International regime of counteraction to laundering of proceeds of crime and financing of terrorism: two vectors of evolution

Abstract. The paper incorporates the substantiation for the two vectors of evolution of international regimes: 1) institutionalization and legal implementation of rules and principles of interaction between the states, which leads a regime to transform into an institution; 2) preservation of the exterior «softness» of the law, which serves as a bedrock for regime, with its de-facto acquisition of all attributes of legitimate legal tools. Illustrated through the example of intergovernmental body FATF, a research has been conducted on specific aspects of development and efficiency in the contemporary conditions of the regime of counteraction to the legalization (laundering) of proceeds of crime and financing of terrorism (AMF/CFT).

Political will is a key to success in combating money laundering as a negative social phenomenon. The attempts by certain national leaders to maintain a neutral position or to use the tactics of «silent evasion» or «imitation of intensive activity with the actual total inaction» would lead to disastrous consequences in the nearest future in the majority of the underdeveloped and developing countries where political positions have been obtained by oligarchic clans which acquired their first earnings via illicit criminal activities. Projecting such way of living upon state administration has become a common practice in the post-Socialist states and serves as the most favourable ground for emergence of an entire conglomeration of such pseudo-statesmen.

The authors’ original term has been introduced into scientific circulation to identify the structure which emerges as a consequence of the development of the regime according to the second vector - «quasi-institutional body of intergovernmental influence».

It has been asserted that in the conditions of centralization of the global financial system and growing threats of terrorism and extremism across the world the success of AML/CFT regime largely depends on determining a reasonable balance between strict institutionalization, provisions for compliance of national legal systems with global standards and democratization of foundations of cooperation between member states and inviolability of their sovereignty.
Keywords: International Regime; Counteraction to Laundering of Proceeds of Crime and Financing of Terrorism (AML/CFT); «Soft Law»; Financial Action Task Force on Money Laundering (FATF); Quasi-Institutional Body of Intergovernmental Influence; Money Laundering/Terrorism Financing (ML/TF)

JEL Classification: F53; F55; K33

Acknowledgements and Funding: The authors received no direct funding for this research.

Contribution: Each author contributed equally to the research.

DOI: https://doi.org/10.21003/ea.V181-03
1. Introduction

Over the last decades, advances in transportation, communication and a multitude of other technologies have changed the world substantially however they did not transform it into a safer place. Those preferences, which the law-abiding citizens and institutions existing within the law acquired with the development of technologies, have started to be implemented by criminal elements as well. International criminal organizations realize high profits by exploiting the capabilities of the global financial system, efficient transport communications and novel, more effective and low-cost modes of information exchange. In this regard, the countries have been faced with the necessity to join forces in order to solve an unconventional task: to restrict the access to the international financial system on the part of particular entities and simultaneously not to put the balance of economic relations around the globe in jeopardy. The given task is fairly complex with consideration for two fundamental impediments. First ly, the states are extremely limited in their influence upon what happens outside of their borders, specifically when it concerns the cross-border criminal activity. Secondly, not all states are equally motivated to actively combat crimes that have international reach. It occurs due to a non-uniform impact of their consequences upon various states and, likewise, the insufficiency of resources within these states to wage a system-wide fight against above-mentioned negative developments.

Such a complex and multifaceted situation has led to the emergence of a similarly controversial international political tool - a regime of counteraction to legalization (laundering) of proceeds of crime and combating the financing of terrorism. The article investigates the particularities of formation, development and overall efficacy of international political cooperation within this sphere as well as its effects for global economy as a whole.

2. Brief Literature Review

Essential attributes and role of international regimes as an instrument of silent pressure on the state within the context of social transformation has been researched by numerous specialists in the field of economy, law, and political science. The presented article contains only a part of the actual scope of research on the given subject. A conceptual foundation for the study of regimes as a projection of the «soft law» onto the field of international relations has been laid by research efforts of Ruggie (1975), Krasner (1982), and Keohane (1989). Works by contemporary researchers in this field as well represent a subject of interest, in particular the studies by Dostov, Shust, Leonova and Krivoruchko (2019) as well as Teichmann (2020).

For the purpose of exploring the novel practices of AML/CFT as well as the degree of sustainability of internationally recognized standards regarding prevention of terrorism financing, the works by Freeman (2011); Freeman and Ruehsen (2013); Gilmour (2020); Gilmour, Hicks and Dilloway S. (2017); Bötticher (2017) have been analyzed. Among the fundamental studies of the influence of global terrorism upon the economic development of the countries in the world we have given special consideration to the collective scientific effort «The Impact of Global Terrorism on Economic and Political Development» (2019), in particular the section dedicated to the issues of terrorism financing under the authorship of Biswas and Sana (2019).

For the comprehension of regional particularities in the schemes of money laundering and terrorism financing, we have referred to the works by Hamin, Omar and Abdul Hakim (2015) for
Asian region; McCaffery, Richardson and Bélanger (2016) - for Canada; Tierney (2017) - for Middle East; Ravndal (2016) and Koster (2020) - for Western Europe and European Union, specifically.

In the course of the research the core documents such as FATF (1990-2020), Money Laundering and Terrorist Financing Awareness Handbook for Tax Examiners and Tax Auditors (2019), other similar documents and reference materials have been utilized. Indicators of risk assessment for laundering of proceeds of crime and financing of terrorism on the national level have been investigated on the basis of FATF reports as well as the data from the Basel Index. The work by D. Cash (2019) «Sigma ratings: adapting the credit rating agency model for the anti-money laundering world» proved helpful for understanding of diverse international ratings and indices within the framework of AML/CFT.

The studies of the AML/CFT research agenda in the context of modern technologies by Jacobson (2010); Irwin, Slay, Raymond Choo and Lui (2014); Archetti (2015); Jarvis, Macdonald and Whiting (2015) are of a significant interest for our work. These studies will serve as a foundation for our subsequent research endeavours in this particular field.

3. Purpose: through the example of the activity of intergovernmental body FATF, to conduct a research into the evolution and possible prospects for further development of the international regime of AML/CFT.

