Explaining Compliance with International Commitments to Combat Financial Crime: The G8 and FATF

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Several definitions of money laundering exist, but they all have one characteristic in common: the transfer of illegal assets into the official economic system (Garcia, 2001).

Since the end of the nineties, we have witnessed a growing international mobilization against 'dirty' money, and a global anti-money laundering (AML) regime has been elaborated. We will here define a global regime as '*a set of rules, norms and procedures around which the expectations of actors converge in a certain issue area*' (Krasner, 1983).

In the construction of this global regime, the G7/8 has had an increasing influence: it created the FATF in 1989, and has since used this Task Force to diffuse its messages regarding financial crime. The G7/8 Summits have now become a routine in Media attention and public scrutiny. Nevertheless, these annual gatherings hide a preparation process which involves different actors within the G8 system. This explains why the role played by the G8 concerning AML is often not clearly understood.

This paper aims firstly to demonstrate and explain the role of the G7/8 in the setting of a global AML regime and secondly to highlight the difficulties encountered by this global regime.

The G7/8's role in the setting of the Anti-Money Laundering (AML) regime

The FATF and the elaboration of the AML regime

Money laundering (ML) was brought as an issue in the G7/8 framework in 1989, at the Paris Summit, within the context of the 'war on drugs' launched by the United States. Under a specific section entitled 'drug issues' in the final Summit declaration, member States of the G7 (Russia was not yet a member) recognized that '*the drug problem has reached devastating proportions'* and therefore convened '*a financial action task force from Summit participants and other countries interested in these problems. Its mandate is to assess the results of cooperation already undertaken in order to prevent the utilization of the banking system and financial institutions for the purpose of money laundering, and to consider additional preventive efforts in this field, including the adaptation of the legal and regulatory systems so as to enhance multilateral judicial assistance'*. The Financial Action Task Force (FATF) was then set up, and gave its first report at the Houston G7 Summit the following year. In 1991, at the London Summit, the G7 members legitimized the FATF action and endorsed '*the recommendation of the FATF that it should operate on a continuing basis with a secretariat supplied by the OECD*'. The FATF has since been recognized as the international forum for setting universal norms against ML.

Its 1990 recommendations were grouped under three central objectives: the improvement of national legal AML systems; the strengthening of international co-operation; and the enhancement of the role of the financial system in the fight against ML. These 40 recommendations and their revised version in 1996 created international standards, and as they were not legally binding, they largely contributed to the creation of a *soft law* regime that had a considerable influence on *hard law* regimes within domestic legislations but also in regional institutions such as the European Union (EU).

The AML regime has since evolved and its targets have changed over time: at the very beginning, the criminalization of ML was deemed to be an effective weapon in the international war on drugs (Mitsilegas, 2003). This issue has been enhanced by concerns regarding the negative impact that the flow of 'dirty' money could have on the integrity and the stability of the international system. The perceived need to counter the organized crime

threat then legitimized the extension of the global AML framework. After the 9/11 attacks, the fight against ML was redirected to terrorist financing.
Those concerns, mostly defined within the FATF, have led to a harmonization of the AML fight at the global level. This harmonization can be demonstrated in two ways: the overall accepted extension of the criminalization of ML, and the common tools used in order to counter this crime.

The extension of criminalization of ML to serious crimes beyond the issue of drug trafficking, advocated in the 1996 FATF recommendations ('Countries should apply the crime of money laundering to all serious offences', recommendation 1), is a trend that has been implemented within the UE[1] and the UN[2]. Furthermore, the 9 FATF special recommendations on terrorist financing elaborated just after 9/11 have been implemented within European Commission directives[3] and followed up in the UN 1373 resolution. Those 9 recommendations include the **c**riminalization of the financing of terrorism, the freezing and the confiscation of terrorist assets and the reporting of suspicious transactions related to terrorism.
Within the elaboration of the AML regime, the FATF recommendations have played an important role, and they are now widely seen as international standards of reference. The FATF gathers today 33 member States and 7 FATF-style regional bodies.

Regarding the tools used to fight ML, two main aspects can be identified: the reactive side and the preventive/proactive one.
The reactive side includes the confiscation of laundered property and the freezing and seizure of these assets during the time of investigation.
The preventive/proactive side includes measures that should be undertaken by private sectors, with the implication of financial institutions:

- Customer identification and record keeping rules: the Know Your Customer (KYC) rule for credit and financial institutions.
- An increased diligence assigned to these credit and financial institutions: they now have to report any unusual or complex transaction.

