



A Financial Transparency Index

An outline research proposal

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1. Background

Since the mid-1990s, there have been increasing concerns about the impact of both tax havens and offshore finance centres (OFCs). Attempts to manage the problems they create have so far met with limited success for a number of reasons:

- a. There has been definitional and intellectual confusion about what tax havens are and how their behaviour might be differentiated from that of OFCs.
- b. There has been very limited coordination between international efforts to improve cooperation in tax enforcement and the supervision of financial markets and institutions.
- c. The main impetus for new initiatives has come through the G7 / G8 and the OECD. These initiatives have in consequence largely neglected the impact of this issue on developing countries. That impact has been highlighted by a number of studies which show how the secrecy offered by havens and OFCs facilitates corruption, capital flight, tax evasion and tax avoidance (Oxfam 2000, Baker 2005, TJN 2005, TJN 2007). These studies show that effective measures to combat these issues would do far more to promote development than increases in aid flows, as well as greatly contributing to good global governance.

2. The purpose of this proposal

This proposal aims to help remedy this fault in two ways.

Firstly it will demonstrate that any effective policy on tax havens has to tackle two separate issues. The first of these is the tax haven agenda. This is the government driven agenda that provides the regulatory space in which the characteristics of these spaces are

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created. Those characteristics are associated with secrecy, low taxation, limited information exchange and a regulatory environment that seeks to minimise its impact upon the first three characteristics.

The second of these issues is the OFC agenda. This is the commercial response to the regulatory space that tax havens provide. This commercial response is the preserve of the banks, accountants, lawyers, trust companies, insurance companies and investment funds that provide services associated with (if not necessarily from) these locations as means of securing for their clients a reduction in the obligations with which they might otherwise need to comply.

This intellectual differentiation of these two systems (together “offshore”) is critical to the analysis that is to be offered by this research proposal. This is because existing systems of review are ineffective in preventing the concealment of dirty money through even the most sophisticated and respectable centres, such as London or New York since the surveillance of standards of financial regulation is generally separated from issues of transparency for international tax cooperation purposes. The two are, however, integrally related in the tax haven space. Notably though, the IMF-WB’s Reviews of Standards and Codes (ROSC) and Offshore Financial Centres Assessment Programmes do not include any assessment of centres’ compliance with international tax transparency standards (IMF-WB 2005).

Separating these related issues has in practice made it more attractive to use OFCs located within these tax haven spaces as conduits for dirty money, since centres which comply with financial stability standards are afforded respectability for complying with the regulatory requirements of the anti-money-laundering and counter-financing of terrorism (AML-CFT) standards of the Financial Action Task Force (FATF). These standards do, however, mainly target organised crime, and have only limited effectiveness against corruption or tax avoidance. These last two activities might in consequence have been given enhanced opportunity to exploit the tax haven space for the purpose of what is also criminal activity.

Conversely, the OECD’s campaign against tax havens has been concerned with tax losses from OECD countries, which is a loss that the OFCs promote. It has not as a result addressed the issues of capital flight and tax avoidance from other states and especially developing countries. These losses result largely from the basic availability of tax haven structures; the complexity associated with OFCs being of little concern to those in this sector. As a result, however, the offshore lobby has been successful in arguing for a ‘level playing field’ because, as they have pointed out, many of the facilities which are targeted by the OECD as enabling tax avoidance, such as bearer shares and anonymity for non-residents holdings of financial assets, are also available in leading OECD countries. This does, however, ignore the difference in the relationship between the state and the financial services sector within those countries that might, if regulated properly, prevent the characteristics of offshore developing in those locations. This proposal seeks to recognise that relationship and to explore its impact with the intention of creating a better theoretical framework for understanding these issues and more refined information on which to base policy initiatives.

3. The Proposed Index

This proposal suggests undertaking a pilot study for a Financial Transparency Index. This would rank jurisdictions by their contribution to the opacity of international finance. The Index would be based on objective evaluations of both quantitative and qualitative data.

Reliance on subjective judgements of 'perceptions' has weakened the legitimacy of previous listings, such as the Corruption Perceptions Index of Transparency International, or the listings of tax havens produced by the OECD. These listings have generated resentment, especially among small or poor countries which feel they have been unfairly targeted by the methodologies employed by these organisations.

