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U.S. Government Agencies Confirm That Low-Tax Jurisdictions Are Not Money Laundering Havens

The State Department, Central Intelligence Agency, and Internal Revenue Service each independently assess whether countries are money laundering centers and/or have systems that make them vulnerable to dirty money. All of these government agencies – as well as the OECD's Financial Action Task Force – conclude that tax havens do not attract a disproportionate share of the world's criminal loot. Indeed, the reports indicate that dirty money is far more likely to be laundered in high-tax nations.

By Daniel J. Mitchell

In the aftermath of September 11, many policy makers assumed that terrorists were hiding their money in so-called tax havens. Investigators have since discovered, however, that the terrorists relied on the banking systems of the United States, the United Kingdom, Germany, and various nations in the Middle East for the vast majority of their financial transactions.

In spite of stereotypes formed by reading John Grisham novels, tax havens do not attract a significant portion of the world's dirty money. The State Department, the Central Intelligence Agency (CIA), the Financial Action Task Force (FATF – of which the U.S. is a member) and the Internal Revenue Service (IRS) each independently assess the extent to which a jurisdiction attracts – or has the potential to attract – dirty money. Some low-tax jurisdictions are on these lists, but the accompanying table shows that they are clearly outnumbered by high-tax nations.

Who Are The Real Money Laundering Jurisdictions?	Financial Action Task Force	CIA Money Laundering Center		State Department Money Laundering Vulnerability	
	Non-Cooperative Jurisdictions	Yes	Vulnerable	Primary	Secondary
Tax Havens	8 (0)	4 (3)	5 (3)	14 (8)	16 (8)
Non-Tax Havens	11 (1)	11 (4)	6 (1)	38 (17)	33 (7)

As the table indicates, every money laundering rating system finds that non-tax havens outnumber tax havens. It is especially instructive to examine the numbers in parentheses. These figures indicate the number of jurisdictions in each category that were given a clean bill of health by the IRS, and they show that the so-called tax havens received significantly better grades than their high-tax brethren.

There is no evidence to suggest that tax havens are a magnet for dirty money. This does not mean every low-tax jurisdiction has a perfect track record. After all, no country with a significant financial services sector is immune to money laundering. But it is clear that tax havens are neither the source nor the destination for a disproportionate share of the world's criminal proceeds.

Tax Havens and Money Laundering

Tax havens attract wealth, but most of the money is institutional investment. Bermuda, for instance, is a leading center for the insurance industry. Luxembourg and Switzerland are world leaders in managing mutual fund assets. The Cayman Islands is near the top in almost all facets of financial services and also draws a substantial amount of bank-to-bank deposits. American corporations make extensive use of offshore regimes, earning almost one-third of their profits in low-tax jurisdictions.¹

Individual investors also utilize tax havens, but very little of this money has criminal origins. Instead, it represents legitimate investment by people seeking sound money management, asset protection, and lower tax bills. This last feature is controversial, to be sure, but only because many high-tax nations assert the right to tax income earned outside their borders and get upset when low-tax nations do not help them enforce their tax laws.

There are several reasons why criminals are unlikely to rely on tax havens. On a practical level, it is very difficult to transfer money to a low-tax jurisdiction unless the funds already are in a financial institution. Yet if the criminal money is in a bank, the laundering already has taken place. So why bother going “offshore?” Criminals also avoid tax havens because of the added risk. Shifting money across borders—and then back “onshore” when the funds are needed—significantly increases the probability of detection. The United Nations has even acknowledged that criminals avoid so-called tax havens because they are a “red flag” for law enforcement.² Terrorists are even less likely to utilize tax havens since they are motivated by hate rather than tax minimization and/or asset protection.

High-Tax Nations and Money Laundering

By its very definition, money laundering is hard to measure, so any effort to pinpoint where it takes place necessarily involves speculation. Nonetheless, many “onshore” experts acknowledge that the real problem is in their own backyards. The FATF admits, for instance, that criminal “funds are usually processed relatively close to the under-lying activity; often...in the country where the funds originate.”³ And since most of the world's criminal activity takes place in North America and Europe, it should come as no surprise that tax havens are not major money laundering centers.

