EXPLAINING INTERNATIONAL ORGANIZATIONS

How International Organizations Rule the World: The Case of the Financial Action Task Force on Money Laundering

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For some time, students of global governance have been interested in how international organizations make global rules. While the focus has been on rules that are formally binding, international organizations frequently resort to nonbinding rules, termed "soft law," "best practice," or "standards." In the following, we argue that to understand how the Financial Action Task Force on Money Laundering (FATF) has become an influential global regulator, it is best understood as a standard-setting organization. To do so, we use a framework from organization studies. This framework highlights the fact that FATF makes a considerable effort to endow its rules with legitimacy in order to foster voluntary compliance. At the same time, we suggest how the organization theory approach needs to be modified to explain direct coercion by this standard setter. To the extent our argument is convincing, it implies a dialogue between the fields of organization studies and the study of international organizations can be useful.

Introduction

While it has been long-considered a paradise for money laundering, Myanmar is no longer such a place. In October 2006, the Financial Action Task Force on Money Laundering (FATF), the international regulator in that field, removed Myanmar from its blacklist. Since Myanmar had been the last of twenty-three countries on the list, FATF declared the blacklist a success and abandoned it. This episode seems to capture, in a nutshell, the importance of power for global rule-making in the field of money laundering. FATF uses naming and shaming as a "stick" to pressure disobedient states into compliance (Clunan, 2006, p. 580). Furthermore, since the U.S. nudged FATF into blacklisting, it is also an indicator of the continued importance of state power in global governance.

However, a close look reveals the evidence of the case of global Anti-Money Laundering (AML) regulation is more ambiguous. Undeniably, the use of relational power, in which one actor manages to impose its will on another, is an important aspect of global AML. Yet, it is equally difficult to deny FATF also used noncoercive means to make others comply with its rules. After

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all, FATF rules do not consist of coercive regulation but of voluntary "recommendations." These open recommendations are subsequently specified and implemented within an open benchmarking process involving states in specific regions of the world. Therefore, FATF can be equally seen as being part of a broader shift in global regulation from coercive public international law to global standards (Cutler, Haufler and Porter, 1999; Brunsson and Jacobsson, 2000; Kirton and Trebilcock, 2004; Clark and Tickell, 2005, Peters et al., 2009).

How can these two contradictory perspectives be reconciled? How can FATF be a coercive as well as voluntarist rule maker? To date, most contributions have resolved this contradiction by emphasizing one perspective over the other. While some treated FATF as a coercive rule setter (Drezner, 2005), others emphasized the voluntary nature of many of FATF's activities (Hülsse, 2008; Jakobi, 2010). Emphasizing one side of the activities at the expense of the other leads to a partial understanding of how this organization works as a rule setter. In order to come to a more encompassing understanding, we suggest seeing FATF as an international standard setter. To do so, we are going to adopt a framework taken from organizational sociology. First of all, this perspective suggests standard setters are not just instruments of their members but, at least to some degree, autonomous organizations. What is more, this approach allows taking the voluntary nature of standard setting seriously while allowing for coercion as well. Standards work as voluntary rules if standard setters base their standards on credible expertise and to the extent they allow for participation of users in the standard setting process. At the same time, such voluntary standards are often enforced by other actors, for example certification agencies or states. The overall effect of this decentralized enforcement is it becomes hard to attribute the effects of standards to the standard setter (Kerwer, 2005). As a consequence, standard setters become "hidden powers."[2] The approach, therefore, does not only allow reconciling the voluntary as well as the compulsory nature of standard setting but also shows why it is important to do so: to understand the peculiar way in which standard setters function as global authorities.

In the following, we show that to understand how FATF has become an influential global regulator, it is best understood as a standard-setting organization in the sense of organization theory.[3] Not only do FATF's standards as well as implementation procedures lack any binding effect, what is more, FATF is a rule maker that confirms the basic hypothesis of organization theory on how standard setting works. FATF makes a considerable effort to endow its rules with legitimacy in order to foster voluntary compliance. However, the organization theory approach in its present view has a more limited view of coercion in standard setting than we find in our case. While the approach acknowledges the importance of ex-post enforcement of standards by other actors, it has difficulties coming to terms with the fact that FATF itself resorts to coercion in the form of a blacklist. We suggest how the organization theory approach can be modified to explain direct coercion by a standard setter.

Our argument implies a dialogue between the fields of organization studies and the field of international relations can be very useful. On the one hand, imports from organization studies can be useful for an analysis of global politics, and on the other hand, students of

2. The term "hidden power" was suggested to one of the authors by Klaus Schlichte to capture the peculiar way in which standard setters exert influence.

3. Our case study is based on the analysis of the scholarly literature, official documents, and fourteen interviews conducted by Rainer Hülsse in France, Belgium, the Netherlands, Germany, and Switzerland in 2003. Interviewees came from the FATF secretariate, the EU, from national ministries and government agencies, as well as from NGOs and the private sector.

global politics have interesting insights to offer for organization scholars (see Dingwerth, Kerwer, and Nölke, 2009).