4. Results

4.1. Conceptualization of the agenda of international regimes

A surge of interest towards the agenda of international regimes occurred in the 1970s. John Ruggie in his seminal 1975 article notes that «international behaviour» is institutionalized, i.e. limited within the confines of a specific mode of activity. In Ruggie’s treatment international regimes serve as a transient form of a collective action: something in between a soft (inherent in epistemic communities) and an institutionalized (e.g. international organization) one. However, a classical definition of international regimes was first formulated in the work by Stephen D. Krasner in 1982 where it was defined as «a set of implicit or explicit principles, norms, rules and decision-making procedures around which actors’ expectations converge in a given area of international relations» (Krasner, 1982).

Such treatment is relatively close to the viewpoint of J. Ruggie, according to which regimes are perceived as a less institutionalized form of cooperation which does not stipulate the creation of international organization. Studying the prerequisites for the development of the concept of regimes within scholarly circles, J. Ruggie and F. Kratochwil prove that its wide spread became a logical outcome of the terminological gap within the theoretical basis of international interaction. In practice there emerge such forms of cooperation that can be accounted for neither through the impact of systemic factor, nor through the activities of international organizations. Hence, international regimes «occupy ontological position between formal institutions and systemic factors».

The role of regimes in the global «picture» of international relations has been repeatedly redefined. While at the outset it was regarded as an intervening variable between organizations and systemic factors this notion has undergone revisions over the time. Gradually the regimes become to be regarded as a sustained social practice which may acquire diverse forms.

As early as in 1989 R. Keohane proposed to define them as «institutions with explicit rules, agreed upon by governments, that pertain to particular sets of issues in international relations». Narrowing down the four elements of the regime (principles, norms, rules and procedures) to rules Keohane not only considerably facilitated the task of defining a regime. In essence he broadened the notion of a regime over any structured interaction between states or other actors.

Within scientific community debates persist with regard to whether there exists a necessity for theoretical differentiation of international «institutions» and «regimes». An apparent distinction lies in the degree of freedom in respect of adopting and executing particular legal, economic, political and other international-level initiatives by the actors involved. Regimes inherently rely upon the «soft law», i.e. resolutions adopted by their actors are not mandatory for execution. Associations within the scope of a regime are represented by groups (not organizations!) while an
indirect instrument of influence upon its participants is generally realized through recommendations. Systematic reports from such associations demonstrate primarily informational, methodological character.

Four positive aspects of the «soft law» were substantiated back in 2000 by K. Abbott and D. Snidal. Firstly, it may be more attractive as it allows to reduce transaction costs which are unavoidable in legally binding agreements. Recommendations do not require ratification and are adopted by consensus. Further to it, informal relations allow to evade the existing bureaucratic procedures. Secondly, pressure upon national sovereignty of the state is diminished considerably. Being non-binding, rules of the «soft law» enable a particular level of discretion and formally do not obligate the governments to abide by the requirements imposed from the outside. Thirdly, they are better adaptable to rapidly changing international relations and situations with a high degree of uncertainty. Undoubtedly «strict» agreements as compared to recommendations end up being less adaptive. Finally, the fourth positive aspect lies in the fact that a postulated non-binding nature of rules significantly facilitates reaching compromises between diverse categories of actors irrespective of their political «weight» and other characteristics (Abbot & Snidal, 2000).

Observing the effects of the «soft law» in the contemporary glocal world (as may be exemplified, among other documents, by the Code of Conduct for Transnational Corporations) we may assert with confidence that its desirable and non-binding tools are often taking over the consciousness of the general public so strongly that it starts to perceive them as legitimate legal rules. Hence, the increased pressure on governments that cannot neglect public attitudes. In their turn courts, various non-profit organizations and even corporations start to rely upon the instruments of the «soft law» and attach such importance to them that they become to be used to assert the effects of legal provisions. Frequently enough they are employed to enforce the binding rules of international law (opinio juris) with the objective of application or interpretation of a treaty.

All these considerations lead to contemplate whether the predictable outcome of the evolution of any international regime based upon the «soft law» is in essence its gradual and «discreet» transformation into a formalized structure with former rules becoming enshrined in legislative acts, i.e. the transition into the level of institutionalization and «hard law». And while the regimes that belong to the monetary sphere or govern international trade and natural resources utilization potentially perceive such loss of freedom as economically and socially unjustified, the institutionalization of regimes and legislative enactment of unwritten rules of interaction between the states within the framework of national security (particularly in the conditions of growing terrorist and extremist threat across the globe) appears to be an entirely logical development.

On the other hand, it is becoming increasingly common to implement the practice of silent pressure on the state by means of the «soft law», which does not formally acquire its institutionalization within specific regulatory acts, however in the course of time becomes a more influential factor, particularly within the economic system. Such form of pressure is referred to as «naming and shaming» while in the EU it is commonly known as an «open method of coordination» (which prompts the members of EU to enforce legally non-binding rules). To strengthen the «soft law» various institutions are brought into operation. For instance, to enforce Basel Accords an eponymous Committee was created, which is responsible for the elaboration of norms and standards, on par with the Financial Stability Board. There are structures operational that exercise control over how the states follow and implement these standards which serves as a basis for drawing up numerous ratings. The amount of loans for which the state may qualify for depend to a great extent on its position in such ratings.

Therefore, contemporary world has two currently relevant vectors for evolution of international regimes: 1) institutionalization and legal implementation of informal rules of interaction between the states (a regime becomes an institution); 2) preservation of the exterior «softness» of the law with its de-facto acquisition of all attributes of legitimate legal tools. For the sake of terminological precision, we suggest naming the structure which emerges in consequence of the development according to the second vector as «quasi-institutional body of intergovernmental influence».