Unfortunately, the same thing cannot be said about high-tax nations. According to a recent article in *Government Executive*, a publication for U.S. policy makers, “The International Monetary Fund estimates that about \$600 billion is laundered each year

¹“Gimme Shelter,” *The Economist*, January 29, 2000.

² United Nations, “Financial Havens, Banking Secrecy, and Money Laundering,” 1998, at <https://www.imolin.org/finhaeng.htm>

³Financial Action Task Force, “Basic Facts About Money Laundering,” at http://www1.oecd.org/fatf/MLaundering_en.htm

globally. Estimates of U.S. money-laundering traffic hover at \$300 billion, including about \$60 billion in drug money alone.”⁴ A more recent article in the FBI’s May, 2001 *Law Enforcement Bulletin* comes to a similar conclusion. The author noted that “...not only does the amount [of money laundered] lie somewhere between \$500 billion and \$1 trillion, but that half is being laundered through U.S. banks.”⁵ And a recent report issued by one of the top fraud recovery firms in Europe estimates that the United States is the source of nearly 50 percent of the world’s dirty money. The same study reveals that there is only one so-called tax haven among the top 10 jurisdictions where dirty money is invested.⁶

High-tax nations, like their low-tax counterparts, do have laws against money laundering. Unfortunately, they are not very successful. The U.S. Treasury Department estimates that 99.9 percent of the criminal money in the United States is laundered successfully.⁷ Other OECD nations have equally poor records. Dirty money in Germany almost always escapes detection,⁸ while the United Kingdom admits that more than 99 percent of criminal money in the City of London is successfully laundered.⁹

High-Tax Nations Versus Low-Tax Nations

None of the government bodies that rate money-laundering vulnerability include representation from low-tax jurisdictions. Three are agencies of the U.S. government and the fourth – the FATF – is part of the OECD, which is notorious for its anti-tax haven initiative. Yet these four groups independently have concluded that low-tax jurisdictions do not attract a disproportionate share of dirty money. Indeed, they almost surely have better track records than high-tax nations.

Consider, for example, the CIA’s list of money laundering centers.¹⁰ According to the agency, only four out of the 41 OECD-identified “tax havens” fall into this category.¹¹ This is considerably less than the 11 non-tax havens that received this label from the CIA – including the United States and the United Kingdom. Even if the list is expanded to jurisdictions that merely are considered “vulnerable” to money laundering, there are only five more “tax havens” on that list compared to another six high-tax nations.

The State Department’s list is much bigger than the CIA list, but the results do not change. The diplomats estimate that 14 tax havens are a primary concern for money laundering vulnerability. That may sound like a lot, but it is insignificant compared to the 38

⁴Julie Wakefield, “Following the Money,” *Government Executive*, October 1, 2000, at <http://www.govexec.com/features/1000/1000s5.htm>

⁵William Schroeder, “Money Laundering: A Global Threat and the International Community’s Response,” *Law Enforcement Bulletin*, Vol. 70, No. 5, Federal Bureau of Investigation, May 2001.

⁶The Maxima Group, Plc, “Asset Stealth and Recovery.” See <http://www.maxima-group.com> for more information.

⁷Raymond Baker, “Money Laundering and Flight Capital: The Impact on Private Banking,” testimony before the Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate, November 10, 1999.

⁸Raymond Baker, “The Biggest Loophole in the Free-Market System,” *The Washington Quarterly*, Autumn 1999.

⁹Veronique de Rugy, “Of Terrorists and Taxes,” *Wall Street Journal Europe*, October 24, 2001.

¹⁰Central Intelligence Agency, “The World Factbook, 2001,” available at <http://www.cia.gov/cia/publications/factbook/index.html>.

¹¹The OECD list of “tax havens” can be found at <http://www.oecd.org/pdf/M000014000/M00014130.pdf>.

non-haven jurisdictions that are on the list. Once again, the United States and United Kingdom receive the lowest possible grade. Looking at the State Department's list of "secondary" jurisdictions, the pattern remains. Sixteen low-tax jurisdictions are listed, but this is less than one-half the number of high-tax countries that are in this category.