The argument will proceed as follows. In section two, we give an overview of FATF's activities showing this organization has a voluntary and a coercive dimension. In section three, we introduce the organization theory perspective on standard setting and develop its major hypotheses on how standard setters can become influential rule makers. In section four, we focus on the hitherto neglected voluntary dimension of standard setting. In section five, we analyze the coercive dimension of FATF and suggest how the organization theory approach to standard setting needs to be modified in order to come to terms with it. We conclude with a summary of the argument and a discussion of what our case study contributes to an advancement of the organization theory approach and to an analysis of global governance.

Anti-Money Laundering Rules

Money laundering, i.e., the activity of disguising the illegal origin of money, is an old practice, yet it was not considered much of a problem until the 1980s, when the U.S. criminalized money laundering in the context of its "war on drugs." Aware of the problem's international dimension, the U.S. together with its G-7 partners started the fight against money laundering. Together, in 1989, they created FATF, the organization that was to coordinate their efforts. Officially only a task force, FATF is an intergovernmental organization with a small secretariate based in Paris. Its membership was initially very exclusive—restricted to the G-7 countries plus other Organisation for Economic Co-operation and Development (OECD) members. The organization's club character (Drezner, 2007, p. 122, p. 142) enabled FATF members to quickly agree on a set of common standards, the "Forty Recommendations," which were intended as a nonbinding benchmark for national AML legislation. Following the terrorist attacks of 11 September 2001, members decided to add "Eight Special Recommendations on Terrorist Finance" (later extended to nine) (Zagaris, 2004; Clunan, 2006; Shehu, 2005). Though money laundering and the finance of terrorism are two rather distinct activities, linking them has given an enormous boost to AML (Winer and Roule, 2002).

Presently, the "40+9 Recommendations" are widely accepted as *the* international standards against money laundering and the finance of terrorism (Drezner, 2007, p. 145; Kern, 2001; Heng and McDonagh 2008). Two basic strategies can be identified. In order to promote its nonbinding recommendations, FATF sought to persuade as many states as possible that money laundering is in fact a grave problem, and FATF had good solutions to offer. In the early years of its existence, FATF addressed mostly its own members (Drezner, 2005, p. 851). For the most part, its member states rapidly and voluntarily adopted the recommendations.[4] In the mid-1990s, FATF shifted its attention to nonmembers to prevent dirty money from flowing to less-regulated countries (Drezner, 2005, p. 851). After all, free-riding countries were a severe threat to the regime's overall effectiveness (Clunan, 2006). Again, it was fairly successful. By the end of the 1990s, many non-FATF members had voluntarily adopted the forty recommendations (Heng and McDonagh, 2008, p. 565; Shehu, 2005, p. 233).

4. However, the latest round of mutual evaluations indicates in recent years the compliance of FATF members has decreased (see Johnson, 2008).

International Organizations as Standard Setters

Although a large number of international organizations have started ruling the world through standards, their importance is seldom acknowledged. The reason is a lack of understanding of why international organizations find soft rules attractive and how they should become effective. Many scholars in the field of international relations (IR) have so far adopted a biased perspective on global rules in two respects: First, they have been preoccupied with compulsory rules. To date, they have regarded global rules as international law backed up by material sanctions, or as norms backed up by moral obligations (Raustiala and Slaughter, 2002; Checkel, 2001; Abbott et al., 2000). Both perspectives share the view that states only follow global rules if sanctions loom. Nevertheless, standards have not been neglected entirely. In IR, standardization conflicts are usually conceptualized as a coordination game, in which participant states have an interest in finding a common standard but have different preferences about its shape. In such a setting, powerful states can set a focal point around which other states then voluntarily converge (Drezner, 2007). Second, IR scholars have been preoccupied with the question of rulefollowing, i.e*.,* the demand side of governance. Compliance research asks why states care to follow global rules (Simmons and Martin, 2002). The implicit assumption is global rules have already assumed a certain degree of importance. But this assumption is not plausible for voluntary rules, since they can be more easily ignored. Thus, while mainstream IR scholarship undeniably has contributed to our understanding of global rule-making, it has little to say on how global governance based on standards actually works.

In order to deal with international organizations that act as standard setters, it is useful to draw on an approach to standard setting from the sociology of organizations (Ahrne and Brunsson, 2004; Brunsson, 1999; Brunsson and Jacobsson, 2000; Djelic and Sahlin-Andersson, 2006; Mörth, 2004; Hallström, 2004; Hülsse & Kerwer 2007). According to this approach, standard setting cannot be reduced to technical issues but is conceived of as a universal form of rule-making in its own right. Standards in this sense are an important alternative to regulation by coercive law. This conceptualization is justified by the numerous examples of standards in most issue areas of international politics ranging from the environment to finance and to security. The empirical reality raises an important question: How do international organizations as standard setters become so prominent? How do they work? According to a sociological perspective, international organizations rule the world to the extent they acquire rule-making authority (Barnett and Finnemore, 2004). The same is true for standard-setting organizations. Standards are based on expertise, they "give advice to many" (Brunsson, 1999) and "many" do in fact see them as "expert knowledge stored in the form of rules" (Jacobsson, 2000, p. 41). Hence, the standards' legitimacy is due to the fact they are made by people "who are presumed to know more than the rest of us" (Jacobsson, 2000, p. 41). Moreover, rule takers accept the standards for practical reasons: The standards give sound practical advice and, thus, reduce users' search costs (Hallström, 2004). Rather than searching for a custom-made solution to a problem, users may rely on the standards as guides in problem solving. Thus, standard setters need to base their standards on credible expertise to make them legitimate.

