Behind the Corporate Veil: A Participant Study of Financial Anonymity and Crime

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ABSTRACT

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How can we tell whether rules that apply in theory actually do so in practice? The gap between what formal rules proscribe and their effectiveness may be particularly wide at the international level. This paper tests the effectiveness of international soft law standards prohibiting anonymous participation in the global financial system by seeking to break these standards. Specifically, the author solicited offers for anonymous shell corporations with bank accounts from 45 corporate service providers in 22 countries, and purchased a sub-set of these. Such a direct, participation approach corrects for problems of selection bias, endogeneity and formalism that compromise much of the literature on global governance and regimes. The findings indicate that the prohibition on anonymous corporations is relatively ineffective. Furthermore, the rules are flouted much more in G7 countries than tax havens. The availability of anonymous corporations means that progress on fighting money laundering, tax evasion, grand corruption, and other financial crimes will be slow.

Rules are at the heart of the study of politics. But how can we tell whether the rules that apply in theory do so in practice? It is a commonplace that laws, regulations and policies can be a dead letter, completely ineffectual and irrelevant for actors' behavior. The gap between formal rules and actors' behavior may be all the more significant at the international level in the absence of a world government. Yet political scientists have rarely taken the most direct approach to testing the effectiveness of rules: attempting to break them, and seeing what happens. This paper practises just such a participant approach. It is based on seeking to violate recent global soft law standards prohibiting anonymous participation in the international financial system so as to assess the effectiveness of these standards. Such a test is especially apposite in looking at the effect of international rules, long argued to be troubled by particular enforcement difficulties.

Aside from addressing realists' skepticism about international rules in general, this unusually direct approach to testing the impact of global rules helps to counter-act a worrisome bias in the existing literature on global governance and international regimes, which tends to overstate the success of international rules. This propensity springs from three sources: selection bias, endogeneity and formalism. A selection bias exists because states tend to only begin negotiation where they believe there is a reasonable chance of success, meaning that easy issues are favored over difficult ones. Similarly, by and large, international actors only commit to rules when they believe it will be in their interest to follow them (endogeneity). Finally, too often observers have concentrated on the successful conclusion of a treaty, convention, or soft law standard, rather than evaluating whether such arrangements have made any difference to actors' behavior (formalism). In combination, these biases have often meant that the study of global

governance and international regimes has run counter to the general scientific presumption of favoring tough tests over easy ones (Popper 1968; King, Keohane and Verba 1994: 100). By providing a more direct and demanding test, a participation approach helps to re-balance empirical work in this area. And whether as scholars or as citizens, when we ask 'do the rules make a difference?' we are asking whether rules proscribing an activity (speeding, selling cocaine, torture, genocide, nuclear proliferation, polluting etc.) have made it significantly less likely that this activity will occur. In this context, an investigation premised on rule-testing by rule-breaking enjoys an advantage over less direct methods.

The standards in question arise from a recent international campaign to proof the international financial system against financial crime, especially money laundering, large-scale corruption and tax evasion. The proximate goal of this campaign is to ensure that the world's financial and banking systems are transparent and 'legible' (Scott 1998): every actor and transaction within the system must be able to be traced to a discrete, identifiable individual. International organizations, private financial institutions and states have thus diffused rules outlawing anonymous participation in global financial and banking networks, a provision now legislated in over 180 countries (FATF 2007). Anonymity is forbidden precisely because it is so useful for those looking to perpetrate financial crimes.

This paper tests these global rules prohibiting anonymous participation in the international banking system by seeking to break these same rules. The project is based on attempting to found anonymous corporate vehicles which conceal the author's identity, establishing corporate bank accounts for these vehicles, and making wire transfers from these accounts. Such a participant approach (akin to a field experiment) fills an important gap in our

knowledge by providing direct, primary empirical evidence about the effectiveness of global governance in this realm. To the extent that the new emphasis on transparency and surveillance renders these attempts difficult or impossible, this would comprise compelling testimony of the power of states, international organizations, soft law and private firms in regulating that supposedly most unfettered subject and agent of globalization: the global financial system. But if breaking the rules by participating anonymously in the global financial system is easy, this provides a strong indication that in this case the rules reflect nothing more substantial than pious hopes. In this case, progress on fighting money laundering, tax evasion, major corruption and related financial crimes will be slow or negligible.