The vector pursuant to which the regime of counteraction to laundering (legalization) of the proceeds of crime and financing of terrorism (AML/CFT) is developing in current conditions will be determined in the subsequent part of our research.
4.2. System of international cooperation in the sphere of counteraction to laundering of proceeds of crime and financing of terrorism

Despite the fact that the laundering of funds may assume a variety of forms, its scenario generally remains unchanged and is realized through several stages. In this way, the process is initiated through committing a predicate crime that allows to illegally obtaining funds. The first stage is the «placement» of funds into the legal economy, for instance conversion of cash funds into non-cash form, second - «layering» of funds in the course of which illegal cash flows become intermixed with the legal ones achieved through numerous intentionally complex financial transactions; in the third stage - «integration» - the funds once again become injected into the legal economy, in particular when purchasing real estate or other assets. From the standpoint of an external observer such funds appear to be completely legit. Financing of terrorism essentially represents the process reverse to the legalization of funds. While in the case of laundering the funds from illegal sources may be used for entirely legit financial operations, in financing the terrorism the funds are allocated for intentionally illicit purposes. In such case the source of funding might be completely legit, for example a donation from a charity foundation.

Most recently the legalization of proceeds of crime has acquired a clearly pronounced cross-border nature and international cooperation in the sphere of AML/CFT lies, primarily, in the coordinated counteraction of countries to transnational criminal activity. Legalization of proceeds of crime disrupts the foundations of international economic relations, correspondingly combating against the legalization of such proceeds has effectively become international. These specified offences are criminalized already on the international level. The issue is recognized to be a high priority by the UN and its specialized agencies, international financial organization (The World Trade Organization (WTO), The International Monetary Fund (IMF), The World Bank, The Offshore Group of Banking Supervisors (OGBS) and police institutions (INTERPOL and EUROPOL). The UN plays a pivotal role in the coordination of activities of various structures responsible for AML/CFT on the international and regional levels. Among these structures an important position is occupied by The United Nations Office on Drugs and Crime (UNODC), whose specialists developed the UN Global Programme against Money-Laundering (1997).

Contemporary global AML/CFT system has been formulated as a «response» of the international community to the global expansion and proliferation of such excess profit criminal businesses as drug trafficking, arms trafficking, human trafficking and prostitution. In 1920s-1930s, when the legalization of proceeds of crime was only beginning to gain momentum in Europe and USA, the strategy of forced action upon the hotbeds of such criminal activity was chosen. Nonetheless, it proved to be erroneous as it only resulted in the symmetrical build-up of the criminal force capacity which enabled this force to maintain resistance to law enforcement agencies. A logical outcome of searching for a solution to a problem was to resort to financial levers. To make criminal business less profitable and to complicate the process of laundering the proceeds of crime - namely such an approach was eventually recognized on the international level as being the most efficient.

Counteraction to money laundering/terrorism financing (ML/TF) begins from the highest spheres of the government when the state leaders unite in a specific kind of consortium and enter into commitments for actions according to a unified algorithm which would render uncontrollable money flows into these jurisdictions impossible. Political will is the first and foremost key to success in combating this negative social phenomenon. The attempts by certain national leaders to maintain a neutral position or to use the tactics of «silent evasion» or «imitation of intensive activity with the actual total inaction» would lead to disastrous consequences in the nearest future. The problem of the level of mentality consists in the fact that the «helm» in the majority of the underdeveloped and developing countries is taken by oligarchic clans which obtained their first earnings through illicit criminal activities. Projecting such way of living upon state administration has become common practice for these «leaders». The post-Socialist states serve as the most favourable ground for emergence of an entire conglomeration of such pseudo-statesmen.

It must be noted that a panacea to this social disease consists not in total control but in considerate and well-balanced decisions by the governments of the affected countries. As an example, a required condition for any positive developments in the sphere of AML/CFT on the national level (particularly for countries of the former Soviet Union) is the implementation of the annual declaration for private persons while granting them possibilities for «zeroing» the declaration (under the condition of observing all the precautionary measures).
From 1990s until present a key role in ensuring the effectiveness of AML/CFT is played by the consortium of countries initially limited to the countries of the «Group of Seven». «Soft» pressure by this association of the leading countries of the world upon criminal hotbeds of money laundering and financing of terrorism has undergone substantial change in the past thirty years, which would be further disclosed in subsequent part of our study.

4.2.1. Evolution of international regimes on the example of FATF

Financial Action Task Force on Money Laundering (FATF) is an intergovernmental body with its primary objective in the development and implementation at the international level of measures and standards of counteraction to laundering of proceeds of crime and financing of terrorism. The organization was founded in 1989 on the initiative of the «Group of Seven (G7)» countries - USA, Great Britain, Canada, France, Italy, Germany and Japan with the participation of the European Economic Community (EEC). The first round of work by FATF was conducted with the participation of representatives from Sweden, the Netherlands, Belgium, Luxembourg, Switzerland, Austria, Spain and Australia. Hence, initially this international group (hereafter - the Group) comprised 15 states and the EEC which was represented by the European commission. According to the Single European Act (SEA) signed in 1986 the EEC was obligated to make provisions with regard to establishing a single market for free movement of goods, services, capital and persons (Single European Act, 1986, article 13). This way the fight against the cross-border capital laundering only indirectly fell within the scope of EEC mandate. Consequently, this mandate was de-facto expanded whereas the appropriate representation of the issue of cross-border criminal activity and cooperation in criminal matters was formulated not until the Maastricht Treaty (Treaty on the European Union, 7 February 1992) three years later and without any substantial authority granted to supranational bodies.

From the early stage of its operation, the Group displayed selectivity in attracting new member which asserted its «club» nature and similarity to the G7. For instance, Portugal, Ireland, Denmark and Greece were not invited to the development of 1990 FATF report while the corresponding invitation was issued to the countries which, at that time, were not the members of the EEC (Austria, Sweden, Switzerland). The causes of such selectivity lie within the economic perspective: back then the four abovementioned countries, which were not admitted to participation in the Group’s work, had the lowest level of GDP (in US dollars in comparison to other members. Therefore, in the initial stage of FATF evolution the selection criterion for the Group was merely economic-related while the issues under scrutiny were related to combating criminal activity.

