MEASURING TRANSPARENCY

A proposal for research and development of a Financial Transparency Index

January 2008

Proposal summary

The **Tax Justice Network** proposes an 18 month research and development project to refine the methodology of a **Financial Transparency Index** (FTI) and to collate and analyse the base data required to bring the Index into operation.

The FTI will focus on selected jurisdictions which encourage and facilitate illicit financial flows (especially from poorer countries) by providing the legislative and judicial secrecy space that hinders legitimate investigation of these flows.

The purpose of the FTI is to highlight how secrecy jurisdictions furnish a supply side environment which induces illicit financial flows and related tax evasion, and to reveal how systemic financial market failures contribute to the impoverishment of poorer people in developing countries.

The project will culminate in the publication of the first period index results, and a full explanation and discussion of the methodology used in its compilation.

Contents

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1. Background

Concerns about the developmental impact of secrecy jurisdictions (widely referred to as tax havens) and the commercial offshore finance centres (OFCs) that are located within these territories have increased in recent years, but attempts to remedy the problem have been hindered by a variety of factors.

Firstly, there has been very limited coordination between international efforts to improve cooperation in tax matters and supervision of financial markets and institutions.

Secondly, the main impetus for new initiatives has come through the G7 and the OECD. These initiatives have typically neglected the impact of this issue on developing countries.

This impact has been highlighted by a number of studies which show how the services offered by secrecy jurisdictions and OFCs facilitate corruption, capital flight, and tax evasion and avoidance (Oxfam 2000, Baker 2005, TJN 2005, 2007).

These studies conclude that effective measures to combat cross border flows of dirty money[1] would do far more to promote development than increases in aid flows. Tackling corrupt tax practices, which damage the legitimacy of tax regimes and the rule of law, would also strengthen relations between citizens and politicians in democratically governed societies and improve corporate governance.

This proposal aims to help remedy this by filling an important gap. Existing systems are ineffective in preventing the concealment of dirty money through even the most sophisticated financial centres. A major reason is that surveillance of standards of financial regulation is generally separated from issues of transparency for international tax cooperation purposes. Notably, the **IMF-World Bank**'s **Reviews of Standards and Codes** (ROSC) and **Offshore Financial Centres Assessment Programme** do not include any assessment of centres' compliance with international tax transparency standards (IMF-WB 2005).

Separating the issues in practice makes it more attractive to use financial centres as conduits for dirty money, because centres which comply with financial stability standards are made more secure and can present themselves out as respectable since they are expected to comply with 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, which account for the majority of cross-border illicit financial flows.

Conversely, the **OECD**'s campaign against tax havens has been concerned with tax losses from OECD countries, and not with capital flight and tax avoidance from developing countries and economies in transition.

[1] Dirty money is defined here as money that is either obtained, transferred or used illicitly.

The outcome of this piecemeal approach to tackling these systemic problems, which have been exacerbated by financial market liberalisation, is that very little progress has been made towards developing a truly comprehensive programme for strengthening international cooperation in combating capital flight from developing countries and the associated tax evasion. The conduits through which these flows are routed, in particular the secrecy jurisdictions, continue to function without significant impediment, and developing countries lose their financial wealth and taxation revenues in volumes several times greater than the aid flows intended to alleviate their poverty.

2. The Financial Transparency Index methodology

The Financial Transparency Index (FTI) aims to identify and rank jurisdictions according to their contribution to the opacity of the international financial system. It is designed to go beyond existing systems in several ways, while making use of various initiatives being conducted by international organisations to provide sources of data.

The Index is 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. This has generated resentment especially amongst smaller or poorer countries, which feel they have been unfairly targeted. The data-based approach aims to be even-handed in its treatment of jurisdictions.

The FTI will use quantitative data to establish a ranking of secrecy jurisdictions in terms of the scale of their `offshore' financial services activities. 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.

The Index will therefore have two components:

(i) a **Financial Centre** ranking, based on a primarily quantitative methodology;

(ii) a **Transparency Weighting**, based on a primarily qualitative methodology.

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

The quantitative data will make use of relevant datasets collected by international organisations, including **Bank for International Settlements** locational banking statistics, the IMF **Coordinated Portfolio Investment Survey**, IMF International Financial Statistics, and IMF Balance of Payments Statistics. The qualitative data will also use relevant reports of international organisations as a framework, combined with more detailed evaluations by a network of specialists in relation to the selected jurisdictions.

The key focus will be on secrecy, which is now widely understood to be the main obstacle to effective international coordination of the enforcement of financial and fiscal laws. 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 focus on ending facilitation of concealment will also reinforce the even-handed approach, as regulators in all countries would benefit from greater financial transparency. It avoids passing judgement, for example on the propensity to corruption of some countries rather than others, and imposes procedural rather than substantive regulatory requirements.

