another way of viewing the use (and failure of the abuse) of standards for law is the triumph of objectivity. The application of technical expertise to solve technical problems is designed to be objective (based on facts) and not subjective (based on viewpoint). The standards are reviewed by an objective process. They are then generally accepted through objective review by domestic sub-state actors. The assessment of compliance is accomplished by an objective process. Ratings of compliance can then be used by local sub-state actors to guide their application of hard power.

What then is the answer to the question posed by Nietzsche: Does the objectivity implied in the use of standards for law originate in a "heightened need and demand for justice," or does objectivity just "create the appearance" of such need? A comparison of the serious criticism levied on the false application of objectivity in the income tax area with the general acceptance of the real application of objectivity in the other areas argues for a tentative "yes." The validity of this tentative "yes" may be tested during the current period of international recession. No doubt OFCs are hoping that it is not merely a "detrimental and too flattering bias."

APPENDIX: FSF, OECD, AND FATF LISTS⁴⁹¹

COUNTRY	FSF OFC Prudential 3rd Tier List 2000	OECD Tax Havens 2000	OECD Tax Havens 2001	OECD Tax Havens 2004	OECD Tax Havens 2006	FATF NCCTs 2000	FATF NCCTs 2001	FATF NCCTs 2002	FATF NCCTs 2005	FATF NCCTs June 2006
AFRICA										
Egypt							X	X		
Liberia		X	X	X						
Maldives		X								
Seychelles	X	X								
ASIA and PACIFIC										
Cook Islands	X	X				X	X	X		
Indonesia							X	X		
Marshall Islands	X	X	X	X		X	X			
Myanmar (Burma)							X	X	X	X
Nauru	X	X	X			X	X	X	X	
Niue	X	X				X	X			
Samoa	X	X								
Tonga		X								
Vanuatu	X	X	X							
EUROPE										
Andorra		X	X	X	X					
Cyprus	X									
Gibraltar		X								
Guernsey		X								
Hungary							X			
Isle of Man		X								
Jersey		X								
Liechtenstein	X	X	X	X	X	X				

491. Brigitte Unger & Joras Ferweda, *Regulating Money Laundering and Tax Havens: The Role of Blacklisting* 5–6, 8–9 (Tjalling C. Koopmans Research Institute, Utrecht School of Economics, Discussion Paper Series No. 08-12, 2008), available at <http://www.uu.nl/uupublish/content/08-12.pdf>; IMF, *Offshore Financial Centers IMF Background Paper* (June 23, 2000), <http://www.imf.org/external/np/mae/oshore/2000/eng/back.htm>.