[1] Second EC Directive, 2001/97/EC, on the prevention of the use of the financial system for the purpose of ML.
[2] UN Convention on Transnational Organized Crime, Palermo, 2000.
[3] Third EC Directive, 2005/60/EC, on the prevention of the use of the financial system for the purpose of ML and terrorist financing.

Since 9/11, tools that encountered obstacles in some domestic legislations before (such as the obligation of professional secrecy) have been adopted at the international level: the preventive/proactive side has been extended not only to casinos, *bureaux de change*, but also to professions that were recognized as sensitive, such as lawyers, accountants, or real estate agents. And among the 9 special FATF recommendations on terrorism, non-profit organizations are also targeted.

The G7/8's role in the AML global regime

Even though the FATF has gained independence in 1990, the Task Force is constantly influenced by the G7/8, and there is still an 'organic link' between the FATF and the G7/8.
After the emergence of the ML issue in the 1989 Paris G7 Summit declaration, G7 members have gradually delegated this initiative at the ministerial level, with the consequence that it became more and more autonomous during the nineties. In the field of ML, the G7 finance Ministers have endorsed a couple of initiatives aiming at enhancing the global efforts against ML:

- setting up of international networks, with the creation of Financial Intelligence Units (FIUs), which are assembled in the Egmont Group
- widespread adoption of suspicious reports mechanism (FINTRAC)
- creation of the Financial Stability Forum (FSF) in 1999
- inclusion of International Financial Institutions such as the IMF and the World Bank into the fight against ML

The G7 finance Ministers also issue reports and recommendations, such as the Fukuoka Report (prior to the Okinawa G8 Summit) in 2000 and the Roma Report (prior to the Genoa G8 Summit) in 2001. The work made by G7 finance Ministers plays an important role to support, but also to impulse FATF actions. Some examples illustrate this impulsion:

- Just after the 9/11 attacks, the G7 finance Ministers '*called on the Financial Action Task Force to encompass terrorist financing into its activities*'. In their Action Plan to

Combat Financing of Terrorism, the Ministers advised the FATF to '*focus on specific measures to combat terrorist financing*' which led to the 9 special FATF recommendations on terrorist financing.

- Proactive participation of 'gatekeepers' (lawyers, accountants, etc.) has been previously discussed by the G7 finance Ministers in their 'Actions against Abuse of the Global Financial System'. The Ministers declared : '*We take note that, as a follow-up to the October 1999 Moscow Ministerial Conference on Combating Transnational Organized Crime, an experts group was convened to study the issues related to the involvement of professionals such as lawyers and accountants ('gatekeepers' to the international financial system) in money laundering. We express our support for the continuation of this work*'.

This last example demonstrates that the AML actions within the G7/8 framework are not restricted to the G7 finance Ministers. The references made to the Moscow Justice and Interior Ministerial Conference and to specific experts groups show that other G8 mechanisms do have an impact on the FATF and on the global AML regime in general. The G8 Justice and Interior Ministers are also active in promoting international standards against ML, as we have just seen with the implication of the 'gatekeepers'.

Along with the declarations made during these ministerial meetings, the work made by G8 experts groups should also be taken into account. For example, the G8 experts Group on Transnational Crime, known as the Lyons Group, aims to be complementary to the FATF in the field of ML. This G8 experts Group intends to offer an additional expertise, specifically concerning the police and judicial aspects. In their 40 recommendations issued in 2002, the experts presented specific recommendations on ML:

- States should share information on money laundering techniques and investigative methods and draw on their collective experience to enhance national and international training activities, including the provision of technical assistance to help other countries adopting FATF standards.
- States should implement appropriate measures to detect and monitor movements across their borders of cash, appropriate negotiable instruments, and other appropriate transmissions of value, subject to strict safeguards to ensure proper use of information and without impeding in any way the freedom of legitimate capital movements. In this regard, States should consider subjecting to verification cross-border physical

transfers, above a given threshold, administrative monitoring, declaration or record keeping requirements.

