

FISCAL CAPACITY AND MONEY LAUNDERING RISK: THE ROLE OF FISCAL TRANSPARENCY IN STRENGTHENING ANTI-MONEY LAUNDERING FRAMEWORKS

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Abstract

The study aims to analyze the relationship between fiscal capacity and money-laundering risk in G20 economies, covering the period from 2012 to 2025. It also investigates the potential to improve fiscal capacity to limit financial crime through better institutional governance and reduced asymmetric information. To provide robust and reliable estimation, empirical analysis involves various tests and methods, including the Cross-Sectional Dependency (CD) test, Second Generation Panel Unit Root Tests, Pooled Ordinary Least Squares (POLS), the Hausman Specification Test, the Driscoll-Kraay Standard Error Fixed Effects Model, and the Generalized Method of Moments (GMM) Estimator. The empirical results consistently show a negative and statistically significant relationship between fiscal capacity and money laundering risk across all estimation techniques. The results show that higher fiscal capacity increases financial accountability and the effectiveness of tax regulation and decreases the room for illicit financial transactions. The high robustness of the results is achieved with OLS, Fixed Effects, Driscoll–Kraay, and GMM, ensuring that the relationship remains stable after controlling for heterogeneity, cross-sectional dependence, and endogeneity. The research provides empirical evidence for Institutional Theory and Information Asymmetry Theory, as the results show that the greater the development of the institutional framework, the lower the information asymmetry and the more efficient the anti-money laundering measures. The study emphasizes the importance of strengthening of fiscal administrative capacity, strengthening international information exchange between tax authorities, and increasing tax regulatory enforcement to address money laundering and financial integrity. The outcome reflects the lack of research on the economic impact of money laundering on developing nations and sheds light on the work of policymakers, tax authorities, financial market regulators, and international bodies to create effective anti-money laundering measures. The study applies robust panel econometric methods, such as the Driscoll–Kraay Fixed Effects Model and GMM estimation, to provide robust empirical evidence that builds on prior research on the relationship among governance, fiscal capacity, and financial crime.

Introduction

The dramatic shift in the financial landscape, driven by the pace of digitalization and economic transition, has created new opportunities for growth but has also heightened vulnerability to financial crime and other illegal uses of finance (Al Naqbi et al., 2026). This new issue has become more apparent with the swift evolution and adoption of financial technologies, affecting the speed, convenience, and the way transactions are conducted (Burgess & Liu, 2025). While the decentralized nature of modern technologies and their anonymity create opportunities for eavesdropping, they can also be susceptible to scams, fraud, money laundering, tax evasion, and other unlawful activities (Ayebofo et al., 2025). The total value of illegal operations jumped from \$3.1 trillion in 2023 to \$4.4 trillion in 2025, with approximately half of these linked to the illicit drug trade, trafficking, and money laundering (Ali et al., 2026). In the last decade, money laundering has greatly affected the worldwide economy. Shocking figures showing the magnitude and impact of the problem have helped raise public awareness of it among various international organizations and academic institutions. The United Nations Office on Drugs and Crime (UNODC, 2025) estimated that the loss caused by money laundering is between \$800 billion and \$2 trillion each year, roughly 2-5% of global GDP. They have a significant impact on financial authorities, businesses, and financial institutions, as they threaten the integrity of legitimate economic activity, damage financial networks, cause inequalities, and impede economic growth (Arthur et al., 2025).

Economic stability and financial security require effective counteraction of money laundering, a risk that threatens economic efficiency and effectiveness (Dobrovolska & Rozhkova, 2024). It weakens essential principles of good governance, transparency, accountability, and integrity, resulting in citizens' mistrust, impeding innovative developments, jeopardizing the credibility of the financial system, and compromising the stability of economic growth and development (Dote-Pardo & Severino-González, 2025). AML compliance

costs currently are at \$60 billion per year for financial institutions. Less than 1% of the money laundered is recovered; 90% goes unreported (Aidoo et al., 2025). Fiscal capacity is an emerging and promising element for identifying and countering the risks of money laundering, characterized by adequate public revenue, reduced secrecy, increased accountability, and stronger audits in the global financial sector. Finally, implementing effective legislation and monitoring systems that ensure ethical financial compliance and practices helps turn high-risk countries into low-risk countries (Ghulam & Szalay, 2024). To achieve long-term economic sustainability, it also encourages the implementation of effective policies and regulations to finance public services and collect taxes sustainably (Challoumis, 2024).