Publication of the Index as a ranking of jurisdictions would have a significant impact, due to its 'shaming' effects. Financial centres rely substantially on their reputation, and this could be significantly damaged by a poor Financial Transparency ranking. 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 secrecy 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 significant disadvantages, especially in relying on an all-or-nothing judgement. The ranking approach suggested for the FTI would avoid the making of a single judgment which divides sheep and goats.

To ensure that neither component dominates when they are combined, they should be of equivalent scale. It seems likely (though not inevitable) that the quantitative criteria for the FTI 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 or arithmetic) 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, one would then take one minus the Transparency Weighting (to obtain a financial opacity index, where higher scores now indicate greater opacity) and multiply this by the Financial 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 research and development phase will be to determine 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.

3. Budget

This budget is priced in €uro.

It is assumed that the research and development phase will last 18 months from commissioning, by which stage expert review processes will have been completed and the first index results will be ready for dissemination. The budget includes an allocation for an active dissemination process. Beyond that stage, TJN will be seeking additional resources to continue its research into ongoing monitoring of the evolution of secrecy jurisdictions.

The project budget assumes a research and development team consisting of six members, including financial and legal specialists, a project coordinator and a researcher / analyst. It is assumed that the majority of the project deliverables will be generated by core team members and / or associated partners.

The summary budget is as follows:

Item	Daily rate (€)	Days	Total (€)
Coordinator and researcher / analyst	300	100	30,000
Specialist team*	500	80	50,000
External consultants	500	20	10,000
Travel			20,000
Office costs			10,000
Total			**€ 120,000**

External consultants will be used to:

a. Collate data unavailable from other sources;
b. Assist qualitative reviews where additional expertise is required of either issues or particular financial centres.

Due to the nature of the project, travel costs will be incurred during the R&D phase and in results dissemination.

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 uses.

4. Project personnel

The core team members for the project will be:

John Christensen. An economist, John is director of the Tax Justice Network International Secretariat. He is a graduate of **Reading University**, and did his postgraduate training at **Oxford University (Templeton College)** and the **London School of Economics**. He is former senior economic adviser to the **States of Jersey**, and has also worked as senior economist to a London-based economic consulting firm. He has considerable experience of directing and project managing multi-disciplinary quantitative and qualitative research projects.

Prof Sol Picciotto. Professor of law at **Lancaster University**. He has published widely on international economic law, international business regulation, state theory and international capital, and law and social theory. His books include ***International Business Taxation***, published by Weidenfeld and Nicolson (l992).

Alex Cobham. Alex Cobham manages the policy unit at **Christian Aid**. From 1999-2002 he held various research posts at the University of Oxford's **Department of International Development (Queen Elizabeth House),** researching into international and domestic financial market topics. From 2003-2007 he held the post of Supernumerary Fellow in Economics at **St Anne's College**, and was also from 2005-2007 the Director of the Economy Section at the **Oxford Council on Good Governance**. His recent publications include an article in the European ***Journal of Development Research***, and popular pieces for ***The Guardian*** newspaper.

David Spencer. David Spencer is a US lawyer. He is a graduate of **Harvard College** and **Harvard Law School** and has a Masters of Law Degree in Taxation. Before opening his own law firm he practiced tax and banking law at a major Wall Street law firm and at **Citigroup/Citibank**. He has authored many articles on the OECD proposals on harmful tax practices and the **EU Directive on the Taxation of Savings**.

Richard Murphy. A UK based chartered accountant. He is director of **Tax Research LLP**, a visiting fellow in the **Centre for Global Politcial 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**.

In addition, a researcher / analyst will be recruited by TJN in February 2008 to provide support with data collation and interpretation.

The project will draw on data resources of the OECD, which has indicated its willingness to cooperate.

5. Applicant details

Organisational profile

Founded in 2003, the Tax Justice Network (TJN) is a global coalition of researchers, financial professionals, economists, development NGOs, journalists and other representatives of civil society with a shared interest in matters relating to fiscal policy and development, including and especially illicit financial transfers, tax evasion and harmful tax practices generally. The key focus of all our activities is to promote fiscal policies which serve the interests of poor people and ecological sustainability.

TJN is constituted in Belgium as an **international not-for-profit association** (Association number 884.481.731). The Network's Constitution is available for download at: www.taxjustice.net/cms/upload/pdf/TJN_Constitution_English_-_DEC-2006.pdf

Details of the current membership of the association are available at: www.taxjustice.net/cms/front_content.php?idcat=2

The Network operates an international secretariat established in London, which employs one full time director. The international secretariat works on the basis of outsourcing the majority of its functions to partner organizations and specialists. Our principal research partner is **Tax Research LLP**, a highly specialized agency with a focus on policy analysis and bespoke research. The International Secretariat also provides specialist advice to member organisations, and directly assists and participates in their policy research / advocacy and campaign activities.