While all standard setters draw on expertise, some face additional challenges. Comparing two cases of standard-setting, the International Organization for Standardization (ISO) and the

International Accountancy Standards Committee (IASC), Kristina Hallström found standard setters sometimes cannot rely exclusively on expertise but need to resort to additional promotion strategies. While both the ISO and the IASC heavily rely on the expertise behind their standards, the IASC additionally emphasizes its standards are the result of a participatory process. This difference is explained to be an effect of the different environments in which the standard setters operate (Hallström, 2004). While organizations operating in technical environments can legitimize themselves by their output only, institutionalized environments consist of norms organizations also need to conform to (Powell and Di Maggio, 1991). IASC is an example of a standard setter entering a field with a well established tradition of rule making by different actors. One of the prime norms governing rule making in the field of accounting standard setting is that interested parties have a right to participate in some way. And this is why IASC is more inclusive than ISO. To the extent standard setters are confronted with the frequent norm of participation, they will find themselves in a contradictory situation (Hallström, 2004). On the one hand, they have to increase user participation; on the other hand, they have to safeguard the quality of their standards by incorporating expertise. For example, IASC needed to decide whether least-developed countries should have a say in standard setting although they did not have relevant experts in the field. Including them would have enhanced the organization's legitimacy through inclusion but at the cost of likely damage to the integrity of the expertise. Standard setters facing this contradiction need to find ways to manage it without ever resolving it completely.

To sum up, international organizations are likely to be successful standard setters if the following preconditions hold: First and foremost, standards need to be based on credible expertise to motivate rule-following. Second, standard-setters must adhere to established norms in their environment. For international standard organizations an important precondition for success will almost always imply adhering to the norm of democracy by allowing for some form of participation of rule addressees.

Both explanatory hypotheses underline the fact that from an organization theory perspective, standard setting is about rule making which is nonbinding. However, it would be wrong to conclude it is impossible to deal with coercion within this approach. On the contrary, organization theory scholars have pointed to the fact that standards can be enforced in numerous ways. For example, standards can be enforced by the fact many other relevant actors use them, by certification, ranking and rating organizations making public to what extent a certain standard is followed, or by international organizations making standards compulsory for its members (Kerwer, 2005, p. 618). Yet, the approach would predict this type of coercion is strictly limited to enforcement by "third parties," i.e., to actors outside the standard setter–user relationship. If standard setters themselves would resort to force, they would undermine their claim that their rules should be followed, because they are a guide to effective problem solving. In the following, we will show the organization theory approach can predict the rule-making strategies of FATF, which behaves very much like a voluntarist rule maker. However, as the subsequent section will show, the organization theory approach does not anticipate direct enforcement by the standard setter itself, as in the case of the blacklist.

Anti-Money Laundering Rules as Global Standards

In this section, we use the above theoretical framework to examine the case of AML regulation. There is considerable evidence that FATF works as predicted by organization theory. We begin with an analysis of the role of expertise in AML's regime before we deal with the role of participation.

Expertise

AML's regime in general and FATF in particular have often been described as a transnational expert network (Helleiner, 2002, pp. 186–88; Sharman, 2007, pp. 32–3; Winer, 2002, p. 43; Reinicke, 1998, p. 161; Biersteker, Eckert, and Romaniuk, 2008, p. 240). The experts are mostly government officials from national finance ministries, from law enforcement authorities, and from financial supervisory and regulatory agencies (Simmons, 2000, p. 255; Winer, 2002, p. 44). As the regime became more transnational over time, civil servants from participating international organizations also became involved in this expert network. Due to these experts' shared world views and values, they quickly agreed on a common approach for fighting money laundering (Helleiner, 2002, p. 188). The expert network produced standards that states considered "neutral, and its judgments, initially confidential, were recognized to be fair" (Winer, 2002, p. 44). Hence, FATF recommendations were perceived to be legitimate precisely because they were written by neutral experts with superior knowledge of the problem. Arguably, this may have been of particular importance for non-FATF members. Presumably, these countries find it easier to comply with rules of a club organization like FATF, if they are convinced the rules are made by experts and, thus, provide solutions that are advantageous to all countries.

A closer look at the various institutions and instruments of FATF reveals it actively seeks to "expertise" its work. FATF's plenary meetings, where representatives of member states discuss standard-setting projects, revise old standards and adopt new standards, are not, as one would expect, a political forum but rather a gathering of experts. With respect to its very first plenary, FATF points out "more than one hundred and thirty experts from various ministries, law enforcement authorities, and bank supervisory and regulatory agencies, met and worked together" (FATF Annual Report, 1989–90, p. 3). Similarly, every annual report since has characterized FATF's plenary sessions as expert meetings. FATF's typology meetings are also presented as "experts' meetings" (FATF Annual Report, 1998–99, p. 6), as a "forum for law enforcement and regulatory experts" (FATF Annual Report, 1998–99, p. 48) to discuss recent trends in money laundering methods and possible countermeasures. Hence, FATF leaves little doubt its most important meetings are dominated by experts.