Literature Review and Proposed Hypotheses

Effective fiscal capacity is essential for a country's economic development, as it reduces tax evasion, boosts accountability, establishes efficient tax regulatory frameworks, enhances financial systems, and improves infrastructure investments (Megersa, 2021). Many studies (Khelil et al., 2025; Limachi et al., 2025; Stiglingh et al., 2022) have concluded that fiscal capacity and effective tax management are assets in the fight against money-laundering risk and illicit financial activities. Effective tax administration can lessen institutional weaknesses and systemic shortcomings that may contribute to money laundering. Improving financial transparency and accountability is crucial and involves fiscal compliance, auditability of documents, proactive risks, and control mechanisms (Limachi et al., 2025). Fiscal capacity tends to go hand in hand with more stringent tax systems, including cash-based taxes, and may lead to lower tax evasion and reduced money-laundering risks (Stiglingh et al., 2022). In identifying money laundering, the use of modern technology, including machine learning and AI automation, has become crucial. This can be achieved by strengthening policies and regulations across three major domains: accountability, integrity, and effective auditing (Ghulam & Szalay, 2024). Additionally, beneficial

ownership transparency is one of the most effective strategies to combat money laundering risk, which can be enhanced by effective legal management, accountability, risk identification (Sihombing, 2023), and establishing networks between organizations, corporations, and financial institutions, resulting in a robust framework for mitigating adverse effects of financial crime (Knobel et al., 2018). In countries where this ownership is lacking, it can be easier to engage in illegal financial transactions, thereby enabling the concealment of illicit income and making it more difficult to control criminal activity (Gilmour, 2020). However, other studies have established an important link between money laundering risk and the fiscal system; because financial institutions prefer not to operate in less transparent countries, EU money laundering rules and legislation are more stringent there (Rose, 2022). Tax havens in developing countries enable and incentivize fraud, money laundering, and other illicit practices by creating tax regimes for the wealthy and powerful (Otusanya & Adeyeye, 2022).

Fiscal capacity also contributes to anti-money laundering efforts by mitigating tax evasion via efficient EU AML laws (Denk, 2022). The implementation of anti-money laundering regulations and tax compliance requirements can help track and control most illegal financial activities. The effect of excellent anti-money laundering rules is a 15% reduction in fiscal benefit (Eulaiwi et al., 2024). Money laundering: the current issue for regulators is the persistent problem of money laundering, as well as the new technologies being used to facilitate it, such as cryptocurrencies, digital currencies, and online platforms (Janjua & Khan, 2022). Accordingly, regulatory authorities need to be proactive in identifying suspicious transactions and in adapting to and evolving with the financial crime landscape and the tactics used by criminals, so as not to be outplayed by the sophistication of the technological platforms criminals use (Oluwaferanmi, 2025). In addition, innovation and technological development are improving anti-money laundering systems, which in turn will support economic development and increase

disclosures and financial integrity (Dote-Pardo & Severino-González, 2025). The integration of blockchain and Generative Artificial Intelligence (AI) into anti-money laundering (AML) systems reduces tax compliance costs by 20% and enhances transparency by 35% (Nie et al., 2025). The technologies are also associated with enhanced efficiency, accountability, and transparency in financial systems, owing to the decentralized control, consistency, and continuous monitoring they offer (ABIOLA et al., 2023), thereby improving tax record-keeping. These technologies also enhance efficiency, accountability, and transparency in financial systems by enabling decentralized control, consistency, and continuous monitoring (ABIOLA et al., 2023), thereby improving tax record-keeping.

H1: Fiscal capacity is negatively influenced by money laundering risk.