- States should consider adopting effective legislative measures for: the confiscation or seizure of illicit proceeds from, and instrumentalities of, drug trafficking, terrorism, and other serious offences; asset forfeiture, as required; and the availability of expeditious provisional arrangements, such as the freezing or seizing of assets, always with due respect for the interest of bona fide third parties. States should also consider the introduction of arrangements for the equitable sharing of such forfeited assets, as set forth in the guidelines developed by the G8.
- In order to improve understanding and information on the detection of financial networks linked to transnational organized crime (in particular investments by transnational organized crime) and terrorism, we encourage States to take measures to gather financial information and, as much as possible, facilitate the exchange of such information, and exchanges between law enforcement agencies and regulatory bodies, in particular for the purpose of investigating and prosecuting criminal offenses.

Since 9/11, G8 experts on transnational crime meetings are organized jointly with the G8 experts on terrorism (known as the Roma Group), which have also worked on terrorist financing.

This short and general overview of the work made by the G7/8 mechanisms highlights the activism of the G8 in the AML global regime and the fact that the G8 plays a multiple role with regard to the FATF: a role of support, a role of legitimization, and a role of impulsion.

The difficulties encountered in the global AML regime

Two main difficulties can be identified in the AML global regime. The first one concerns the issue of money laundering itself and the problems encountered in the implementation of some of the tools advocated in this regime. The second one concerns legitimacy deficit of this regime.

The money laundering issue and the ambiguity of some tools

A prevailing discourse on ML has been imposed during the nineties among international fora. The fight against 'dirty' money has gained '*exceptional importance and legitimacy'* (Favarel, 2003), because it has been linked to the fight against organized crime, which is presented as having transnational ramifications and therefore is seen as global threat. As the G8 states at the Birmingham Summit in 1998: '*Globalization has been accompanied by a dramatic increase in transnational crime. This takes many forms, including trafficking in drugs and weapons; smuggling of human beings; the abuse of new technologies to steal, defraud and evade the law; and the laundering of the proceeds of crime. Such crimes pose a threat not only to our own citizens and their communities, through lives blighted by drugs and societies living in fear of organized crime; but also a global threat which can undermine the democratic and economic basis of societies through the investment of illegal money by international cartels, corruption, a weakening of institutions and a loss of confidence in the rule of law. To fight this threat, international cooperation is indispensable*'.

The same terms can be found in the discourses made by the EU, the OECD and the UN, constantly justifying the need for international cooperation. This prevailing rhetoric among international institutions and some academics has been seriously challenged by others. Organized crime suggests an image of the 'mafia' that is a well established, and has a strong and rigid hierarchy. Things might not be as simple, and many authors have argued for instance that what some qualify as organized crime is actually disorganized crime (Reuter, 1983). In the last decades various authors have challenged this mainstream interpretation of organized crime and have suggested that many old-style criminal hierarchies are reorganizing (or perhaps they always were) into sprawling transnational networks with shifting associations and alliances that depend on market dynamics. Today, most researchers agree that organized

crime is not a formal corporate-like organization but rather a bunch of networks that frequently operate in relatively confined geographic areas. Organized crime presents therefore a rather disorganized image of many fragmented, localized and fluid networks (Vassou, 2005, Bear and Naylor, 1999).

In this context, the concept 'transnational organized crime', understood as a perfectly identifiable entity, is far from being obvious. Despite the vagueness of the concept of 'transnational organized crime', the many-faceted representations given to the concept and the discourses of the international institutions have validated organized criminal groups as objective entities. They have thereby justified the fight against ML, which has been recognized as an essential tool in order to contain them (by an effect of deprivation – depriving criminals of the proceeds of their crimes- and deterrence – by eliminating their main incentive for committing crimes).

With regards to money laundering, one main problem appears if we accept the idea that organized crime is not so organized. The repressive argument could be compelling if we were facing strongly structured criminal organizations. The deprivation of their proceeds would then make their 'capital of exploitation' disappear and would destroy the organization as a whole. In the eyes of what we just tried to show, that organized crime might be rather disorganized, this argument falls apart, and the likely impact on 'criminal organizations' fall back to the more individual deterrent effect (Levi, 2003). The deterrence argument is thus not very compelling. Moreover, as Michael Levi suggest, it is now widely recognized that many proceeds of crime are spent before arrest, and *a fortiori* before confiscation (Levi, 2003).

