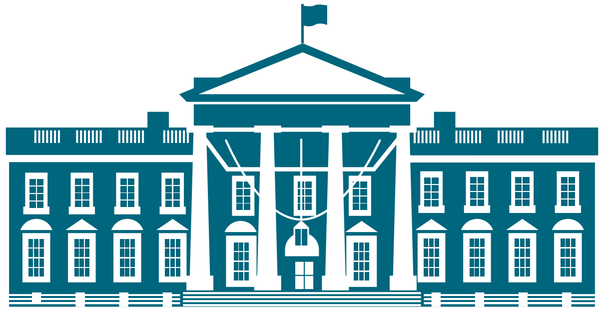
Center for Global Development

December 2020



The White House and the World

A Domestic Financial Transparency Agenda for Stronger Development Outcomes

Clemence Landers

The secret flow money has become a major feature of our globalized economy. It is also a major challenge for developing countries. The developing world loses billions of dollars a year to illicit financial flows—money crossing borders that is illegal either in its source, transfer, or use.[1] A recent World Bank paper found that in the world's most aid-dependent countries, aid deposits coincide with increases in bank deposits in offshore financial centers.[2]

Financial secrecy enables activities that are often counter to the public good, from illicit financial flows, to acts of bribery, to often legal but troubling acts of corporate profit shifting. They combine to drain resources from government coffers, undermine economic growth, impede the functioning of institutions, and exacerbate wealth inequality. And they often hurt the poor the most by reducing the availability and quality of basic services, while increasing their cost. [3]

The US financial system—by virtue of its size and low financial transparency standards—has become an Achilles' heel in global efforts to curb the secret flow of international funds. In recent years, the United States has increasingly fallen behind peer countries in setting and implementing high standards around financial transparency, while others, like the United Kingdom and parts of the European Union, have moved forward with ambitious reform agendas. The Center for Global Development's

KEY RECOMMENDATIONS

- Curb the use of anonymous shell companies by working with Congress to pass legislation requiring the systematic disclosure of their beneficial owners.
- Commit to high transparency standards in the oil, gas, and mining sectors by announcing the administration's intention to comply with the Extractive Industries and Transparency Initiative and work with Congress to implement the Cardin Lugar Provision of the Dodd Frank Act.
- Deter multinational corporate profit shifting by passing legislation requiring that companies publicly disclose country-by-country reporting of their global economic activities.

Commitment to Development Index—which assesses the 40 most powerful countries based on how much their policies advance development—ranks the United States 38th out of 40 countries on financial transparency, with failing grades on beneficial ownership and country-by-country reporting and room for improvement in natural resource transparency.[4] The IMF's 2020 US Article IV consultation highlights that ongoing shortcomings in the US regulatory system make it easier for foreign corrupt officials to hide stolen proceeds in the United States, including resources from COVID-19-related spending initiatives.[5]

The Biden administration has a unique window to capitalize on pro-transparency sentiment at home, and the reform momentum abroad, to implement a series of much-needed updates to the US domestic financial transparency apparatus. An ambitious domestic reform agenda would help reassert America's credibility as a leader and standard setter on financial transparency issues. It would also fulfill a major global development and economic policy objective: addressing the global erosion of trust in institutions and markets that has coincided with the rise of corrupt authoritarian regimes. And it is also a way of recommitting to the United Nations Sustainable Development Goals since reducing illicit financial flows is a key objective under Goal 16. Greater transparency and accountability will also directly benefit the United States: it will render the United States less vulnerable to foreign adversaries seeking to exploit weaknesses in the American system to undermine American interests.

The United States is the world's largest financial center, and historically has been a standard setter for global rules and regulations. And US domestic policy choices have outsized influence around the globe. While many reforms would require congressional action, the House and Senate have introduced legislation—in some cases on a bipartisan basis—related to beneficial ownership and disclosure standards for country-by-country reporting for multinational corporations.

The Biden administration should announce a financial transparency agenda that makes concealing funds in the United States—and around the world—substantially more difficult. This agenda could be a key component of its broader international development policy. But any reform effort would need to be phased: the United States cannot credibly advocate for high standards overseas that it does not uphold at home. For this reason, the Biden administration should first seek to move the needle on several domestic big-ticket items.

These include cracking down on anonymously owned shell companies; recommitting to high transparency standards in the extractive sectors; and launching a global corporate tax transparency agenda.