Even the Financial Action Task Force (FATF) list contains a number of surprises.¹² There are eight "tax havens" on the FATF blacklist, but this is fewer than the 11 non-havens that are on the list. The FATF list is especially interesting because the organization is an adjunct body of the OECD. As such, the FATF list is widely viewed as being politically tainted by a desire to target low-tax jurisdictions.

Yet even with this biased perspective, FATF branded more high-tax nations than low-tax nations as being "non-cooperative" in the battle against money laundering. The balance would have been even more weighted toward high-tax countries if FATF was willing to list its own members as "non-cooperative." According to the organization's recent self-assessment survey, only 10 of 29 members met all of FATF's criteria, and four members – the United States, Canada, Japan, and Mexico – received failing grades.¹³

Last but not least, the Internal Revenue Service determines whether a jurisdiction has effective know-your-customer laws when deciding to grant "qualified intermediary" status to foreign financial institutions.¹⁴ Of all the agencies, the IRS would be most likely to hard-nosed, yet 19 of the OECD's supposed tax havens have received the agency's blessing, with another two awaiting approval (most, if not all, of the others have not bothered to apply).¹⁵ Every major financial center has received QI status, including the Cayman Islands, the Bahamas, the Channel Islands, Panama, Liechtenstein, the British Virgin Islands, Monaco, Gibraltar, Barbados, and the Netherlands Antilles.

Conclusion

The International Monetary Fund recently announced that it wants to help a country upgrade its money-laundering laws. But the nation the IMF is targeting is not Liechtenstein, Panama, or the Bahamas. It is the United States.¹⁶ This does not mean, of course, that anything is wrong with American laws. The bureaucracies that review money-laundering laws, after all, seem oblivious to cost-benefit analyses. They also seem to completely disregard the value of personal privacy and legal protections against unreasonable search and seizure. And perhaps most important, they apparently do not assess whether new laws will help catch criminals. A former Treasury Department official recently admitted, for instance, that the money-laundering provisions in the new PATRIOT legislation in the United States would not have detected the September 11 terrorists.¹⁷

¹² Financial Action Task Force, "List of Non-Cooperative Countries and Territories," at http://www1.oecd.org/fatf/NCCT_en.htm

¹³ Financial Action Task Force, "Non-Cooperative Countries and Territories," 2001, available at http://www1.oecd.org/fatf/NCCT_en.htm

¹⁴ For more information on the QI regulation, see www.freedomandprosperity.org/tk.

¹⁵ Internal Revenue Service, "List of Approved KYC Rules and Rules Awaiting Approval," 2001, available at http://www.irs.gov/prod/bus_info/qi/cntry-list.html#Approved.

¹⁶ See <http://www.imf.org/external/np/mae/aml/2001/eng/110801.htm> for more information.

¹⁷ Glenn Simpson, "Hijacker's Money Transfers Illustrate the Limits of New Laundering Laws," *The Wall Street Journal*, December 14, 2001.

Punishing criminals and deterring future crime is a core responsibility of government. To properly carry out this function, however, lawmakers should make reasoned decisions using the best data. Several U.S. government agencies and one international bureaucracy have analyzed the problem of money laundering and these groups have unambiguously concluded that low-tax jurisdictions are neither the source nor the destination for a disproportionate share of the world's dirty money. It remains to be seen, however, whether this reduces the amount of demagoguery against tax havens.