Theoretical Support

Theoretically, this research is based on institutional theory and information asymmetry theory, which explain how governance quality influences financial transparency and the risk of money laundering. Institutional theory focuses on the strengths of legal systems, effective regulations, and governance systems that will improve institutional performance and minimize the scope for financial crimes. Information asymmetry theory is an explanation that arises from differences in the information available to individuals and organizations, enabling them to hide illegal financial activities and thereby enhancing the risk of money laundering. Efficient fiscal capacity, political stability, and regulatory quality help minimize information asymmetry, enhance institutional effectiveness, and foster financial integrity (Ajide et al., 2025). These theories can be combined to analyze how governance factors affect perceptions of money-laundering risk across G20 economies (AlQudah et al., 2025).

Institutional Theory

Institutional theory posits that formal institutions, such as laws, regulations, governance, and enforcement capacity, are critical to the success of institutions and economies. Effective institutions foster accountability, transparency, and adherence to financial regulations, thereby minimizing the potential for money laundering and other illicit financial activities (Suddaby & Zakaria, 2026). Better regulation, political stability, and effective fiscal capacity enhance the aforementioned institutions' ability to combat financial crimes and improve economic governance within the G20 economies (Mahmood et al., 2026). For this reason, institutional theory is used as a theoretical framework to understand the level of money-laundering risk that occurred during 2012-2025.

Information Asymmetry Theory

According to the information asymmetry theory, a financial market is inefficient when there is information asymmetry between the two players involved. Lack of transparency and disclosure, and weak regulatory oversight, leave information gaps that enable tax evasion, corruption, and money laundering. In turn, effective fiscal capacity, regulatory effectiveness, and a stable political structure help create greater availability and reliability of financial information, which decreases information asymmetry (Kovalchuk et al., 2026). The more transparent everything becomes, the easier it will be for regulators to track financial transactions, making it harder to keep illegal ones secret (Kovalchuk et al., 2026). Thus, this theory supports the notion that minimizing information mismatches reduces the propensity for money laundering in G20 economies.

Model Specification

The current paper examines the influential role of fiscal capacity on money laundering risk. The following is the model's regression equation:

$$MLR_{it} = \alpha + \beta_1 FC_{it} + \beta_2 PS_{it} + \beta_3 RQ_{it} + \varepsilon_{it} \\ \text{--- -- -- (i)}$$

Where MLR denotes money laundering risk, reflecting the primary outcome of interest. FC signifies fiscal capacity and serves as an independent variable expected to influence the

risk of money laundering. Additionally, PS represents political stability, and RQ represents regulatory quality, both of which are used as control variables in this study. The study employed panel data from G20 economies, covering 2012 to 2025. Data sources include the Basel Institute on Governance, the World Development Indicators (WDI), and the World Governance Indicators (WGI). Money laundering risk is measured using the Basel Institute on Governance's "Basel Anti-Money Laundering Index (AML)". Fiscal capacity is measured by "tax revenue (% of GDP)", sourced from World Development Indicators (WDI). Additionally, the control variables, political stability and regulatory quality, are sourced from the World Governance Indicators (WGI) and measured as estimates of these indicators.

Methodology

The research method used in this study is quantitative, with balanced panel data from the G20 economies in the period 2012-2025. Secondary data have been gathered from internationally recognized databases, including the World Bank, the Worldwide Governance Indicators (WGI), the Basel AML Index, the OECD, and other reliable sources. The descriptive statistics are presented first, followed by a correlation analysis and a Variance Inflation Factor (VIF) analysis to explore relationships among variables and detect multicollinearity. The Cross-sectional Dependency (CD) test is next performed to see whether cross-country dependence exists. Using the results of the CD test, the Second-Generation Panel Unit Root Test is applied to analyze the stationarity of the variables. The study begins with an estimate of a Pooled Ordinary Least Squares (POLS) regression as a baseline model, then performs the Hausman specification test to identify which of the two panel estimator types to use. Note that macro-panel data are typically heteroskedastic, autocorrelated, and cross-sectionally dependent, so the Driscoll-Kraay Standard Error Fixed Effects Model is used to obtain robust estimates. Finally, the Generalized Method of Moments (GMM) estimator is employed as a robustness check, given

potential endogeneity and dynamic relationships among the variables.