The data-based approach will aim to be even-handed in its treatment of jurisdictions. Qualitative data will be used to produce a separate weighting of each centre according to its arrangements for ensuring transparency in relation to international regulatory enforcement. This will, importantly, extend to international cooperation for tax enforcement (both avoidance and evasion), as well as for financial regulation, and anti-money-laundering. This ranking relates to financial transparency and will assess the jurisdiction's behaviour as a tax haven.

Quantitative data will be used to establish a ranking of the size of the OFC located within that tax haven. This component will assess the importance of the jurisdiction as a financial centre.

The Financial Centre ranking will be combined with the Financial Transparency weighting to produce a Financial Transparency Index (FTI).

To ensure that neither component dominates when they are combined, they should be of equivalent scale. It seems likely (although it is not inevitable) that the quantitative criteria for the Offshore Centre index will produce a percentage value, and the Transparency Weighting could also be normalised on the range 0-1 (0-100%). Combining scores on various measures in this way would be straightforward. A range of scores, for example from 0 to 5 (where higher scores indicate greater transparency), could be weighted to reflect their relative importance (e.g. if tax information exchange were seen as more important than auditing standards, or vice versa), and the average (geometric) then taken. This could then be expressed as a percentage of the potential maximum (i.e. the score for 'perfect' financial transparency).

In order to obtain a combined index where higher scores indicate greater contributions to the opacity of global finance, the FTI would subtract the Transparency Weighting from one (to obtain a financial opacity index, where higher scores now indicate greater opacity) and multiply this by the Offshore Centre index (whose higher scores indicate a larger role in global finance) to obtain a final value for each jurisdiction between 0 and 1 where higher values reflect a greater contribution to global financial opacity.

Potential methodologies for each component of the Index have been identified by those proposing this study but a key feature of the pilot programme will be determination of what is feasible in terms of data completeness and index design to meet the objectives outlined. At this stage sufficient data has been identified to suggest with reasonable confidence that the proposed indices can be reliably generated.

4. Data

The quantitative analysis undertaken to create the rankings will use relevant datasets collected by international organisations, including BIS locational banking statistics, the IMF Coordinated Portfolio Investment Survey, IMF International Financial Statistics, and IMF Balance of Payments Statistics. In combination data from these sources is available for 112 locations at present. Although coverage is not complete in all datasets imputation of data should produce sufficiently reliable measures for assessment purposes given the size of the overall population. This method was used by Zoromé in his recent work for the IMF (Zoromé, 2007).

For the purposes of the pilot project, the qualitative data to be used will rely heavily upon the OECD's *Tax Co-operation: Towards a Level Playing Field* (OECD, 2006). This assessed transparency requirements in 82 territories.

OECD transparency data is available for 67 of the locations for which financial data is available from the IMF and other sources on financial centres. It is proposed that these locations form the basis for the pilot index. Inevitably in some instances the available data will not support the creation of a reliable ranking at this time. It is, however, hoped that an initial index of approximately sixty jurisdictions will result from the proposed work. It is believed that this sample will be sufficient to prove the credibility of the methodology and will generate enough information to stimulate policy-based debate.

5. Data development

The OECD transparency data is useful. We understand that it is also currently being updated with publication of the next report planned for 2008. It does, however, have limitations. It focuses upon:

- Exchanging Information
- Access to Bank Information
- Access to Ownership, Identity and Accounting Information
- Availability of Ownership, Identity and Accounting Information

With exception of the first, which remains limited in scope, this means the assessment is based on the recording of transactions within the jurisdictional space. The exchange review is substantially procedural and does not consider issues relating to how the resulting financial architecture is used by individuals and companies resident outside the jurisdictional space. It is this use, however, that is key to the activity of a tax haven.

As part of the pilot study a review of two or three locations will be undertaken to assess the way in which the jurisdiction designs its regulatory environment for the benefit of those operating from outside that location. The key focus of this review will be on the means by which the jurisdiction promotes secrecy, which is now widely understood to be the main obstacle to effective international coordination of the enforcement of financial and fiscal laws. Whilst much progress has been made by international regulatory bodies in identifying the main means of the concealment of illicit funds, and establishing international standards and procedures for obtaining and exchanging information what is now needed is a mechanism for evaluating the extent to which each jurisdiction complies with these standards.

The locations to be reviewed will be representative. As such it is likely that they will include a major developed country that is used as an OFC. The Netherlands might be example. A second example would be a location recognised as a tax haven from which an OFC operates. Cayman or the Isle of Man might be examples. The third would be a haven in which limited OFC activity takes place. St Kitts & Nevis might be such a location. These suggestions are made as examples only at this stage. It is hoped that visits to these locations might be possible as part of the research process so that desk based research can be confirmed by interview based enquiry.