In order to ensure compliance with AML standards, FATF members conduct *mutual* evaluations of their respective progress (Sansonetti, 2000; Levi and Gilmore, 2002). These mutual evaluations are clearly expert ground (Gardner, 2007, p. 33). Evaluation teams consist of "three or four selected experts, drawn from legal, financial and law enforcement fields of other members" (FATF Annual Report, 1998–99, p. 9). The job is done by experts because they are seen as a guarantee for objective monitoring: "The purpose of this exercise is to provide a comprehensive and *objective* assessment of the extent to which the country in question has moved forward in

implementing effective measures to counter-money laundering (FATF Annual Report, 1998–99, p. 9, emphasis added). As a result, the mutual evaluation mechanism "holds out the promise of greater legitimation and 'buys in' potential that measures that are simply imposed" (Levi and Gilmore, 2002, p. 95).[5] All three institutions have a signaling effect to the non-FATF world: FATF is an organization where objective facts trump political considerations, the reason why every country can expect to be treated in a fair manner.

As mentioned above, FATF in 2000 drew up a blacklist of money laundering havens and, thereby, relied on coercive means to secure compliance. Interestingly, expertise played a pivotal role even here: "Throughout the NCCT process, the FATF has sought to ensure its openness, fairness, and objectivity" (FATF Annual Report, 2003–04, p. 10). Indeed, FATF took great care in designing the process in a way that would help countering criticism, making it look objective and fair. Experts developed the evaluation criteria, expert assessment of a country's compliance record was a prerequisite for the decision to put it on the blacklist, and representatives of countries under examination were invited to "meet with FATF *experts* in a face-to-face meeting to discuss any unresolved questions" (FATF Annual Report, 2003–04, p. 10; emphasis added). The whole process was geared toward setting up a blacklist that is not arbitrary but represents an objective assessment by neutral experts. Thus, legitimacy was considered important even in what looks like simple power politics. FATF did not simply impose coercive measures upon uncooperative countries but tried to endow these measures with legitimacy.

Practitioners in the field of money laundering confirm the importance of expertise. Many of the national officials, international bureaucrats, and private sector representatives we interviewed emphasized the importance of practical knowledge in AML's field, the technical character of the challenges, and the outstanding role played by experts as a result of this.[6] They also pointed to the numerous AML seminars and the development of a market offering professional knowledge about (anti-) money laundering as an indication for the great importance of expertise in this field.[7]

In sum, we can note FATF has actively pursued a strategy of "expertization." It has constructed its rule-making as an expertocratic process that produces useful and correct solutions, not political compromises. This strategy has worked—at least in so far as the importance of expertise is widely acknowledged. Against this background, it is much less puzzling now how voluntary standards such as FATF's Forty Recommendations work.

Inclusion

In order to make its standards more legitimate, FATF increasingly included other actors, both private and public, in its decision-making process. As to private actors, the banking sector was the prime target, as it plays a central role in (anti-) money laundering (Levi and Gilmore, 2002, pp. 92–3; Sica, 2000, p. 53; Serrano and Kenny, 2003, p. 436; Simmons 2000, p. 262). In the mid 1990s, FATF initiated the "Financial Services Forum" to meet with representatives

5. This may be one of the reasons why several other international bodies, both within and beyond the field of AML, have copied the mutual evaluation method (see Levi and Gilmore, 2002, pp.101–08; Sansonetti, 2000, pp.223–24).

6. Authors' interviews: 22 July 2003, 4 August 2003, 11 November 2003, 13 November 2003, 17 November 2003.

7. Authors' interview: 4 August 2003.

of the banking industry (Simmons, 2000, p. 255, Fn. 32; Reinicke 1998, p. 160). However, this forum met only every-other-year and the private sector continued to feel marginalized.[8] This impression seemed confirmed by the cold reaction of FATF to an initiative by twelve major banks—the so-called Wolfsberg Group—of setting their own AML standards.[9] FATF's stance changed during the 2001–03 review process of the Forty Recommendations, when it tried to secure the input of the private sector (FATF Annual Report, 2001–01, p. 17). And more recently, FATF has intensified its contact with the financial industry significantly (Kremer, 2004, p. 15). It now calls the Wolfsberg Group and the International Banking Federation its dialogue partners (FATF Annual Report, 2004–05, p. 11). It commits itself to regular consultation with the private sector (FATF Annual Report, 2005–06, Introduction) and, to this end, has launched a new forum of consultation that formalizes its contact with the private sector (FATF, 2007, p. 2). Overall, the various measures can be interpreted as efforts to enhance the organization's legitimacy by allowing for greater participation of the private sector. However, it is important to note the role of the private actors is a consultative one only; hence, we are dealing with a rather limited form of participation. After all, as government representatives were eager to point out in interviews, the relationship is a hierarchical one.[10]