Such approach proved to be inherently erroneous since the hotbeds of money laundering immediately relocated to those countries which, for economic reasons, were not eligible for membership in FATF. It was necessary to resolve the dilemma: whether to eventually achieve the maximum coverage of countries by the influence of the Group or to reconcile with the inefficiency of the measures taken by it. The third scenario was even more unfeasible - to isolate own economies from «unreliable» partners. It was owing to a non-formalized nature of this intergovernmental entity that the most efficient methods of resolving the pending issue were eventually chosen: firstly, relatively flexible criteria for membership were formulated; secondly, a network of regional groups was created by the example of FATF.

Formal criteria for membership were finalized only in 2008. They can be tentatively combined into two groups: fundamental (size of economy, influence upon the global economic system, acceptance of the principles of the Group and their observance) and technical (compliance with international AML/CFT standards and membership in the regional group).

Each member of FATF in fact took on supervision over its target region. The lead was given by Japan which held the meeting with the representatives of 45 states of the Asia-Pacific Region back in 1991, followed by the European Commission which held similar events with six post-socialist countries of the Eastern European region. Such practice gained wide circulation and yielded positive result: as of the early 2020 there exist 10 functioning regional groups by type of FATF, each of those incorporating on the average between 10 and 40 jurisdictions. The smallest by the number of member states is the Eurasian group on combating money laundering and financing of terrorism (EAG) consisting of 9 member states, the largest - the Asia/Pacific Group on Money Laundering (APG) consisting of 41 member states.

Apart from it, the members of the Group took a consolidated decision to invite international organizations as observers: United Nations Office on Drugs and Crime (UNODC); The International
Initially the documents adopted by FATF were solely recommendatory in nature and their significance was even artificially downplayed (as was the case of the Statement of Principles of the Basel Committee). 1990 FATF Recommendations were only formally approved by the member states and did not undergo ratification. None of the reports contains the signature of the official representatives of the states. In the course of time FATF Recommendations became virtually mandatory for those states which acceded to them. Voluntary annual reports, harmonized procedures and mechanisms of mutual assessment became a considerable «supporting» factor for existing standards of counteraction to money laundering and financing of terrorism. The II Report by FATF (the Session of 1990-1991) already asserted: the majority of member states implemented the recommendations within their national legal systems. Furthermore, the work towards bringing the legislation of the states in compliance with the Recommendations became the top priority for the Group.

Alongside the development of regulatory framework there occurs a formal documentary recording of the prohibition for financial institutions to keep anonymous bank accounts, the practice of bilateral and multilateral agreements for investigation of cases of laundering of proceeds from crime become widely spread while calls are becoming increasingly vocal with regard to expanding the scope of crimes that must be treated as predicate ones. Even though some of these requirements were recorded earlier - within the framework of UN conventions - their finalization occurred namely within FATF Recommendations.

The very activities of FATF demonstrate the merits of the concept of international regimes. In accordance with the classical understanding, the development of the latter does not necessitate a creation of a special international organization. FATF is not an international organization in its direct sense, it does not have the Statute and its secretariat belongs under the administration of the Organisation for Economic Co-operation and Development and is not formally independent. The status of the Group, from the legal standpoint, also remains undefined. For the first time the issue of the institutional structure of FATF came under consideration in the report of the Group as of 1990-1991. At that time the countries expressed their support for the organization to «continue to function as a free-standing ad hoc group [...] and should remain as flexible and informal as it is now» (Financial Action Task Force on Money Laundering Report, 1990-1991). Three years later, in 1994, the member states returned to this issue yet the decision remained unchanged. In the new FATF mandate for 2012-2020 (Financial Action Task Force Mandate, 2012-2020), which remains in force as of the time of the presented research, the Group is identified as an «intergovernmental body». It must be noted that this document, compared to the previous edition, contains the most detailed representation of objectives, tasks and institutional structure of this intergovernmental entity.

There arises an obvious question why the FATF mandate does not have an established unlimited duration by the example of the «Group of Seven», the «Group of Twenty», The Basel Committee on Banking Supervision and other institutions.

First and foremost, such situation may testify to a certain level of institutional inertia. For instance, from the very outset the work of the Group was restricted to one-year and five-year mandates. Transition to unlimited duration of activity would bear a symbolic significance since it will become an acknowledgment of the fact that the problems for which the group was conceived do not have an ultimate resolution. Secondly, the states might be concerned over a possible inefficiency of the group later on and in the condition of indefinite duration it will be simpler to prolong its activity than to create something entirely new. Thirdly, the willingness of the international community to preserve the Group’s nature as an expert «platform» is apparent. Granting it the permanent status would in essence make it equal to the «Group of Twenty», the competition with which would be impossible due to the narrow character of its subject field of activity.

The most likely scenario is the prolongation of FATF mandate starting from 2020 for a particular, undefined period which would create provision for acting as an informal, technical group authorized to develop global standards.

Hence, what are the actual benefits and preferences for the states that accept the rules established by FATF? For the regime of counteraction to such criminal manifestations an entire range of strategic games is inherent, in the likes of the «weakest link» based on the principle «the power
of the system is determined by how strong is the weakest of its actors». From these positions, the importance is not in certain dynamic benefits, but rather in achieving the observance of rules by all the countries around the globe, with no exception.

The most common are two forms of games according to the defined type. The first one - when the state, for reasons beyond its control, is unable to observe the established standards (Bodansky, 2012). In such case the instruments of technical influence come into action, as a rule, through regional groups created by analogy with FATF. The second one - when certain countries do not observe the standards intentionally, expecting to obtain particular benefits. In such cases sanctions and instruments of political influence are stipulated. Non-observance of standards and assumption of the role of the «weakest link» might be to a certain extent beneficial as it allows gaining access to the investments «rejected» from other jurisdictions and, at the same time, not to bear the costs associated with committing predicate crimes in country’s own territory. This form of strategic games constitutes a particular threat when money laundering has the objective of further financing of terrorism and weapons of mass destruction. In such case financial benefits are significantly less tangible than the threats to stability and peace both on the national and the global level as well as the economic sanctions.

It is exemplary how the fight against such «weakest links» is straightly determined as high-priority within the scope of the Australian session of FATF in 2014-2015. It was clearly stated that «the fight against jurisdictional arbitration is, in fact, the fundamental essence of FATF activity» (Objectives for FATF XXVI, 2014-2015).