The logic behind this specific research design is that a company or other corporate form (trust, foundation, partnership, etc.) is little more than an alternative legal identity. Because these legal persons can have their own bank accounts, to the extent the true owner of the corporate entity is hidden, all transactions processed through the corporate account became untraceable. Such a corporate veil is thus very useful for those looking to hide criminal profits, make or receive bribes, or escape tax obligations. The research design involved electronically soliciting offers of anonymous corporate vehicles from 45 different corporate service providers in 22 different countries, and collating the various responses. The next step was to purchase a sub-set of these vehicles to determine whether the prohibitions on anonymous corporate entities (and thus anonymous participation in the international banking system) that apply in theory actually obtain in practice. Beyond assessing the ease or difficulty of establishing anonymous bank accounts overall, this research design also tests relative effectiveness of rules in different types of countries. Specifically, it tests the claim that these global rules are much less effective in offshore

financial centers than major OECD economies. Policy-makers in the major institutions of global economic governance have consistently acted on the basis that offshore centers or tax havens pose the greatest threat to the integrity of the financial system, and tend to facilitate the conduct of financial crime through providing strict financial secrecy (G20 2008, especially the sections on Promoting Integrity in Financial Markets; EU 2008; UN-World Bank 2007; FSF 2000, 2007; Senate 2008). Yet this presumption has remained largely untested.

To foreshadow the results, it is relatively easy to break the supposedly hard-and-fast rule prohibiting anonymous participation in the global financial system. Seventeen of the 45 attempts to solicit anonymous corporate vehicles met with success. Of these, 13 of 17 successful approaches were to service providers in OECD countries, compared with only four of 28 in tax havens. Establishing a corporate bank account while preserving this anonymity proved more difficult. Nevertheless, five of the solicitations were successful in obtaining offers for an anonymous corporate vehicle with an associated bank account without having to provide any certified identification documentation as to the true owner of the company and account. This success rate (indicating that the prohibition was effective almost ninety percent of the time) may seem like an endorsement of the existing rules; after all, no system is perfect. But the author's effort to procure anonymous corporate and banking services was a relatively amateurish, lowbudget affair carried out in the absence of any formal legal training or advice, involving Google and a budget of \$20,000. Even such a shoe-string affair managed to break a central principle of global financial regulation relatively quickly, cheaply and without sanction (so far). Compare this with the resources available to the criminal conspiracies perpetrated by rogue corporations like Enron, mafia organizations in Russia and elsewhere, and kleptocrat leaders in Africa and Asia;

the hollowness of the rule mandating financial transparency becomes clear, and with it the difficulty of fighting the global scourges listed above.

How does rule-effectiveness varies between tax havens and OECD countries? Here the result is exactly the opposite of what most observers have maintained: with regards to financial transparency, small island offshore centers have standards that are much higher than major OECD economies like the United States and the United Kingdom. The centers with the highest standards are those like Bermuda, the British Virgin Islands, the Bahamas, the Cayman Islands and Panama which uniformly require extensive identity documentation before establishing a corporate entity, let alone a bank account. A second group of centers was less observant, allowing the establishment of anonymous shell companies, but generally requiring identification before opening a bank account. These included Belize, Hong Kong, Canada and Britain. The third group, represented by Somalia and, worst of all, the United States are prepared to provide both anonymous corporations bank accounts without proper identity documentation. Before 2008 in the United States and pre-2007 in the United Kingdom the situation was even worse, with providers offering companies with corporate accounts without the need for any documentation at all. This pattern of results completely contradicts the rather sanguine picture of rule-effectiveness painted by powerful G7 states and the international organizations they dominate, which are responsible for monitoring these standards. In particular, the conclusion that the most serious weaknesses to the prohibition on financial anonymity lie in these bodies' largest member states, rather than small offshore financial centers, runs diametrically counter to the conventional wisdom on which a great deal of current policy-making is based (see references above).