Furthermore, the general discourse on money laundering and its extension to terrorist activities has justified some tools that are rather ambiguous. One should note that the 9/11 attacks didn't lead to a rupture in the AML regime. But the context certainly has allowed some procedures that have previously encountered many obstacles, specifically when it comes to the respect of civil liberties, legal principles and human rights.

Even before 9/11, the enhancement of the role of the financial system included in the 1990 FATF 40 recommendations have created some problems, specifically concerning the banker-customer relationship, '*(the bankers) have to reduce the protection of the customers' privacy in order to co-operate with the state not only reacting to requests, but also proactively, by reporting suspicious transactions*' (Mitsilegas, 2003). With the new policy undertaken by the

FATF after 9/11, the FATF has entered a new field, even though strong doubts remain regarding the relevance of the linkage made between terrorist financing and ML. Even the strongest defendants of an AML Governance recognize that '*terrorists do not actually launder much money*' (Williams, 2002), that terrorist financing comes mostly from legitimate sources (Mitsilegas, 2003) and that relatively moderate sums are needed for terrorist actions (Levi, 2003). Of more importance seems to be the non-profit organizations that may be instrumental in channeling money to terrorist cells, an issue raised by the 9th special FATF recommendations. As Van Duyne points out, '*If most banks failed to discern the provenance of the millions of dollars held in accounts in the names of the sons of the late Nigerian Dictator, how can we be confident that they will spot the much smaller sums belonging to non-profit organizations whose activities are otherwise legitimate?*' (Van Duyne, 2003) Generally speaking, the proactive role assigned to financial institutions is deeply delicate: they now have to monitor 'where money is going to as well as where it is coming from'. We can then see a paradox emerging: according to the AML regime, one has to combat not only illegal proceeds, but also legal ones if they are possessed by criminal organizations… The inclusion of terrorist funding in the AML regime is far from gathering consensus, even among FATF experts who, even before 9/11, expressed disagreement on this linkage (Favarel, 2005).

The delicate proactive role assigned to bankers has been extended to lawyers, accountants and real estate agents, know as 'gatekeepers'. Regarding lawyers, this not only has important privacy implications, but may also jeopardize the defendant's right to a fair trial (Mitsilegas, 2003). This aspect has led to heated controversies, specifically in the UE (which finally implemented this rule in its 2004 Directive) and is still a constitutional challenge for some States, such as Canada.

All this ambiguous aspects of the AML regime demonstrate a quasi-impossible balance between countering money laundering and protecting legal principles.

The legitimacy deficit

Even though the AML regime shows a strong international mobilization, the apparent consensus is far from being shared globally. The position of the FATF and by extension the position of the G7/8 on the AML regime has been the target of many criticisms.

The main criticism concerns the stigmatization and the pressure put on some countries that don't implement the FATF recommendations. This *naming-shaming* effect is obvious with the FATF evaluation mechanism, which yearly denounces the Non-Cooperative Countries and Territories (NCCTs). This black list can be seen as a double-edge sword.

At a first glance, it put pressure on the black-listed countries and territories, and the naming-shaming effect seemed to work, as most of the black-listed were progressively removed from it. In 2000, 15 non-cooperative jurisdictions were identified, including Bahamas, Cayman, Israel, Philippines and Russia. One year later, the Bahamas, the Cayman Islands, Liechtenstein and Panama were removed from the list. Today, only Myanmar and Nigeria remain. The AML regime is therefore one of the most perfect example of the impact of global norms on domestic legislation. Norms are here defined from a constructivist perspective, as '*a collective expectation of the proper behavior of actors with a given identity'* (Katzenstein, 1996). Identities are understood as providing a measure of inclusion and exclusion by defining a social 'we' and delineating the boundaries against the 'others' (Risse and Sikkink, 1999). As FATF recommendations have no coercive value, compliance with them relies mainly on the good will of members. Risse and Sikkink propose a theoretical framework for the process of norms socialization. Even though this framework was elaborated for the case of human rights norms, its application to the case of ML is compelling as well. The goal of socialization is for actors to internalize norms so that external pressure is no longer needed to ensure compliance. Risse and Sikkink distinguish three types of socialization processes that are necessary for norms compliance, known as a 'spiral model': first, the process of adaptation and strategic bargaining; second, the process of moral consciousness-raising, 'shaming', argumentation, dialogue, and persuasion; and third, processes of institutionalization and habitualization. The power of the shaming effect with regards to the FATF black list is thus doubtless. The most striking example is certainly the case of Russia, which was on the list in 2000 and subsequently made huge efforts to comply with the FATF standards so that it was removed from the list in 2002 and became a full member of the FATF in 2003. The AML issue in Russia perfectly demonstrates the success of norms socialization,