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Additional Issues of *Prosperitas*:

November 2001, *Prosperitas*, Vol. I, Issue IV, *The Adverse Impact of Tax Harmonization and Information Exchange on the U.S. Economy*, by Daniel J. Mitchell. Web page link below:

<http://www.freedomandprosperity.org/Papers/taxharm/taxharm.shtml>

October 2001, *Prosperitas*, Vol. I, Issue III, *Money Laundering Legislation Would Discourage International Cooperation in the Fight Against Crime*, by Andrew F. Quinlan. Web page link below:

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August 2001, *Prosperitas*, Vol. I, Issue II, *United Nations Seeks Global Tax Authority*, by Daniel J. Mitchell. Web page link below:

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August 2001, *Prosperitas*, Vol. I, Issue I, *Oxfam's Shoddy Attack on Low-Tax Jurisdictions*, by Daniel J. Mitchell. Web page link below:

<http://www.freedomandprosperity.org/Papers/oxfam/oxfam.shtml>

Organization for Economic Cooperation and Development	Financial Action Task Force	CIA		State Department		Internal Revenue Service
	Anti-Money Laundering Review Non-Cooperative	Money Laundering Center		Money Laundering Vulnerability		Qualified Intermediary Status
		Yes	Vulnerable	Primary	Secondary	
Andorra						X
Anguilla						
Antigua and Barbuda		X		X		X - Pending
Aruba		X			X	X
The Bahamas			X	X		X
Bahrain					X	X - Pending
Barbados					X	X
Belize			X		X	
Bermuda						X
British Virgin Islands					X	X
Cayman Islands			X	X		X
Cook Islands	X				X	
Cyprus				X		X
Dominica	X		X	X		
Gibraltar					X	X
Grenada	X			X		
Guernsey				X		X
Isle of Man				X		X
Jersey				X		X
Liberia						
Liechtenstein			X	X		X
Maldives						
Malta						X
Marshall Islands	X				X	
Mauritius						
Monaco					X	X
Montserrat						
Nauru	X			X		
Netherlands Antilles		X			X	X
Niue	X				X	
Panama		X		X		X
Samoa					X	
San Marino						
Seychelles					X	
St Kitts and Nevis	X			X		
St Lucia					X	X
St Vincent & the Grenadines	X			X		
Tonga						
Turks & Caicos					X	X
US Virgin Islands						
Vanuatu					X	
Tax Havens	8	4	5	14	16	19/20
Non-Tax Havens	11	11	6	36	33	28/3/45
Albania					X	
Argentina		X			X	X
Australia				X		X
Austria				X		X
Belgium					X	X
Bolivia					X	
Brazil				X		
Burma	X	X		X		
Bulgaria					X	
Cambodia			X		X	
Canada				X		X
China				X		
Colombia				X		Pending
Czech Republic					X	X
Chile					X	X
Costa Rica					X	

Non-Tax Havens	Financial Action Task Force	CIA		State Department		Internal Revenue Service
	Anti-Money Laundering Review	Money Laundering Center		Money Laundering Vulnerability		Qualified Intermediary Status
	Non-Cooperative	Yes	Vulnerable	Primary	Secondary	
Denmark						X
Dominican Republic				X		
Egypt	X				X	
El Salvador					X	
Ecuador		X			X	
Finland						X
France				X		X
Guatemala	X		X		X	
Germany				X		X
Greece				X		X
Hong Kong		X		X		X
Honduras			X		X	
Haiti			X		X	
Hungary	X			X		
India				X		
Indonesia	X			X		
Israel	X			X		X
Italy				X		X
Ireland					X	X
Japan				X		X
Jamaica					X	
Lebanon	X			X		Pending
Luxembourg				X		X
S. Korea					X	X
N. Korea					X	
Mexico				X		
Macau					X	
Malaysia					X	
Latvia					X	
Netherlands				X		X
Nicaragua					X	
Nigeria	X			X		
Norway						X
Philippines	X			X		
Pakistan				X		
Paraguay				X		
Palau					X	
Peru					X	
Poland					X	
Portugal					X	X
Russia	X			X		
Romania					X	
Singapore		X		X		X
Sweden						X
Spain				X		X
Switzerland			X	X		X
Slovakia					X	
S. Africa					X	
Taiwan				X		
Thailand		X		X		
Turkey				X		
Ukraine	X		X		X	
U.K.		X		X		X
U.S.		X		X		
U.A.E.		X		X		Pending
Uruguay				X		X
Venezuela		X		X		
Vietnam					X	
Yugoslavia					X	
Zambia		X				