Table 1: Description of Variables

Table 1 presents a comprehensive overview of the variables, their measures, and data collection sources.

<i>Variables</i>	<i>Measurements</i>	<i>Sources</i>	<i>References</i>
<i>Money Laundering Risk</i>	Basel Anti-Money Laundering Index	Basel Institute on Governance	(Brici & Achim, 2023)
<i>Fiscal Capacity</i>	Tax Revenue (% of GDP)	World Development Indicators (WDI)	(Baer et al., 2025)
<i>Political Stability</i>	Political Stability: estimate	World Governance Indicators (WGI)	(Alsagr et al., 2025)
<i>Regulatory Quality</i>	Regulatory Quality: estimate	World Governance Indicators (WGI)	(Handoyo, 2023)

Results and Interpretations

Table 2: Descriptive Statistics

<i>Variable</i>	<i>Obs</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>Min</i>	<i>Max</i>
<i>MLR</i>	266	4.932953	1.402863	0	7.347673
<i>FC</i>	266	13.76759	7.658117	0	26.88902
<i>PS</i>	266	-0.0028693	0.6870371	-1.78017	1.275879
<i>RQ</i>	266	0.5990364	0.8013471	-1.068284	1.930003

Table 2 illustrates the descriptive statistics of all variables used in this study. Money laundering risk has an average value of 4.932953, with a range of 0 to 7.347673. The standard deviation is 1.402863, showing a moderate degree of variability in money laundering. The mean value of fiscal capacity is 13.76759, having minimum and maximum values of 0 and 26.88902, respectively. The value of standard deviation is

7.658117, indicating a high degree of variability. Political stability's variability is very high (standard deviation of 0.6870371), ranging from a minimum of -1.78017 to a maximum of 1.275879, with a mean of -0.0028693. The average regulatory quality is 0.5990364, with a minimum of -1.068284 and a maximum of 1.930003. There is significant variation, as the standard deviation is 0.8013471.

Table 3: Correlation Matrix

	<i>ML</i>	<i>FC</i>	<i>PS</i>	<i>RQ</i>
<i>MLR</i>	1.0000			
<i>FC</i>	-0.1636*	1.0000		
<i>PS</i>	-0.1166*	0.1023	1.0000	
<i>RQ</i>	-0.1528*	0.2327*	0.7948*	1.0000

Note: ***, **, * is for significant at 1%, 5% and 10%.

Table 3 presents the correlation matrix of the variables to assess multicollinearity, a basic assumption of the CLRM. The results showed no multicollinearity, as none of the correlations

among the explanatory variables fell within the threshold range indicating perfect multicollinearity.

Table 4: Variance Inflation Factor (VIF)

<i>Variable</i>	<i>VIF</i>	<i>1/VIF</i>
<i>FC</i>	1.08	0.927264
<i>PS</i>	2.77	0.360988
<i>RQ</i>	2.90	0.345046
<i>Mean VIF</i>	2.25	

A Variance Inflation Factor (VIF) is a technique that measures the degree of inflation in a regression coefficient's variance. The findings revealed no multicollinearity among the variables,

as none exceeded the VIF threshold of 5. The model is statistically reliable with respect to multicollinearity.

Table 5: Cross-sectional Dependency

<i>Pesaran's test of cross-sectional independence</i>	13.059
<i>Pvalue</i>	0.0000***

Note: ***, **, * is for significant at 1%, 5% and 10%.

Table 5 shows the results of the cross-sectional dependency test. The findings indicate that the t-statistic is 13.059 and the p-value is 0.000***, which is statistically significant. Thus, the cross-sectional independence null hypothesis is rejected, indicating significant cross-sectional dependence among the panel units. The finding indicates that

common shocks or unobserved factors affect the countries in the sample, thereby making them interconnected. Hence, second-generation panel data methods, which explicitly account for cross-sectional dependence, are well-suited to subsequent empirical analysis and yield reliable, consistent estimates.