All of the actors involved in the regime are additionally bound by numerous obligations that only indirectly concern the counteraction to the shadow economy. These should primarily be referred to through an international convention-related framework: the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988, the United Nations Convention against Transnational Organized Crime of 2000, the United Nations Convention against Corruption of 2003 (all ratified by corresponding Laws of Ukraine). Further to it, the states are bound by a number of agreements within the scope of the Organisation for Economic Co-operation and Development (OECD), the World Customs Organization (WCO), etc. These may be represented by free trade agreements, preferential trade agreements or regional trade agreement. At the time of WTO founding in 1995 a total of 47 such agreements were concluded with 57 notifications recorded. Presently the number of regional agreements increased to 301, notifications - to 480 (WTO comprises 164 countries). If the countries of the world, between which trade agreements exist, were to be connected with imaginary lines in the map (each with its rules, tariffs and institutional structure), it would resemble a «spaghetti bowl». As a metaphor the term was first used by Jagdish Bhagwati (1995) in his work «U.S. Trade Policy: The Infatuation with Free Trade Agreements». The author’s idea lies in the concept that the more trade agreements are concluded between the countries, the more complex and the less open the trade procedures become. Juxtaposing the metaphor by J. Bhagwati against the contemporary state of counteraction to the money laundering and financing of terrorism across the globe by means of such international regime as FATF with its multiple institutions, interlocking membership and radial-type connections, it is possible to define the concept rather as «spaghetti around the fork».

4.2.2. Risks of laundering of proceeds of crime and financing of terrorism on the national level: from identification to mitigation

Identification and assessment of risks related to laundering of proceeds of crime and financing of terrorism is an integral component of AML/CFT regime functioning on the national level, including both legislative and regulatory enforcement measures. The so-called risk-based approach is the centrepiece of FATF standards as declared in the Recommendation and its Interpretive Note.

FATF has developed an effective procedure of identification and assessment of risks in accordance with which the stage of «identification» is marked by the statement of threats and vulnerability to them (on the basis of Typology reports, statistical data from law enforcement authorities, Reports of supervisory authorities, etc.); at the stage of «analysis» the nature of threats, their source, likelihood and possible impact are defined; at the stage of «assessment» the classification of threat by the degree of exposure (Figure 1) is carried out with subsequent choice of a particular strategy for its mitigation and formulation of recommendations to the country in each specific case.

The results of research on ML/TF risks around the world allow FATF to utilize such instrument of «soft» pressure upon the countries with high risk of threat to AML/CFT as «blacklisting». They are published annually and focus attention on two groups of countries: 1) Jurisdictions under Increased Monitoring which have certain strategic deficiencies and fall within the scope of monitoring on the part of the Group; 2) High-Risk Jurisdictions subject to a Call for Action which must immediately apply comprehensive measures for improvement of the situation. As of 2020 the first group included Albania, The Bahamas, Barbados, Botswana, Cambodia, Ghana, Iceland, Jamaica, Mauritius, Mongolia, Myanmar, Nicaragua, Pakistan, Panama, Syria, Uganda, Yemen and Zimbabwe. The countries with highest degree of risk according to the FATF «black list» include DPRK and Iran.

The countries that consistently remain in the list of the first group over the past three years are Syria, Yemen and Pakistan. After the lengthy period of its stay in this group Iraq has left the list of «unreliable» countries since 2018. An objective nature of such assessment on the part of FATF is asserted by the rise in economic development according to a number of indicators with the consideration for long-standing armed conflict that persists in the area and the oncoming global economic downturn related to falling oil prices (Table 1). According to the recommendations of FATF Iraq has implemented all required procedures for identification and freezing of terrorist assets; measures are applied to ensure that financial institutions comply with the established requirements for reporting suspicious transactions; an adequate programme of supervision and control in the sphere of AML/CFT is implemented for all financial institutions. It must be noted that the very fact of removal of Iraq from under increased monitoring by FATF has proven to be a favourable factor for the development of economic potential of the country. And while long-term prospects hint specialists to forecast the economy of Iraq to reduce by 5% due to the collapse of oil prices and other global threats, including COVID-19 pandemics, the positive impact of «soft pressure» by FATF presently becomes evident.

Table 1:
Summary data on economic development of Iraq (2017-2019)

<table>
<thead>
<tr>
<th>Economic development criterion</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 GDP (PPP)</td>
<td>0.66</td>
<td>1.86</td>
<td>5.25</td>
</tr>
<tr>
<td>2 Current account balance, USD trillion</td>
<td>3.50</td>
<td>15.5</td>
<td>*</td>
</tr>
<tr>
<td>3 Commitments by Fiscal Year (USD million)</td>
<td>1.489</td>
<td>1.110</td>
<td>200</td>
</tr>
<tr>
<td>4 HDI (Human Development Index)</td>
<td>0.68</td>
<td>0.69</td>
<td>0.68</td>
</tr>
<tr>
<td>5 Corruption Perceptions Index</td>
<td>18</td>
<td>18</td>
<td>20</td>
</tr>
</tbody>
</table>

Note: * - no data.

Source: Compiled by the authors based on data as follows:
Points 1, 2, 4 - IMF: World Economic Outlook (WEO) (2019, October)
Point 5: Corruption Perceptions Index by Transparency International, 2019

An opposing situation is displayed by Pakistan that consistently remains under the monitoring of the Group however does not demonstrate positive dynamics in the sphere of AML/CFT. Over the past three years the country’s total public debt (as % of GDP) increased from 67.00 to 71.70, accompanied by low HDI indicator (0.56) and high unemployment rate (6-6.2), negligible growth of GDP (PPP) (from USD 1057.71 billion to USD 1201.63 billion), a deterioration in current account balance. Though Pakistan current account balance fluctuated substantially in recent years, it tended to decrease through 2000-2019 ending at USD -13.1 billion in 2019.