With respect to public actors, a first measure was FATF's regionalization strategy, aimed at including non-FATF member states in the global AML network (Heng and McDonagh, 2008, p. 571; Shehu, 2005, pp. 234–35).[11] Already in 1990, FATF supported the creation of the first regional AML organization, the Caribbean Financial Action Task Force (CFATF). More "FATF-Style Regional Bodies" (FSRBs) were founded in the following years with FATF's support (Reinicke 1998, p. 164). Yet, FSRBs played only a secondary role in AML's regime until the end of the 1990s, when FATF renewed its regionalization effort, as a result of which four new regional AML organizations were created: in the Middle East and North Africa (MENAFATF), in Eurasia (EAG), South America (GAFISUD), and in West Africa (GIABA).[12] However, despite their formal independence from FATF, these FSRBs depend on financial and technical assistance by FATF and/or FATF members (Reinicke 1998, p. 164). And FSRBs—with one exception—do not set their own AML standards, against which they would evaluate their members, but simply endorse FATF's Forty Recommendations.[13] Also, FSRBs' mutual evaluation procedures are regularly examined by FATF for their conformation with FATF's own mutual evaluation procedures (FATF Annual Report, 1996–97, p. 23). Hence, FATF remains largely in control over the regional AML bodies.[14] And while FATF now grants FSRBs the status of associate members (FATF Annual Report, 2005–06, p. 5), it has no intention of making them full members. In fact, AML officials emphasize FATF remains the international standard setter and FSRBs are not on

8. Authors' interviews: 22 July 2003, 11 November 2003, 26 November 2003.

9. Authors' interviews: 22 July 2003, 4 August 2003, 10 November 2003, 11 November 2003, 18 November 2003, 26 November 2003.

10. Authors' interview: 18 November 2003, 4 August 2003.

11. Another aspect of FATF's regionalization strategy is to allow for rule addressees to implement the standards in a way that takes the local circumstances into account," as the president of FATF recently put it (http://www.fatf-gafi.org/document/7/0,3343,en_ 32250379_32236879 _44764103_1_1_1_1,00.html; accessed 15 January 2011).

12. Actually, GIABA had already been set up in 1999, but due to a number of deficiencies–among them the lack of a permanent secretariat—FATF had refused to recognise GIABA as an FSRB until 2006.

13. The exception is CFATF, which has developed its own Nineteen Recommendations to take account of some regional specificities. These regional recommendations, however, do not replace FATF's Forty Recommendations but are taken as a complement to the latter.

14. Authors' Interview: 4 August 2003.

the same level as FATF.[15] Hence, the regionalization strategy certainly enhances the participation of nonmembers, but there are also clear limits to this participation.

A second measure to increase the participation of states was to admit new members to the club. Until the late 1990s, FATF membership had been limited basically to OECD's world. After that, FATF decided to open up for members outside OECD's world. Not just any country could apply for membership, but only countries FATF deemed "strategically important" (FATF Annual Report, 1997–1998, p. 9). In the meantime, six countries have been awarded FATF membership: Argentina, Brazil, Mexico, South Africa, Russia, and China. South Korea and India are currently on the waiting list. FATF emphasizes it wants to remain an exclusive organization: "FATF has perhaps approached the limit of members if it is to continue to retain its current structure and character" (FATF Annual Report, 2003–04, Annex 2). Thus, FATF is still far from being an inclusive standard setter. A membership of thirty-four states is hardly universal, smaller countries without strategic relevance continue to be excluded from the standard-setting process. With respect to both types of actors, private (banks) and public (states), FATF pursues a strategy of bounded inclusion.

At first glance, the case of AML rule making seems to confirm the expectation of our theoretical framework that decision-making procedures can become important for regulatory legitimacy. However, it has been argued that participation matters only in institutionalized environments. And FATF operates in a technical environment. Since AML dates back only to the late 1980s, there is no established rule-making tradition in the field. As a consequence, FATF should be able to legitimize its standards through expertise only. However, it resorted to a strategy of inclusion nonetheless. Why? In order to explain this, it is useful to distinguish between two types of procedural measures. While "technocratic participation" is designed to enhance the problem solving capacity of the rules, "democratic participation" aims at more representative decision making. FATF has employed both types. Making money laundering more effective by acquiring the technical expertise of the banks allows for more technocratic participation. Increasing the participation of nonmember states is a way of enhancing democratic participation. The distinction between technocratic and democratic participation allows specifying the explanatory hypothesis. To the extent inclusion strategies promote technocratic participation, they enhance the legitimacy of a rule maker even in a mere technical environment. Only to the extent they are designed to increase representation, they should be limited to environments in which participation is an institutionalized norm.

This modified hypothesis suggests technocratic participation will be a common feature of any standard setter and, hence, also of FATF. However, why does FATF resort to democratic participation as well? One way of accommodating this finding with the framework is to redefine the relevant environment. If FATF is not only seen as a global AML rule maker but rather as one among many global regulators, the more general environment of global governance comes into purview. While global governance consists of a large number of fragmented networks, they do share some strong common norms and procedures, among them the norm that global governance needs to be democratic (Mörth, 2006; Scharpf, 1999). There is evidence this more general environment has become relevant for FATF as well. For

15. Authors' Interview: 13 November 2003.

example, international financial institutions' (IFI) request of FATF to abolish the blacklist was based on the argument that it violates the principles of how international regulators should function. Also, FATF has adopted techniques such as benchmarking and peer review in order to enhance participation, which have been frequently used by other international organizations such as the OECD and the EU (Schäfer, 2006). To the extent FATF also needs to take into considerations the rules of the game of global governance, it is also embedded in an institutionalized environment.

