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The Impact of Gray-Listing on Capital Flows: An Analysis Using Machine Learning

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Abstract

The Financial Action Task Force's gray list publicly identifies countries with strategic deficiencies in their AML/CFT regimes (i.e., in their policies to prevent money laundering and the financing of terrorism). How much gray-listing affects a country's capital flows is of interest to policy makers, investors, and the Fund. This paper estimates the magnitude of the effect using an inferential machine learning technique. It finds that gray-listing results in a large and statistically significant reduction in capital inflows.

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Contents

1	Introduction	3
2	Event Analysis	6
3	Econometric Analysis	11
3.1	Methodology	11
3.2	Model	14
3.3	Data	17
3.4	Results	18
4	Robustness	20
4.1	Event Window	20
4.2	Small Number of Gray-Listing Observations	21
5	Concluding Remarks	22
	Appendices	29
A	FATF Gray-Listing	29
B	Estimation Sample: 2000q1–2017q4	33
C	Gray-Listing and Net Errors and Omissions	34
D	Variables and Data Sources	35