Another effective tool of pressure on the countries with high ML/TF risk level is the Basel Index of counteraction to laundering (legalization) of proceeds of crime and financing of terrorism (the Basel Anti-Money Laundering (AML) Index). It represents a list of countries ranked in relation to the degree of threats and risks in the sphere of AML/CFT. First study with the purpose of developing the corresponding index was held in 2012. The methodology included 14 indicators (divided into five groups) that reflect diverse aspects of AML/CFT system operation (Table 2).

In 2019 index a total of 125 countries are represented. The range of risk varies from 0 (lowest level of risk) to 10 (highest level of risk).

Analyzing the Top 10 countries with the highest ML/TF risk (Table 3) it can be deduced that these countries are not financial centres or suppliers of financial services of any kind. A part of them is situated in Africa to the south of the Sahara - one of the poorest areas in the world, others - in the territories of Asia and Middle East which are the hotbeds of long-standing military conflicts.

Analysis of the indicators according to the Basel Index does not provide reasons for optimism. The majority of countries demonstrate an inconsiderable positive dynamics compared to the previous year however major positive changes have not occurred for as long as the past eight years (since the first such ranking was realized). Most of the countries have been slow to strengthen...

Table 2:
AML/CFT index indicators by Basel Institute on Governance

<table>
<thead>
<tr>
<th>Groups</th>
<th>Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td>AML/CFT risks (65%)</td>
<td>FATF Recommendations (30%)</td>
</tr>
<tr>
<td></td>
<td>Financial Secrecy Index (25%)</td>
</tr>
<tr>
<td></td>
<td>International Narcotics Control Strategy Report (10%)</td>
</tr>
<tr>
<td>Corruption risks (10%)</td>
<td>Corruption perception at the state level (10%)</td>
</tr>
<tr>
<td>Transparency of financial sector (15%)</td>
<td>Corporate Transparency Index (1.88%)</td>
</tr>
<tr>
<td></td>
<td>Regulation of securities exchanges (5.63%)</td>
</tr>
<tr>
<td></td>
<td>Financial sector regulations (1.88%)</td>
</tr>
<tr>
<td>Public transparency and accountability (5%)</td>
<td>Political Finance Database (1.67%)</td>
</tr>
<tr>
<td></td>
<td>Budget transparency score (1.67%)</td>
</tr>
<tr>
<td></td>
<td>Transparency, accountability and correlation (1.67%)</td>
</tr>
<tr>
<td>Political and legal risks (5%)</td>
<td>Freedom of press and Freedom in the World (1.67%)</td>
</tr>
<tr>
<td></td>
<td>Institutional strength (1.67%)</td>
</tr>
<tr>
<td></td>
<td>Rule of law (1.67%)</td>
</tr>
</tbody>
</table>

Source: Compiled by the authors based on data of Basel AML Index 2019: https://www.baselgovernance.org/sites/default/files/2019-08/Basel%20AML%20Index%202019.pdf

Table 3:
Countries with highest and lowest degrees of threats and risks in AML/CFT (according to Basel index - 2019)

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Countries with the highest risk level</th>
<th>Score</th>
<th>Change 2018/19</th>
<th>Ranking</th>
<th>Countries with the lowest risk level</th>
<th>Score</th>
<th>Change 2018/19</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>MOZAMBIQUE</td>
<td>8.22</td>
<td>-0.06</td>
<td>125</td>
<td>ESTONIA*</td>
<td>2.68</td>
<td>-0.05</td>
</tr>
<tr>
<td>2</td>
<td>LAOS</td>
<td>8.21</td>
<td>-0.04</td>
<td>124</td>
<td>FINLAND*</td>
<td>3.17</td>
<td>0</td>
</tr>
<tr>
<td>3</td>
<td>MYANMAR*</td>
<td>7.93</td>
<td>0.43</td>
<td>123</td>
<td>NEW ZEALAND</td>
<td>3.18</td>
<td>-0.02</td>
</tr>
<tr>
<td>4</td>
<td>AFGHANISTAN</td>
<td>7.76</td>
<td>-0.52</td>
<td>122</td>
<td>MACEDONIA</td>
<td>3.22</td>
<td>0.11</td>
</tr>
<tr>
<td>5</td>
<td>LIBERIA</td>
<td>7.35</td>
<td>-0.07</td>
<td>121</td>
<td>SWEDEN*</td>
<td>3.51</td>
<td>-0.24</td>
</tr>
<tr>
<td>6</td>
<td>HAITI</td>
<td>7.34</td>
<td>-0.01</td>
<td>120</td>
<td>BULGARIA</td>
<td>3.51</td>
<td>-0.02</td>
</tr>
<tr>
<td>7</td>
<td>KENYA</td>
<td>7.33</td>
<td>-0.07</td>
<td>119</td>
<td>LITHUANIA*</td>
<td>3.55</td>
<td>0.43</td>
</tr>
<tr>
<td>8</td>
<td>VIETNAM*</td>
<td>7.30</td>
<td>-0.07</td>
<td>118</td>
<td>URUGUAY</td>
<td>3.58</td>
<td>-0.47</td>
</tr>
<tr>
<td>9</td>
<td>BENIN</td>
<td>7.27</td>
<td>0.02</td>
<td>117</td>
<td>SLOVENIA*</td>
<td>3.70</td>
<td>-0.05</td>
</tr>
<tr>
<td>10</td>
<td>SIERRA LEONE</td>
<td>7.20</td>
<td>-0.04</td>
<td>116</td>
<td>ISRAEL*</td>
<td>3.76</td>
<td>-0.08</td>
</tr>
</tbody>
</table>

Note: * - countries assessed with the fourth-round FATF methodology.

Source: Compiled by the authors based on data of Basel AML Index 2019: https://www.baselgovernance.org/basel-aml-index
their sustainability in AML/CFT. Only 27% of the countries (34 out of 125) have improved their scores by more than 0.1 points. The worst dynamics can be observed in Colombia, Latvia, Finland and China which was discovered in the course of FATF fourth-round evaluations. The vast majority of countries (60%), 74 altogether, have a risk score of 5 or more which testifies to its significant level. In comparison with 2018 the mean average level of risk has demonstrated a marginal change - 5.39 (2019) from 5.63 (2018).