Making Sense of Legitimation Strategies

The analysis so far raises a further issue: How do expertization and inclusion actually function as legitimacy enhancing mechanisms? How can these strategies foster rule following according to the logic of appropriateness rather than the logic of consequence, in which rule followers weigh costs and benefits? How do these strategies promote belief in FATF as a legitimate rule maker?

The strategy of expertization promotes FATF's legitimacy by boosting its "output legitimacy."[16] If experts take center stage in decision-making processes, rules are likely to better address the complex technical problems needing to be solved to make AML rules effective and are less likely to be based on lowest-common-denominator compromises typical of multilateral rule making. At the same time, expertization reduces the likelihood such rules can be effectively challenged. Expertise is knowledge produced and administered by specialists and can only be challenged by specialists, whose "competence is considered so advanced . . . that it cannot be evaluated or controlled by persons without the same education and the same access to research" (Jacobsson, 2000, p. 42). Thus, expertise introduces asymmetry between the expert who knows and the layperson who does not. Most of the time, the layperson will have to trust the expert.[17] This is not to argue expert knowledge is never successfully challenged. However, given the complexity of the modern world, more often than not, expert rules are assumed to be correct. Thus, expert rule making is likely to lead to better rules and at the same time discourage criticism. In this way, expertise can lead to a belief of addressees that FATF rules should be followed, because they are effective.

The working of the second strategy seems to be straightforward. In addition to setting useful standards, FATF seeks to encourage the addressees of rules, mostly states and banks, to participate in the rule-making process in various ways. This should enhance "input legitimacy" by promoting a belief in addressees that FATF rules should be followed, because they are being decided in an open and democratic way. However, the empirical analysis has shown FATF has also encouraged restricted participation. If it is correct that the making of voluntary rules inherently only permits bounded inclusion, the question arises: How can this still generate legitimacy? Why would rule takers accept such rules as legitimate, although they have not been allowed to fully participate in the rule making? A trivial explanation is even small advances in participation are likely to increase legitimacy. A more complex explanation for

16. For the distinction between input and output legitimacy, see Scharpf (1999).

17. Expert standard setting contradicts the constructivist account on legitimacy in global governance (e.g., Steffek 2003; Risse, 2003). Whereas constructivists maintain that global rules are legitimate to the extent that they are subject to deliberation, expertise based standards are successful because they avoid the process of argument and persuasion.

how bounded inclusion produces legitimacy can be derived from the literature on "new sovereignty." Even restricted participation signals a commitment to the norm of sovereignty in that it purports to respect the internal autonomy and equality of states. It helps a state to maintain its honor and dignity despite its sovereignty being violated by a hegemonic actor (Krasner, 1999). Rather than forcing FATF standards upon the world, FATF supports the foundation of regional bodies, which then endorse FATF standards.

Legitimation Strategies and Compliance

So far we have argued FATF has tried to enhance its legitimacy by incorporating expertise and new members. Clearly, this is no proof FATF standards have been complied with because they have been considered legitimate. For such a proof, one would have to study the addressees of FATF standards. We, however, have focused on the rule makers. Still, we would hold our research indicates it is quite plausible FATF's legitimation efforts have played a role in enhancing compliance with its rules. Two points, in particular, make this a plausible assumption: First, many non-FATF members had complied with FATF rules long before FATF made use of more coercive means, i.e., the blacklist. And while some countries arguably did so out of their own material interest, for others—especially countries with under-regulated financial markets—compliance with FATF rules did come at considerable cost. These countries would have had little reason to comply in the absence of coercive pressure had they not been convinced of the input- and/or output-legitimacy of the Forty Recommendations. Second, FATF put and puts much effort into legitimizing its rules by including experts and new members and does not do so silently. In its public statements, FATF emphasizes how important it considers expertise and participation. Also, FATF staff and other interviewees from AML's community have stated they regard these practices—and the expertization of FATF standards in particular—as crucial for the rules' success. Taken together, these observations confirm the plausibility of our view that FATF's legitimation strategies did have an impact on the rule addressees' behavior indeed.

Blacklisting Reluctant States

The continued existence of a blacklist seems to contradict the argument that FATF is best understood as a standard setter. However, we want to demonstrate that if FATF is understood as a standard setter in the sense of organization theory, it is possible to take the voluntarist dimension seriously while reconciling it with a more coercive strategy.

Blacklist I

In spite of FATF's efforts, some states continued to oppose the fight against money laundering. In order to reign in these noncompliant states, FATF resorted to coercive enforcement. The precedent for this strategy was set in 1996, when FATF decided to invoke its Recommendation 21 against the Seychelles. This recommendation calls on member states to advise their financial institutions to give heightened attention to any transactions with the country in question (Simmons, 2000, p. 258–59). This use of force was successful, the Seychelles yielded to pressure. In 1999, the G-7 and in particular the Clinton Administration pushed

FATF to reconsider the practice (Sharman, 2006, p. 33; Wechsler, 2001, pp. 48–49). This time, the use of coercion should be more formal and systematic—through the publication of an official blacklist of countries unwilling to comply. In June 2000, FATF published a list of fifteen Non-Cooperative Countries and Territories (NCCT); later, eight more countries were added. FATF threatened the use of countermeasures should its conditions not be met: Options ranged from FATF members releasing financial advisories—as in the Seychelles case—to the restriction or even prohibition of financial transactions with blacklisted countries (Drezner, 1997, pp. 142–43).