especially given the fact that Russia was widely perceived as a 'risky' country. The slow integration of Russia into the G8 process led Russia to commit itself more strongly in the fight against international crime and to implicate itself more effectively into the fight against ML. Presented this way, the NCCT's list appears as an efficient way to ensure compliance with international standards.

However, it is precisely this NCCT's list that has produced a large number of criticisms. Indeed, the FATF suffers from a worldwide legitimacy deficit, as it is an *ad hoc* body consisting of 'rich' countries and not an international organization. The stigmatization of the NCCT, which can lead to severe economic sanctions, is then perceived as a tool to impose the G7/FATF model of financial regulation on the rest of the world (Mitsilegas, 2003). This argument is enhanced by the action undertaken by the FATF regarding offshore financial centers. Even though the issue of tax evasion has never been officially encapsulated by the FATF recommendations, some argue that there exists a 'hidden agenda' behind the attack on money laundering that is '*for big countries to make it much harder for their citizens to evade taxes by cutting off those offshore centers that offer low taxes from the international payment system*' (The Economist, 2001). The unilateral stigmatization of 'non-cooperative' States is thus seen as a 'normative imperialism' which disregards the particular social, economic and political situation in developing countries that may not have the same economic priorities as the FATF members (Mitsilegas, 2003). One can then question the legitimacy of the FATF to establish a list of countries with which other should restrain or forbid economic transactions.

The second criticism concerns the efficiency of the AML regime provided by the standards set up by the FATF. It is really difficult to measure this efficiency. Nevertheless, it seems that the FATF provides standards and patterns of behavior rather than the creation of substantive norms with real impacts (Williams, 2002). The FATF has established a set of standards and practices that require considerable efforts but do not yield commensurate results. As it is impossible to quantify 'dirty' money in the world, it is also impossible to quantify the results of the AML regime.

Conclusion

With regard to the paradoxes, the ambiguities and more generally to the complexity of the existing AML global regime, one may question the future of the FATF and more generally the future of the G8 in this field. Some commentators argue that the inclusion of terrorist financing into the AML regime has reinforced the existing regime, by reinforcing the role assigned to private actors. Others argue that this inclusion has undermined years of awareness campaign on 'dirty' money. Still, it is too soon to settle the debate.

What is more certain is the increasing implication of International Financial Institutions (IFI) in the fight against ML. Budgets and personals assigned to this mission have constantly increased since 9/11. Even if it is the G7/8, via the FATF, that has successfully incorporated IFI in the fight against ML, these IFI, especially the IMF, have gained more and more importance and independence. The IMF has included the 40 FATF recommendations in its Financial Sector Assessment Programs and in its Reports on the Observance of Standards and Codes.

The implication of IFI is currently changing the FATF role (Favarel, 2006). For instance, the FATF gave up the updating of the black list since 2002, even though Myanmar, Nauru and Nigeria still remain on the list in 2006. One of the reasons of this giving up, which seems quite surprising given the fact that this list was the FATF's only tool of pressure, is that the unilateral mechanism was contrary to the major principles of the IMF and the WB of uniformity, willingness and cooperation. In the evaluation mechanisms undertaken by the IMF and the WB, evaluation is not imposed, but rather asked by States; States participate to the evaluation procedures, but can refuse the publication of their outcomes. Now, the IMF has organized its own procedures of evaluation, specifically regarding States that are not FATF members. Another trend thus emerges: the enhanced legitimacy given to the IFI in the fight of AML, because they represent many more countries than the FATF (Favarel, 2006).

The role of the FATF in an AML global regime therefore seems to be challenged. Even though the FATF has obtained another 8 years mandate in 2004, its role seems now to be restricted to 'standards setting'. Concerning the G7/8, one can expect that it will continue to impulse those standards, but will be prevented to use pressures on non-cooperative jurisdictions.

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