In developing these points, the structure of the paper is as follows. The first section argues the general merits of direct participation and field experiment methods. Despite relative neglect, such approaches are suited not only for inspiring new hypotheses, but also in testing hypotheses, even at the level of global governance. The next section reviews the literature on international rules to isolate problems of selection bias, endogeneity and formalism which in combination tend to over-state the impact of international rules. Instead of looking at compliance, the conventional focus, it is argued that for both scholarly and policy reasons effectiveness is a more useful reference point. Company ownership may seem like a minor legal quibble, but the fourth section shows how a succession of major policy reports have identified the prohibition of anonymous shell corporations as the lynchpin of efforts to combat financial crimes ranging from tax evasion, to money laundering, to corruption. The utility of such corporations for illicit activities is illustrated with reference to two major scandals involving international tax evasion and bribery. The article then moves on to describe in detail the procedure for gathering evidence (soliciting and buying anonymous financial arrangements), and presents the findings. Chief amongst these are that international rules proscribing anonymous corporate entities are largely ineffective, though accessing anonymous banking is much harder. Counter-intuitively, and contradicting the conventional wisdom in policy circles, the failure to apply internationally-accepted standards is much more pervasive in G7 centers than tax havens. Finally, the article concludes by drawing out the implications for the study of international rules, regimes and global governance, as well as arguing for the wider application of methods like participation and field experiments in International Relations.

WHY A PARTICIPANT APPROACH?

There are international laws and conventions against torture, corruption, gender and racial discrimination and drugs, yet the existence of these instruments tells us nothing about their practical effectiveness. Common sense suggests that the gap between laws and standards may be very wide. A participation approach, in this case assessing the effectiveness of a rule by trying to break it, gives a particularly acute sense of the magnitude and incidence of this gap. This kind of approach is rare in political science, but is closely related to field experiments (though importantly without randomization). A common objection to field experiments has been that individual scholars can only test small questions, as opposed to the overarching issues most of interest to the field, especially issues in International Relations (Green and Gerber 2002). A first reply would be that even localized, direct interventions or participation can provide inspiration and insight on very important macro matters, up to and including global governance. Even on an informal basis, participant-observation has provided the stimulus for some of the most innovative and influential recent work on international organizations and global governance. Barnett and Finnemore trace their dissatisfaction with conventional wisdom on international organizations to their time working with the United Nations and the World Bank, respectively (2004: vii). From a very different theoretical orientation, Daniel Drezner relates that the formative incident for his realist account of global regulatory regimes took place during a year spent with the US Treasury (significantly, this incident concerned the imposition of anti-money laundering standards centring on the prohibition of corporate and banking anonymity, 2007: xii).

But if the uses of participant-observation and field experiments have been underappreciated in generating propositions about international organizations and global governance, the same goes doubly for testing such propositions (Green and Gerber 2002: 808). An example from economics of the utility of a direct approach in testing propositions is represented in "Are Emily and Greg more Employable than Lakisha and Jamal? A Field Experiment in Labor Market Discrimination." Here the authors sent fictitious resumes in response to job advertisements in Chicago and Boston, randomly assigning black- and white-sounding names to measure the effect of perceived race on employability. Even allowing for perceived class differences, the authors found that perceived race did make a pronounced difference. With identical resumes, white names received 50 percent more requests for interviews (Betrand and Mullainathan 2004). The conclusion drawn was that racial discrimination is still a major factor in the US job market, with crucial implications for the life-chances of black Americans.

An even more closely analogous method to that employed in this article is that used by Hernando de Soto and his team of researchers looking at the causes of worldwide development failures (1989, 2000). De Soto makes the obvious and yet under-appreciated point central this article that "Reading the laws as they are written gives no clue to how they will work in practice" (2002 [1989] xxii). In seeking to test their notions about the difficulty of entering the formal economy in the Third World his team performs a number of what are referred to as 'experiments' or 'simulations.' Thus the team applies for a sole trader license to produce textiles in Lima, Peru following all the requirements of the law and bureaucratic procedure. The researchers carefully recorded all the time spent filling out forms, waiting for official permission and dealing with bribe requests, mimicking as closely as possible the approach of a genuine applicant (2002 [1989] 133-34). They found that even this seemingly simple task required 11 separate procedures, taking 289 work days and cost the equivalent of 32 times the minimum monthly

wage in lost profits, not counting the bribes that had to be paid. De Soto's team later repeated equivalent experiments in Egypt, Haiti and the Philippines, with similar results (2000: 20-21). The significance was to support the proposition that it is extremely hard for those stuck in the underground economy in developing counties (a majority) to enjoy formal property and other legal rights, which in turn greatly raises the barriers to overall national economic development.