In 2007 the operational costs of the International Secretariat operated amounted to approximately €140,000. Much of the funding of the network's research and advocacy work is provided by member organisations on a project by project basis. In addition, the network has benefited significantly from contributions from senior advisers (typically legal and financial specialists) who donate their services on a *pro bono* basis.

Organisational accountability

The highest decision making body of the TJN is the general assembly (the **TJN Council**). The powers and procedures of the Council are laid out in Section III of the Constitution.

The Council elects a Board of Directors to direct its activities. The current Board was elected in January 2007 and will serve a 24 month period. The Board Members are:

African Community Development Foundation, represented by **John Kweri**
AllianceSud (Switzerland), represented by **Bruno Gurtner**
Attac-Deutschland, to be nominated
Attiya Waris representing **Tax Justice Network for Africa**
Christian Aid (UK), represented by **Alex Cobham**
Economic Justice Coalition (Mozambique), represented by **Viriato Tamele**
Integrated Social Development Centre (Ghana), represented by **Vitus Azeem**
Jo Marie Griesgraber representing **TJN-USA**
Kairos-Europe (Belgium), represented by **François Gobbe**
Secours-Catholique Caritas (France), represented by **Michel Roy**

Bruno Gurtner from AllianceSud chairs the Board.

The International Secretariat functions as a secretariat for the Board, and for the regional steering committees (see Section V of the TJN-AISBL Constitution). The International Secretariat is registered in the United Kingdom as a company limited by guarantee, and TJN-AISBL has a controlling membership interest in that company. The most recently published accounts and director's report for TJN-International Secretariat Limited are available for download at: www.taxjustice.net/cms/upload/pdf/TJN-IS_2006_accounts_and_directors_report.pdf

Relations with international and regional development agencies

TJN operates at national, regional and global levels. At the global level, the network has developed strong working relationships with a variety of UN **ECOSOC** related organisations, including the **Finance for Development Office**, **UNCTAD**, and **UNDP**; with the **Fiscal Affairs Department** of the OECD; with the **South Centre**; with the **Leading Group on Solidarity Levies**. TJN holds regular dialogues with members of the World Bank's global governance team, and with the IMF's fiscal department.

At a European level, TJN has developed a working relationship with the **Fiscal and Customs Union Directorate** of the **European Commission**, and our national member organisations have good working relations with the ministries of finance, international development and foreign affairs in a number of countries.

Relationship to the Catholic Church

The Catholic Church is represented on the TJN Global Board by **Secours-Catholique Caritas** (**Michel Roy** participates on their behalf). The Catholic Church is also directly involved in TJN activities at national level in a number of countries, including Belgium, France, Switzerland and the United Kingdom.

CAFOD has funded TJN in the form of grants paid in 2005 and 2006 towards the editorial costs of publishing our quarterly newsletter, *Tax Justice Focus* (copies of which can be downloaded from: www.taxjustice.net/cms/front_content.php?idcat=6)

Caritas Switzerland and **Fastenopfer** (the Catholic Lenten Fund) are both members of AllianceSud, which is a founder member of Tax Justice Network. Fastenopfer is currently sponsoring the educational and capacity building programmes of **Tax Justice for Africa**.

Diversity information

The Tax Justice Network is a network of member organisations and individuals. To our knowledge, our member organisations operate comprehensive equal opportunities policies and are committed to employee diversity.

The Tax Justice Network employs one male person as director of its international secretariat. That person was selected on the basis of specialist knowledge and experience. The employing organisation – **Tax Justice Network International Secretariat Limited** – operates a policy of diversifying its freelance advisers and suppliers of administrative and other services.

Membership of the Board of the global Tax Justice Network is based upon regional quotas for the regions in which the network currently operates. Board Members are elected by the TJN Council to serve for 2 years, and may stand for re-election.

At this stage Board membership is purposefully structured to support growth of the Network's activities in Africa. Four out of a total of ten Board members represent that region. It is expected that the balance will change in 2008 when representatives of Latin America join the Board. Females are slightly under-represented on the Board, and TJN is taking active steps to encourage female participation, for example through giving support to female Board members at regional and national levels.

Tax Justice Nederland employs one part time female person as coordinator for its national activities.

Tax Justice for Africa employs one part time male person as coordinator of its regional activities.

Further information

The TJN website can be found at: www.taxjustice.net

The TJN blog can be found at: http://taxjustice.blogspot.com

Tax Research LLP's website can be found at: www.taxresearch.org.uk

The Tax Research blog can be found at: www.taxresearch.org.uk/Blog

6. Bibliography

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