Among the three best and the three worst performing countries according to the Basel Index two countries displayed the most drastic downturn in scores within their groups over the past year: Mozambique (0.43) and Finland (0.6).

According to the FATF report, Finland reached 45% - by the performance score in relation to effectiveness and 66% - in technical compliance. The country is afflicted by the risks associated to the grey economy. These risks are addressed with a set of well-coordinated measures. Simultaneously, geographical proximity to Russia and post-Soviet Baltic States allows maintaining trade routes with illicit flows of goods and funds. The FATF report emphasizes the limited ability of competent authorities to execute timely and effective control over the activities of legal persons. In March 2019 the National Bureau of Investigation of Finland revealed it recorded dozens of cases of money laundering and hundreds of bank accounts all over the country related to illegal schemes with neighbouring countries. This once again asserts that even the countries with strong AML/CFT frameworks and institutions are not immune to money laundering risks.

Mozambique’s overall risk score is 8.22 out of 10 possible. The problematic situation with AML/CFT in this territory may be attributed to poor border control, weak government institutions and law enforcement system otherwise aimed at efficiently targeting cross-border crimes related to drugs and human trafficking. Mozambique has rampant corruption which serves as a fertile ground for cash smuggling, illicit trade in precious metals. According to the Organized Crime and Corruption Reporting Project (OCCRP), back in 2013 the former finance Minister Manuel Chang «approved USD 2 billion of government loans for funding of illegal maritime projects, while an estimated 10 percent was diverted into bribes and «kickbacks». Mozambique defaulted on the loans and since 2017 the country plunged into a financial crisis with debt soaring to 112% of GDP.

Experience of the countries which demonstrated the greatest improvements according to the Basel Index - Tajikistan (from 8.30 to 6.28), Cambodia (from 7.48 to 6.63), Egypt (from 5.35 to 4.55), Indonesia (from 5.73 to 5.13) and Portugal (from 5.73 to 5.13) - testifies to the fact that successful performance in AML/CFT is to a great extent associated with two major factors: efficiently combating corruption and being dropped from the US INCSR list of major money laundering countries.

In this way, the instrument of «soft law» developed within the scope of AML/CFT regime is an effective tool of pressure on countries which serve as hotbeds for laundering of proceeds of crime and financing of terrorism.

4.2.3. Improving the mechanisms of counteraction to ML/TF: Ukraine’s experience

Based on the data of the Basel AML Index (2019), Ukraine occupies the 37th position in the Index (for comparison, the closest indicator belongs to Estonia staying in the 125th position) with the score of 6.01 which shows 0.05 improvement over 2018 indicator. Which legislative initiatives, institutional changes or prospects for improvements underlie these figures? Does Ukraine presently display positive dynamics in the sphere of AML/CFT? To respond to these questions, it is imperative to conduct a comprehensive analysis according to a minimum of three indicators: 1) legal framework; 2) institutional innovations; 3) transformation in social consciousness.

Mass Destruction» (last edited on 04.28.2020) on October 14th, 2014. This legislation comprises considerable improvements to the procedure of financial monitoring and implements compliance with the standards of financial monitoring according to the latest global and European norms, in particular the FATF recommendations, norms of the 4th Directive (EU) 2015/849 «On the prevention of the use of the financial system for the purposes of money laundering or terrorist financing» as well as the Regulation (EU) 2015/847 «On information accompanying transfers of funds». An important requisite consists in modifying the terminological inconsistency of the term «legalization» used in the scope of the Law which, in the current context, is unacceptable for correct English language adaptation and practice. Legalization of assets is, in essence, the acceptance of the fact that an individual is the rightful owner of such assets. This terminological conundrum presently complicates the engagement of international institutions and implementation of legislative initiatives in combating ML/TF in Ukraine.

Institutional as well as legislative improvements over the past 20 years in Ukraine are sufficiently tangible (Table 4).

The primary objective of Ukraine at the current stage is to create conditions under which tax control and financial monitoring would become more rigorous, the risk of punishment - more perceived and the punishment itself by its scope would significantly exceed the gains obtained from tax evasion and laundering of proceeds of crime.

Simultaneously, one must not overlook the third indicator of the analysis of ML/TF efficiency - transformation of social consciousness which stipulates the formation of such way of thinking in every citizen when the national welfare is perceived as a keystone to individual welfare and vice versa; growth in the level of legal awareness and, most importantly, the increase in the anti-criminalogenic capacity of the general public in the sphere of prevention and counteraction to criminal activity. Positive dynamics according to this indicator depends on the productive (not formal) unification of efforts by educational workers, law enforcement representatives, scientific elite and, undoubtedly, the political will of the government officials.