For the most part, FATF did not have to apply sanctions beyond invoking Recommendation 21, because, afraid of damage to their reputation, the majority of the countries on the NCCT list, hurried to change their laws in accordance with FATF standards, and, as a consequence, were delisted (Clunan, 2006, 577). Only three NCCT countries: Nauru, Ukraine, and Myanmar, actually became the target of economic sanctions (Gardner, 2007, 335; Heng and McDonagh, 2008, p. 567). Eventually, these countries also gave in, and in October 2006, FATF declared "there are no Non-Cooperative Countries and Territories."[18] Within six years, the blacklist had managed to secure the compliance of even the least enthusiastic countries. Against this background, FATF's judgment that "overall the NCCT has proved to be a very useful and efficient tool to improve worldwide implementation of FATF 40 Recommendations" (FATF, 2005, p. 2)—a view shared by many practitioners[19] and academics—seems warranted (Drezner, 2007, pp. 143–44; Tranøy, 2002, 20; Gardner, 2007, p. 338; Hägel, 2003, pp. 13–14; Veng Mei Leong, 2007, p. 149).

Despite the blacklist's apparent success, in November 2002, FATF made a surprising announcement. While it would continue to monitor those countries already on the list and update the list whenever a blacklisted country had made sufficient progress, it would not review or blacklist any new country. In effect, the NCCT practice was suspended. And when Myanmar was delisted in October 2006, the NCCT practice was abandoned.[20]

Blacklist II

After the blacklist had been suspended, it appeared as if the organization would change its approach toward achieving worldwide compliance with its standards. Rather than blacklisting countries unwilling to cooperate, it would look for softer modes of gaining compliance. However, in 2007, FATF's International Cooperation Review Group started to analyze countries deemed unwilling to implement AML standards. As a result, FATF published several public statements in 2008, in which it named countries it found to lack appropriate AML rules. The countries concerned were Iran, Uzbekistan, Pakistan, Turkmenistan, Sao Tomé and Principe, and North Cyprus (FATF, n.d.).

These public statements clearly mark a return to the practice of blacklisting, which seemed to have been abandoned in 2006 at the latest. In February 2009, FATF stepped up

18. http://www.fatf-gafi.org/document/4/0,2340,en_32250379_32236992_33916420_1_1_1_1,00.html (accessed 15 June 2007).

19. For example, a law enforcement expert declared that "the NCCT process has saved at least 10 years of work" (quoted in BBC News Online, 2 September 2002).

20. For a more detailed treatment of the reasons behind the suspension of the blacklist see Rainer Hülsse (2008). On the FATF's experience with blacklisting see also J.C. Sharman (2009), Brigitte Unger, and Joras Ferwerda (2008).

pressure on one of the blacklisted countries, namely Iran, by calling upon its members to apply counter-measures against the country, which, unlike the other countries on the list, had not made any progress toward AML regulation. This call for counter-measures against Iran was reiterated in February, June, and October 2010. In an October 2010 public statement, FATF also added North Korea to its blacklist, though not yet calling its members to apply counter-measures. Moreover, FATF has also published a list of countries "which have strategic AML/CFT deficiencies for which they have developed an action plan with the FATF" (FATF, 2010). This list includes not only well-known money laundering havens like Antigua and Barbuda but also EU member Greece and accession candidate Turkey.

All in all, FATF now has a fairly complex multi-layered blacklist, which names many countries but shames them to different degrees. Obviously, FATF has increased pressure upon noncooperative countries significantly since 2007. FATF's renewed emphasis on coercion has gained momentum after the outbreak of the global financial crisis. It is a response to the demands by the G-20, which in 2009 "called on the FATF to reinvigorate its process for assessing countries' compliance with international AML/CFT standards and to publicly identify high-risk jurisdictions" (FATF Annual Report, 2009–10, p.28).

Making Sense of Coercion

According to the organization theory approach, standard setters are rule makers characterized by the fact they do not resort to coercion themselves in order not to undermine their rule-making authority (see section three). This raises the question whether FATF blacklisting reluctant states can be reconciled with our conceptualization of FATF as a standard setter. Or are the standard-setting activities analyzed above just a smokescreen hiding the fact FATF is simply a coercive international organization?

Some explanations of why FATF resorted to the blacklist support the hypothesis FATF is in fact a disguised coercive regulator. According to one view, FATF was hijacked by its most important member state, the United States. As mentioned earlier, the Clinton Administration was the driving force behind the NCCT process. What is more, there is no evidence FATF abandoned the blacklist to safeguard its legitimacy as a voluntarist standard setter. One explanation points to FATF abandoning the blacklist because it had accomplished its goal (Sharman, 2006, p.155); as all countries on the list had implemented AML regulations, the blacklist was no longer needed. Another explanation points to the limited administrative capacity (Sharman, 2006, pp.156–57);[21] the FATF secretariat—given its small staff of at the time, only about ten people, and its limited resources—was simply unable to cope with the additional workload of the NCCT practice. Still other explanations point to external factors. A policy shift in the U.S. was also the reason why the blacklist was abolished. Under President George W. Bush, a new approach took hold that was "less interested in multilateral approaches and strong regulatory actions" (Wechsler, 2001, p. 55; Heng and McDonagh, 2008, p. 556). The most common explanation points to the role of IMF and the World Bank.[22] In the late 1990s, FATF was trying to cooperate more closely with IFIs. However, IFIs strongly op-