Table 6: Second-Generation Panel Unit Root Test

	<i>t-bar</i>	<i>cv10</i>	<i>cv5</i>	<i>cv1</i>	<i>Z[t-bar]</i>	<i>Pvalue</i>
<i>MLR</i>	-6.094	-2.140	-2.260	-2.470	-16.493	0.000***
<i>FC</i>	-4.557	-2.140	-2.260	-2.470	-10.658	0.000***
<i>PS</i>	-3.992	-2.140	-2.260	-2.470	-8.514	0.000***
<i>RQ</i>	-3.960	-2.140	-2.260	-2.470	-8.390	0.000***

Note: ***, **, * is for significant at 1%, 5% and 10%.

Table 6 illustrates the results of the Second-Generation Unit Root Test. The outcomes indicate that all variables are stationary because the p-values are less than 0.05 and the t-statistics

are highly negative, meaning that money laundering risk, fiscal capacity, political stability, and regulatory quality are level and do not contain a unit root.

Table 7: Pooled Ordinary Least Squares

<i>MLR</i>	<i>Coef.</i>	<i>Std. Err.</i>	<i>t</i>	<i>P> t </i>	<i>[95% Conf. Interval]</i>
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<i>FC</i>	-0.025083	0.0111146	-2.26	0.025**	-0.0469614	-0.0032046
<i>PS</i>	-0.0355784	0.1985592	-0.18	0.085*	-0.4264306	0.3552738
<i>RQ</i>	-0.2860458	0.169775	-1.68	0.093*	-0.6202329	0.0481412
<i>_cons</i>	5.390486	0.1818034	29.65	0.000***	5.032616	5.748355

Note: ***, **, * is for significant at 1%, 5% and 10%.

The OLS findings in Table 7 indicate that fiscal capacity (FC) has a negative and statistically significant impact on money laundering risks (MLR). The estimated coefficient for fiscal capacity is -0.025083, and the p-value is statistically significant at the 1% level ($p=0.025^{**}$). The results show that a 1% increase in tax revenue as a share of GDP is associated with a 2.5% decrease in money laundering risks, indicating a substantial

reduction in illicit financial risks. Additionally, the current study included two control variables, political stability (PS) and regulatory quality (RQ); their respective coefficients are -0.0355784 and -0.2860458, indicating that they are modestly and negatively related to money laundering risks. The intercept term is 5.390486, and the p-value is statistically significant (0.000***).

Table 8: Hausman Test

<i>chi2(3)</i>	12.84
<i>Prob > chi2</i>	0.0050***

Note: ***, **, * is for significant at 1%, 5% and 10%.

The outcomes of the Hausman test are represented in Table 8; the chi-squared (Chi2) value is 12.84, and the p-value is 0.0050***. The significance value (0.05) is greater than the

probability value. Fixed effects are consistent and efficient in the current study, as the findings confirm rejection of the study's null hypothesis (H_0).

Table 9: Driscoll-Kraay Standard Error Fixed Effects Model

<i>MLR</i>	<i>Coef.</i>	<i>Std. Err.</i>	<i>t</i>	<i>P> t </i>	<i>[95% Conf. Interval]</i>
<i>FC</i>	-0.025083	0.0141375	-1.77	0.093*	-0.0547848 0.0046188
<i>PS</i>	-0.0355784	0.351435	-0.10	0.920	-0.773916 0.7027593
<i>RQ</i>	-0.1874724	0.2588311	-0.72	0.078*	-0.7312563 0.3563116
<i>_cons</i>	5.390486	0.3053073	17.66	0.000 ***	4.749059 6.031913

Note: ***, **, * is for significant at 1%, 5% and 10%.

The fixed-effects results, presented in Table 9, show that fiscal capacity (FC) has a modest negative association with money laundering risks (MLR), with a coefficient of -0.02508 and a p-value of 0.093*. This indicates that for every 1-unit increase in fiscal capacity, money-laundering risks decrease by 0.025 units. Furthermore, the two control variables, political stability (PS) and

regulatory quality (RQ), have coefficient values of -0.0355784 and -0.1874724, respectively. This indicates that they are negatively associated with money laundering risks, whereas political stability (PS) is not statistically significant (0.920) and regulatory quality (RQ) is significant (0.078*). The intercept term is 5.390486, and the p-value is statistically significant (0.000***).