FOR THE US TO LEAD IN INTERNATIONAL FINANCIAL TRANSPARENCY EFFORTS, IT MUST START AT HOME

Transparency is at the heart of any successful anti-corruption effort. It deters and exposes illegal activity, helps citizens hold their governments and private sector to account, fosters greater trust in institutions, and helps markets work.[6] The United States applies financial transparency requirements inconsistently, which exposes it to exploitation. The recent FinCEN (the Financial Crimes Enforcement Network) files report shows how major US and international banks helped suspected terrorists, criminal organizations, and corrupt foreign officials move trillions of dollars around the world. Vulnerabilities in the US system, in turn, weaken the ability of the international community to clamp down on illicit financial flows.

Disclosing the beneficial owners of shell companies

Anonymous shell companies are entities that are repositories for assets. While some shell companies exist for legitimate purposes, they are often used to conceal or launder money. According to the World Bank, roughly 70 percent of the biggest corruption cases between 1980 and 2010 involved anonymous companies.[7]

The United States is a major shell company haven. In several states, the corporate service providers that form these companies are not required to verify the true owners of the assets they hold, much less disclose their identities to the government or the public. A 2016 report by the Financial Action Task Force (FATF)—the global standard-setting body on money laundering—found that the US government's failure to identify the ultimate owner of private companies (known as "beneficial ownership", i.e., the natural person behind a legal entity or arrangement) was a "serious deficiency" and put the United States in noncompliance with FATF recommendations.

Against this backdrop, the global momentum has grown—accelerated by the Panama Papers—to clamp down on anonymous shell companies. According to FATF, the two measures of effectiveness of beneficial ownership transparency are reliability of the information and timely access to it.[8] Some countries have sought to establish central registers that hold information on beneficial ownership. Other jurisdictions put the onus on corporate service providers to verify and report the beneficial owners to the authorities. More recently, there has been a trend towards establishing public registers of beneficial ownership. In 2018, the European Union issued its 5th Anti-Money Laundering Directive (5AMLD) requiring that member countries maintain public registers.[9] Over the past five years, the United Kingdom, Norway, and Ukraine have established public beneficial ownership registers and more recently Ghana, Nigeria, and Mexico announced their intention to follow suit.

In the United States there are also positive signs that the impasse around beneficial ownership could be nearing its end. After a series of failed attempts to pass a bill on anonymous shell companies, in October 2019, the Corporate Transparency Act of 2019 passed the House. The bill would require any person who creates a corporation or a limited liability company to report on an ongoing basis to FinCEN the identities of its beneficial owners.[10] In June 2019, Senators Sheldon Whitehouse (D-RI) and Chuck Grassley (R-IA) introduced The True Incorporation Transparency for Law Enforcement (TITLE) Act to require states to obtain information on the true owners of companies formed within their borders.[11] In addition, in 2018 the US government announced the publication of the Obama-era Customer Due Diligence (CDD) rule, which requires financial institutions to collect and verify beneficial ownership information when a company opens an account.

Transparency in extractive industries

The extractive industries are one of the most corruption prone business sectors, accounting for one in five cases of transnational bribery according to the OECD.[12] The Extractive Industries and Transparency Initiative (EITI) was launched in 2003 to promote higher standards of transparency and accountability in natural resources governance in developing and developed countries alike. Fifty-three countries are currently EITI members and roughly 31 have achieved compliance. Under the initiative, companies of member countries in the oil, gas, and mining sectors are required to disclose what they pay to governments in tax, royalties, and signing bonuses. In turn, governments must disclose what they receive. The figures are subsequently reconciled and published.

The United States committed to implementing the initiative in 2011 under the Obama administration in the face of deep opposition from US oil companies.[13] The United States contributed to the EITI Multi-Donor Trust Fund at the World Bank, began the process of achieving EITI compliance, and served on its board (via the State Department). But in the fall of 2017, the Trump administration announced that it would no longer seek to comply with the initiative, arguing it was incompatible with US law. This came on the heels of a move by Congress in early 2017 to block a new proposed Securities and Exchange Commission (SEC) rule that would require extractive companies listed on a US stock exchange to disclose their payments to the United States and to foreign governments—commonly known as the Cardin-Lugar amendment. The rule would have implemented section 1504 of the Dodd Frank Act.[14] (The SEC subsequently issued a new proposed rule in January 2020 that attracted criticism from anti-corruption watchdog groups for setting an arbitrarily high reporting threshold and requiring reporting on a country basis, rather than on project basis.)