21. Authors' interviews: 13 November 2003, 11 November 2003, 18 November 2003.

22. Authors' interviews: 4 August 2003, 11 November 2003, 18 November 2003; see also Daepp (2006, p. 22), Sharman (2006, p. 156), Kremer (2004, p. 24), Holder (2003, p. 387).

posed the NCCT practice, which—according to one IMF official—is "against the nature of the Fund" (quoted in Sharman, 2006, p.156), whose operating procedure is described by another IMF official: "Everything we do is uniform, it's voluntary, and it's cooperative."[23] IFIs made the suspension of the blacklist, which they regarded as illegitimate, a precondition for their engagement. FATF gave in and consequently returned to the exclusively voluntarist approach characteristic of its work in the 1990s.

However, it is possible to reconcile the existence of the blacklist with an understanding of FATF as a standard setter. The crucial insight is the blacklist only plays a limited role in how FATF works. First of all, FATF had been a successful rule maker well before it resorted to the blacklist. This is not to deny the continued importance of the blacklist; especially after its revival in 2007, it has become clear it was not a mere temporary aberration. However, it is important to acknowledge the blacklist plays a rather narrow role. It is an instrument to sanction states that continue to oppose its AML rules. Once states are prepared to cooperate, they are not threatened by it anymore. Thus, the blacklist aims for basic acceptance, while the tricky issue of how to get states to comply with and implement AML rules is left to voluntary standard setting. In this respect, AML regulation is similar to global insider trading regulation, which also combines compulsory features to quell resistance while voluntary networks seek to promote compliance and implementation (Bach and Newman, 2010).

If it is true standard setters can directly enforce their rules to ensure a minimum level of cooperation on the part of potential users, this suggests our approach does not yet acknowledge the full range of possible coercive measures in standard setting. While our approach suggests coercion is limited to enforcement by "third parties," the case of FATF alerts us that enforcement by "first parties," so to speak, is possible as well. The possible domain of a strategy of direct enforcement remains an open research question.

Conclusion

A substantial amount of rules for the world are produced by global standard-setting organizations. In this paper, we analyzed one example of such a standard-setting organization, i.e., the Financial Action Task Force (FATF). FATF is a standard setter that defines a set of standards to prevent money laundering and terrorist financing and calls upon all states to eradicate these evil practices by implementing its rules. To date, FATF has successfully monopolized rule-making authority in this field, and a large number of states have started to implement its standards. Even some reluctant states seeking to preserve their role as tax havens have succumbed to FATFs initiatives. Overall, FATF is, therefore, widely regarded as a successful rule maker.

This success story is puzzling. As a global standard setter, FATF sets nonbinding rules. How can such standards influence powerful states? We have identified two prominent explanations. One attributes the success of FATF to the fact it blacklists reluctant states while the other rests on the observation that FATF has become successful by virtue of acquiring rule-making authority. In short, one explanation sees FATF as a coercive rule maker while the other argues FATF is a case of voluntary standard setting. In our analysis above, we

23. Quoted in BBC Online, 2 September 2002; see also Reuter and Truman (2004: p. 168).

have shown evidence in support of both arguments can be found. This is irritating, since the two explanations seem contradictory. In this contribution, we have argued this contradiction can be resolved. FATF can be a coercive as well as a voluntarist rule maker because the coercive and voluntarist strategies serve different functions. FATF employs blacklisting only to overcome a state's open resistance to AML rules. To promote the implementation of specific rules, FATF exclusively resorts to voluntarist arrangements. In this way, FATF can be a coercive as well as a voluntarist rule maker at the same time.

This finding has significant implications in at least three ways: Empirically, it raises the question of whether this is a recurring pattern in transnational regulation. The finding of a similar pattern for transnational standard setting in finance (see Bach and Newman, 2010) suggests this question is at least relevant for the field of finance. Theoretically, the finding calls for a revision of our theoretical model. Organization theory suggests one way in which the contradiction between voluntary and coercive elements may be overcome. Standard setters set voluntary standards for users, and other actors enforce them. An outright contradiction between voluntary rules and coercion is avoided by third-party enforcement. However, this case suggests another possibility exists for overcoming the contradiction. Standard setters can be coercive, if they limit themselves to basic cooperation, while implementation is left to voluntary rule making. In this case, even first-party enforcement by the standard setter himself is possible. Finally, our analysis of FATF suggests a contribution to the analysis of power in global governance. While we share the view that the literature on global governance has for too long ignored questions of power (Barnett and Duvall, 2005; Drezner, 2007), we would hold that power analysis in global governance must also account for the limits of power. Our empirical case, at least, suggests international organizations impose limits on the way they exert force. FATF uses the blacklist only to nudge states to cooperate with the organization. For the much more important task of getting states to actually comply with and implement rules, it seeks to bolster its rule-making authority by promoting an image of a benign problem solver among rule addressees.

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