Table 10: Generalized Method of Moments (GMM)

<i>MLR</i>	<i>Coef.</i>	<i>Std. Err.</i>	<i>t</i>	<i>P> t </i>	<i>[95% Conf. Interval]</i>
<i>LI</i>	0.0148968	0.0568242	0.26	0.793	-0.0964765 0.1262701
<i>FC</i>	-0.0236354	0.0093566	-2.53	0.012**	-0.0419739 -0.0052968

<i>PS</i>	0.0712228	0.1872219	0.38	0.704	-0.2957253	0.4381709
<i>RQ</i>	-0.3564691	0.1748697	-2.04	0.042**	-0.6992075	-0.0137308
<i>_cons</i>	5.450138	0.3047123	17.89	0.000***	4.852913	6.047363

Note: ***, **, * is for significant at 1%, 5% and 10%.

Table 10 presents the results of the generalized method of moments (GMM). The findings show that a 1-unit increase in past money laundering risk (MLR) leads to a 1.48% rise in current money laundering risk (MLR), as the value of the coefficient is 0.0148968. Past money laundering risk (MLR) positively influences current MLR, but the effect is insignificant ($p = 0.793$). The coefficient value of fiscal capacity (FC) is -0.0236354, which represents that a 1-unit increase in fiscal capacity (FC) is associated with a 2.36% decrease in money laundering risk. Additionally, it is statistically significantly associated with money laundering risk, with a p-value of 0.012**. Political stability (PS) is positively related to money laundering risk (MLR), with a coefficient of 0.0712228 and an insignificant p-value (0.704). A greater regulatory quality (RQ) is associated with lower money laundering risk (MLR), as a one-unit increase in regulatory quality (RQ) leads to a 0.35-unit decline in money laundering risk (MLR). Furthermore, it has a significant effect on the dependent variable (0.042**). The intercept term is 5.450138 and is also statistically significant with a p-value of 0.000***.

Discussion

This study examined the relationship between fiscal capacity and money laundering risk. The findings from the Ordinary Least Squares (OLS) regression clearly show that fiscal capacity is significantly and negatively associated with money-laundering risk (coefficient = -0.025083). This result appears to reflect the impact of effective regulatory capacity and legislation (Khelil et al., 2025). Fiscal compliance, proactive risk management, and regulatory controls are effective in enhancing financial transparency (Limachi et al., 2025). Strong fiscal capacity is associated with higher tax rates and cash-based taxes, thereby potentially reducing tax evasion and the risk of money laundering (Stiglingh et al., 2022).

Likewise, the findings of the Fixed-Effect Model corroborated the negative (-0.025083) effect of money laundering and the marginal (0.093*) effect of fiscal capacity. Results showed that fiscal capacity positively reduces money laundering risks because effective legal management, accountability, and risk identification have been achieved (Sihombing, 2023), thus providing a good framework for mitigating the adverse effects of financial crime (Knobel et al., 2018). The same result has been shown by the Generalized Method of Moments (GMM), which indicates that fiscal capacity negatively influences money laundering risk, with a coefficient of -0.0236354 and a p-value of 0.012**, which is statistically significant in G-20 countries. This confirms that fiscal capacity helps fight the negative consequences of money laundering by curbing tax evasion, improving accountability, and developing effective tax regulatory systems (Megersa, 2021). When rules and statutes are properly implemented and enforced to ensure moral financial compliance and ethical practices, it becomes easier to shift high-risk countries to low-risk ones (Ghulam & Szalay, 2024).

They are additionally supported by the Driscoll-Kraay Fixed Effects Model, which finds that the negative link between fiscal capacity and money laundering risk holds true when accounting for country-specific factors, heteroscedasticity, serial correlation, and cross-sectional dependence. The uniformity of results suggests that a robust tax-administration capacity enables more effective implementation of anti-money laundering provisions, holds institutions more accountable, and facilitates the identification of suspicious financial transactions. The results confirm the results of the previous studies conducted by Khelil et al. (2025), Limachi et al. (2025), Sihombing (2023), Knobel et al. (2018), and Stiglingh et al. (2022) that effective fiscal capacity would strengthen governance, improve the effectiveness

of regulation, and limit the room for illicit financial flows.