Since 2017, EITI has continued to set progressively higher transparency standards for the sector. Most recently, EITI set a standard that requires countries to ensure that all companies that apply for or hold participating interest in an oil, gas, or mining license disclose their beneficial owners. The standard also requires that politically exposed persons (i.e., public officials) be transparent about their financial interests in the extractive sectors.

Corporate tax transparency

The IMF estimates that non-OECD countries lose somewhere around $200 billion in revenues to multinationals profit shifting.[15] There is also evidence that poor countries are more exposed to cross-border profit shifting than richer countries.[16] As part of the Base Erosion and Profit Shifting Program (BEPS), the G20 and OECD agreed that authorities would share country-by-country reporting (CBCR) of multinational company profits across jurisdictions to identify companies that systematically pay their taxes in jurisdictions where they do not generate profits or do not have substantial activities or employees.

Under the CBCR initiative, companies are required to submit reports to the tax authority in their home jurisdiction, which can be shared with other jurisdictions through mutual exchange of information agreements. The reports contain financial information about each companies' activities around the globe, including their revenues, profits, employment, and taxes across the various geographies where they operate. But the information is confidential and only the relevant tax authorities have access to the data. And many developing countries have had trouble accessing the information because exchanges are governed by a complex system of mutual agreements between jurisdictions.[17]

There is growing momentum to make CBCR information public when the standard comes under OECD review (the 2020 review was cancelled due to COVID-19). The case is compelling. Making these reports public would improve developing countries' ability to access the information. And by giving the global public greater scrutiny, the initiative could also promote greater tax accountability for multinational corporations and pave the way for more sweeping multinational tax reforms. (A key question around making CBCRs useful for developing countries is whether the $850 million in annual revenue reporting threshold is too high and weighing it against the cost of lowering the threshold for smaller multinational companies.)

US lawmakers are already pushing for more ambitious disclosure standards. In March 2020, Senator Chris Van Hollen (D-MD), along with Representatives Cynthia Axne (D-IA) and Lloyd Doggett (D-TX), led a letter signed by 33 senators and representatives to the OECD as part of the since-cancelled BEPS review process urging them to strengthen CBCR rules and to require corporations to publicly disclose their reports.[18] In parallel, Senator Van Hollen and Representative Axne introduced legislation in the Senate and House that would mandate the SEC to require large US multinationals to publicly disclose their financial and tax information on a country-by-country basis.[19]

POLICY RECOMMENDATIONS

To advance a financial transparency agenda that makes concealing funds in the United States and elsewhere substantially more difficult— and to reassert America's credibility as a leader in financial transparency issues— the Biden administration should:

Clamp down on anonymously owned shell companies by requiring that they systematically disclose their beneficial owner to the US Treasury Department or another division within the federal government.

- The Treasury Department should work with Congress to pass and enact legislation (such as the Corporate Transparency Act) that would require that corporate service providers verify the true identities of beneficial owners of shell companies and automatically report the information to FinCEN.
- The Treasury should also instruct financial institutions and corporate services providers to apply enhanced due diligence if a beneficial owner is a politically exposed person.
- The Treasury department should task the OECD with developing a template for a standardized data system and establish a process for reciprocal information exchanges between countries.

Promote greater transparency in the extractive sector by recommitting to EITI and implementing section 1504 of the Dodd Frank Wall Street Reform Act (Cardin Lugar Provision).

- The administration should announce US intention to become an EITI implementing country.
- The White House should work with Congress to strengthen the SEC rule enacting Section 1504 of the Dodd-Frank Act (Cardin Lugar).
- The White House should work with Congress to pass legislation to meet the latest EITI standards, including disclosing the beneficial owners of extractive companies.
- The State Department should request and work with Congress to contribute $10 million to the EITI Multi-Donor Trust Fund at the World Bank.

Deter multinational corporate profit shifting by making country-by-country reporting of large multinational firms' geographic breakdown of financial activities public.

- The Treasury Department should work with Congress to pass legislation requiring that multinationals provide public CBCRs on their global activities. These reports would include revenues, profits, employment, and taxes in each country where they do business.

- Treasury should also use the upcoming OECD BEPS review to press for a common global transparency standard around multinational tax reporting and reassess the current threshold for CBCR reporting.

ADDITIONAL READING

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ENDNOTES

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Ideas to Action: Independent research for global prosperity

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