The principal reason for undertaking this work is to test the appropriateness of using the OECD data for the purposes of creating this index. Recent changes in the offshore world including the development of protected cell companies, the practice of redomiciliation and changes in the definition of trusts in many locations mean it is possible that the focus of the OECD work may not meet the needs of this index, or adequately track the likely use of the resulting structures. This work will test that hypothesis.

Our focus on highlighting the creation of mechanisms for concealment is intended to reinforce the even-handed approach which should characterise this work since regulators in all countries would benefit from the resulting greater financial transparency.

6. Outcomes

The research will result in the publication of a pilot index. This will have significant impact, since being rated as contributing significantly to global financial opacity will have a 'shaming' effect. Financial centres rely substantially on their reputation, and this could be significantly damaged or enhanced by the ranking awarded by this index. The likelihood of this outcome would be increased if for presentational purposes the ranking was accompanied by a brief note and comment on each jurisdiction, outlining key strengths and weaknesses, largely for media purposes and for publication on the website. This will not be the same as the longer evaluation note referred to in the following paragraph.

The detailed evaluations supporting the Index, as well as the procedures adopted for collecting and evaluating the data, would also provide a valuable resource in themselves for regulatory agencies around the world, by highlighting weaknesses of each country's systems. As a result regulators could more easily decide when defensive measures are

appropriate against low-transparency jurisdictions, and which measures might be effective. Legitimate customers for financial services would move to the more transparent centres, leaving the less transparent vulnerable to loss of business and potential counter-measures.

There is evidence that the 'shaming' effect resulting from the blacklisting by organisations such as the FATF and the OECD did produce such effects (Sharman 2006, 101-126, 155-56). However, blacklisting has also been shown to have significant disadvantages, especially if based on an all-or-nothing judgement. The ranking approach suggested for the Index would avoid the making of a single judgment. It would also overcome the difficulty of attempting to separate 'offshore' and 'onshore' financial centres, and 'pure' from 'partial' tax havens. The proposed methodology ensures that this will be the case.

7. Budget

This budget is priced in pounds sterling as it will be managed in that currency given the UK base of the team making this proposal.

It is assumed that the project delivery timescale is one year from commissioning.

The project budget assumes there will be two core team members supported by a project assistant. External consultants will be used to assist with econometric issues if required and to assist data collection for the work identified in paragraph 5, above.

It is assumed that a monitoring panel (to comprise the Director of the Tax Justice network, John Christensen and up to three academics of professorial level) will supervise and review this work. They will be expected to attend quarterly meetings and to actively contribute to the work process.

Due to the nature of the project travel costs will be incurred, both as a result of project co-ordination and to present results.

Only modest project overhead costs are allowed for. This reflects the flexible nature of the Tax Justice Network team and the remote working arrangements which it customarily employs.

The resulting budget is as follows:

Item	Payment basis	Time engaged	Cost per unit of charge	Total (£)
Coordinator	Salary	1 year (part time)	£25,000 (incl. employment costs)	25,000
Tax Justice Network project management	Overhead contribution	1 year	£15,000	15,000
Core team (2 people)	Fee	1 year each, part time	£30,000	60,000
Supervisory board (up to 3 people)	Fee	Annual fee	£5,000	15,000
Econometrics				3,000
Travel and associated costs				8,000
Office costs				4,000
Total				130,000

It is proposed that the budget be paid 25% on commencement with further 25% instalments being payable after four and eight months and with the final instalment becoming payable on delivery of the final project report.

8. Team members

The core team members for the project will be:

Richard Murphy. A UK based chartered accountant. He is director of Tax Research LLP, a visiting fellow in the Centre for Global Political Economy at the University of Sussex and an external Research Fellow at the Tax Research Institute, University of Nottingham. He is the principal author of many of the Tax Justice Network's publications and is currently co-authoring a book on tax havens for Cornell University Press.

Alex Cobham. Alex Cobham is supernumerary fellow in Economics at St Anne's College, Oxford and economy section director at the Oxford Council on Good Governance, but will shortly take up a position as Policy Development Manager at UK development NGO Christian Aid. He will combine work on this project with these duties.

The Tax Justice Network will be represented by **John Christensen.** An economist, John is director of the Tax Justice Network International Secretariat. He is former senior economic adviser to the States of Jersey. He is an experienced project manager.

The members of the proposed monitoring board have yet to be confirmed.

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