### Table 4:

**Dynamics of legislative and institutional changes related to AML/CFT in Ukraine (2000-2020)**

<table>
<thead>
<tr>
<th>Time frame</th>
<th>Measures implemented</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-2001</td>
<td>Implementation of European rules of law is carried out: establishment of criminal liability for laundering of proceeds of crime; incorporation into the Law of Ukraine «On Financial Services and State Regulation of Financial Services Markets» and the Law of Ukraine «On Banks and Banking Activity» of specific sections concerned with the prevention of the use of financial system with the purposes of legalization of proceeds.</td>
</tr>
<tr>
<td>September 2001</td>
<td>At the plenary meeting of FATF the measures taken by Ukraine are recognized as insufficient. Ukraine is included into the «black lists» of countries which are not engaged in the cooperation in the sphere of AML/CFT.</td>
</tr>
<tr>
<td>December 2001</td>
<td>By the Decree of the President of Ukraine «On Measures for Prevention and Counteraction to Legalization (Laundering) of Crime Proceeds» as of 10.12.2001 No1199 the Cabinet of Ministers of Ukraine created within the administration of the Ministry of Finance of Ukraine the State Department of Financial Monitoring with the statute of the body of the state administration and the adoption of the corresponding provision.</td>
</tr>
<tr>
<td>January-June 2003</td>
<td>Changes are introduced to the Laws of Ukraine «On Banks and Banking Activity» and «On Financial Services and State Regulation of Financial Services Markets» in terms of establishment of requirements with regard to rules and programmes of internal financial monitoring of banks and other financial institutions as well as the prohibition for financial institutions to keep anonymous (numbered) bank accounts. The Code of Ukraine on Administrative Offences has been complemented by the new article 166-9 that established administrative liability for violation of the legislation on prevention and counteraction to legalization of crime proceeds. The Criminal Code of Ukraine was complemented by the article 209-1 which criminalized the deliberate failure, untimely submission or submission of false information on suspicious financial transactions as well as disclosure of information about such transactions.</td>
</tr>
<tr>
<td>2004</td>
<td>Upon the implementation of FATF recommendations Ukraine was excluded from the «black list», however the procedure of active monitoring with regard to the introduction of special legislative acts was prolonged for an additional year.</td>
</tr>
<tr>
<td>2006</td>
<td>FATF takes decision to terminate the procedure of active monitoring related to the state of affairs with AML/CFT in Ukraine in connection with the implementation of the Group’s recommendations.</td>
</tr>
<tr>
<td>2010-2011</td>
<td>Ukraine adopts a range of legislative acts which enables FATF to acknowledge substantial progress achieved in the improvement of AML/CFT regime.</td>
</tr>
<tr>
<td>2013</td>
<td>The State Financial Monitoring Service of Ukraine develops 23 acts aimed at the improvement of activities on AML/CFT.</td>
</tr>
<tr>
<td>January 2016</td>
<td>The Cabinet of Ministers of Ukraine approves the Strategy of Prevention and Counteraction to ML/TF. The objective of this document is the legislative, institutional improvement of the national AML/CFT system.</td>
</tr>
</tbody>
</table>

Source: Compiled by the authors using official legal sources and study by Bysaga (2016): http://pa.stateandregions.zp.ua/archive/1_2016/9.pdf
The national policy in the sphere of AML/CFT at the current state of development must ensure a balanced combination of the leverage tools of the «soft law», authoritarian to democratic management style and pragmatically legal approach to resolving the existing issues both on the legislative level and in practical terms.

5. Conclusions

Analysis of evolution of the global regime in the sphere of counteraction to legalization (laundering) of proceeds of crime and financing of terrorism on the example of FATF allows making the following conclusions:

Globalization of economy and social transformations on the international level associated with it, despite its multiple positive effects in the short term, became a disruptive factor for numerous national economies in the long term. Universalization of trade regimes and cross-border capital flows did not result in the creation of common planet-wide economic space. Global economy represents a polycentric structure within which the development of states and their associations occurs in a non-uniform pattern. The majority of population of the developing countries is forced to live in the conditions of closed economy separated from the process of intensification of international economic relations. A technology gap between elements of this structure becomes increasingly noticeable. In developed countries the fourth and the fifth techno-economic paradigms are prevalent, in middle-level developed countries the third and the fourth techno-economic paradigms are predominant while global periphery countries still employ pre-industrial technologies. Such dissimilarity and asymmetric pattern of connections serve as a favourable factor for proliferation of economic crimes, particularly in the sphere of ML/TF.

International regimes are at their core based upon the «soft law» which considerably facilitates reaching compromise between countries different in their economic and political «weight». The AML/CFT regime is built around the membership in a particular informal institution which incorporates a two-tier system of control. A crucial role in it is played by the club of the most developed countries, the majority of which are some kind of «supervisors» in their regions. Within regional groups, created in the image and likeness of FATF, the leadership belongs to those members of the Group that direct their counteractors on their way to observe the established rules. Small-sized and underdeveloped countries have only negligible or no impact at all on the activities of the Group. Employing the metaphor by J. Bhagwati with regard to the current state of counteraction to money laundering and financing of terrorism in the world, we may characterize this international regime (one of the instruments of which is FATF with its multiple institutions, interfacing membership and radial-type connections) as «spaghetti around the fork».

Evolution of the regime of counteraction to laundering of proceeds of crime and financing of terrorism demonstrates a growing role of intersubjectivity of perception in relation to particular phenomena. There is a growing conviction that some individual countries possess more «leverage» with regard to forming general standards than other countries despite them representing numerical majority. FATF gradually transforms from a ramified technocratic quasi-institution into a «centre» which accumulates and ensures further development of AML/CFT ideology.

The sphere of FATF activity is becoming conceptualized through the conflict between the role of the law in the jurisdiction and social processes that impact this sphere. The conflict is deepening due to a complete subjection of the majority of jurisdictions to a limited group of «major players» and deficit of democracy in the process of governing relations between the states. Hence the loss of unity and absence of agreement on many important issues. Further to it, FATF recommendations as tools of «soft» pressure on the state do not consider multiple jurisdictional subtleties. Consequently, operating procedures recommended by this intergovernmental body do not always conform to the course of development of national legislation thus being unsuitable for implementation. When in the cases of money laundering and financing of terrorism jurisdiction take, for various reasons, the position of the «weakest link» the entire system loses its power. Effectiveness of regulatory and legal framework related to AML/CFT stems from the result of constant compromise between what the members of such «quasi-institutional body of intergovernmental influence» as FATF obtain and what they lose.

Growing terrorism and extremism threat around the globe forces AML/CFT system to be tougher and more well-structured. While preserving the exterior «softness» of the law, which lies in the foundation of the regime, there occurs its de-facto «solidification» and legitimization as legal tools. Namely this allows FATF to remain efficient as a global developer of standards.
On the other part, loosening of its democratic foundations and hegemonial subjection may subsequently cause the collapse of the system. Closed, «club» nature of FATF is detrimental to a global cause while excessive expansion of the circle of members levels down the convergence of accordance. Hence, the success of the entire AML/CFT regime depends heavily on finding a reasonable balance between strict institutionalization and democratization of cooperation between states in the coming decade.

References


Received 18.12.2019
Received in revised form 11.01.2020
Accepted 26.01.2020
Available online 10.02.2020
Updated version of the paper as of 29.04.2020