The robustness of the results is further strengthened by the Generalized Method of Moments (GMM) estimation, which also shows a negative and statistically significant relationship between fiscal capacity and the risk of money laundering. The results across the three specifications are consistent and support the interpretation that the relationship remains stable, even after accounting for potential endogeneity and dynamic panel bias. In addition, the results validate the Institutional Theory, as they show that the better the governance institutions and their regulations, the lower the level of financial crime. They also uphold the principles of Information Asymmetry Theory, which states that the greater the transparency, the fewer information gaps there are that allow money laundering. Thus, fiscal capacity and tax administration measures and practices should be further reinforced in G20 economies, with a greater share of information made available and regulations enforced, thereby strengthening efforts to mitigate the risk of money laundering and achieve sustainable financial governance.

Conclusion

Using a comprehensive dataset, this study examines the relationship between fiscal capacity and money-laundering risk across G20 economies from 2012 to 2025. The results from the Ordinary Least Squares (OLS), Driscoll-Kraay Fixed Effects (FIX), and Generalized Method of Moments (GMM) estimators are consistently negative and statistically significant for money-laundering risk. The robustness of the results across different estimation methods suggests that increases in fiscal capacity have positive effects on financial accountability, regulatory effectiveness, and opportunities for illicit financial activities. The results provide empirical evidence for Institutional Theory and Information Asymmetry Theory, indicating that strong institutional structures and limited information asymmetry are critical to combating financial crime and enhancing governance outcomes. The study contributes both

theoretically and practically to the literature on financial crime and governance. As a theoretical model, it contributes to the existing literature on the determinants of money laundering risk by integrating institutional quality and information transparency into a single framework to account for cross-country differences in money laundering risk among G20 economies. The methodological aspects of using robust panel econometric techniques increase the reliability of the results by accounting for cross-sectional dependence, heterogeneity, and endogeneity. The findings highlight, from a policy perspective, the need for increased efforts on fiscal capacity measures and regulatory quality, and for strengthening AML enforcement in countries. These measures can contribute to greater financial integrity, the elimination of illicit financial flows, and the promotion of sustainable economic development. Future research could also include additional governance measures, other non-G20 economies, and/or country-specific institutional features to further explore the channels by which fiscal capacity affects money-laundering risk.

Recommendations

Strengthening fiscal capacity should be regarded as a core component of broader anti-money laundering (AML) measures and governance strategies. Greater fiscal capacity can be achieved through stronger disclosure requirements and beneficial ownership transparency, as well as greater automatic exchange of financial information between jurisdictions. Governments also need to strengthen AML rules by improving customer due diligence, enhancing the effectiveness of suspicious transaction reporting, and strengthening cooperation among tax authorities. The use of digital tools like artificial intelligence and data analysis can further enhance the ability to identify illicit financial transactions. Further, strengthening institutions, regulatory frameworks, and international collaboration will enhance fiscal transparency measures, mitigate tax evasion, and reduce opportunities for money laundering. Thus, including fiscal capacity within broader financial integrity and governance

mechanisms will help countries protect their financial systems, enhance regulatory compliance, and reduce the risk of money laundering.

Policy Implications

The results suggest that fiscal capacity should be mainstreamed in anti-money laundering (AML) policies and financial governance. Tax information disclosure, establishing clear beneficial ownership registers, and strengthening the automatic exchange of financial information in line with international standards must be key priorities for governments and regulatory bodies. Moreover, there is a need to enhance coordination between tax authorities, financial intelligence units, financial regulators, and law enforcement agencies to ensure early detection and investigation of suspicious financial transactions. Moreover, digital monitoring systems and the capacity building of regulatory and institutional mechanisms will improve the effectiveness of fiscal capacity measures. All these policy measures can help curb tax evasion and money laundering, enhance the integrity of the financial system, enhance investor confidence, and contribute to sustainable economic growth.

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