The scale, ambition and significance of these studies disproves the notion that participatory and field experiment designs must be limited to small questions and minor concerns. Neither do the geographical restrictions that characterized pioneering work in this vein in political science still obtain (Gosnell 1927). Of course these can be surmounted in a large-budget exercise involving a team of international researchers, as per de Soto (2000). But even when such means are lacking, modern communications can provide an answer. Working alone, the author tested the regulatory regimes of over 20 different countries without the necessity of international travel. The solicitation stage of the exercise required no funds, while the budget for purchasing shell companies and associated bank accounts was relatively modest (c. \$20,000).

INTERNATIONAL RULES: COMPLIANCE OR EFFECTIVENESS?

To the extent that realism has dominated International Relations since the Second World War, there has been a strongly argued case that international covenants and rules are empty formalities with no independent effect on actors' behavior. The field has largely moved on from such a blanket dismissal, and realist-inclined scholars have made some of the most insightful contributions to the study of global governance (e.g., Krasner 1991; Gruber 2000; Drezner 2007).

Yet the basic priority of showing that the international rules that should in theory apply do so in practice remains. In general, Simmons notes that "In the face of daunting conceptual and methodological issues, very little evidence has been accumulated to assess basic propositions about why governments commit to and comply with international legal obligations, and whether this makes any difference to outcomes in which we are interested" (Simmons 2000: 832). But the evidence that has been collected often presents an artificially positive picture of the impact of international rules. Reviews of the compliance literature (Simmons 1998; Raustiala and Slaughter 2002) note that many studies of compliance tend to overstate success (see also Haas et al. 1993: 17-18). First there is a bias because of selection effects: only 'easy' issues tend come up for international negotiation in the first place. The second bias is endogeneity: governments only sign up to commitments that they think it will be in their interest to keep. When behavior is compliant with the rules it is very difficult to show that compliance is occurring because of those rules, as opposed to merely reflecting what the actor would have done anyway.

In the current study, what is it exactly that is being tested? To answer this question it is important to have a clear understanding of the related yet distinct concepts of compliance, effectiveness and implementation. The most common definition of compliance in International Relations is that of Oran Young: "Compliance can be said to occur when the actual behavior of a given subject conforms to prescribed behavior, and non-compliance or violation when actual observed behavior departs significantly from prescribed behavior" (1979: 3). On this view, compliance is different from both implementation (domestic rule-making to enact international agreements) and effectiveness (the effect on the underlying policy problem, for example torture, polluting or money laundering). Compliance, whether states' behavior corresponds with rules,

may be necessary for effectiveness, but it is definitely not sufficient (Simmons 1998: 78). Implementation is neither necessary nor sufficient to translate compliance into effectiveness (Joachim, Reinalda and Verbeek 2008).

However things do not stay this clear for long. Raustiala and Slaughter observe that because compliance is above all concerned with how legal rules affect actual behavior, notions of compliance and effectiveness tend to blur. The level of compliance may in fact say nothing about the impact of rules on behavior (2002: 539), i.e. the outcome that is of most interest to scholars, policy-makers and citizens alike (Nye 1993: ix). Studying compliance in isolation thus poses a danger of formalism, falsely depicting a rule-governed world. This is despite our common sense knowledge that rules' "enforcement might totally contradict the letter of each of their provisions" (de Soto 2002 [1989]: 35). Drezner agrees that "governments often make pledges to co-ordinate without actually doing so," or design "sham standards" merely endorsing the status quo. Thus he favors a definition that runs together compliance and effectiveness (2007: 12). Indeed, this basic objection centering on sham rules is fundamental to the critique of international law as a field, as well as to those in International Relations skeptical of the potential efficacy of binding states with rules (Carr 1939; Mearsheimer 1994/95). From outside International Relations, scholars of public policy and public administration instead conceive of these kinds of questions in terms of implementation: "the conversion of policy into action" (Scofield and Sausman 2004). Beginning with Pressman and Wildavsky (1973), this strand of implementation literature has tended to come to much less positive conclusions from International Relations scholars: policies and rules seldom alter the behavior of targeted actors in the way policy makers expect and hope (O'Toole

2004). Public policy work suggests that International Relations needs to adopt tougher tests focusing on how rules affect actions.

In sum, the problems of selection bias and endogeneity, recognized in the literature on compliance, and formalism, which has received less attention, tend to mean that the empirical test of global rules that do exist often provide only relatively easy, and thus less valuable, tests that tend to confirm the hypothesis that international rules do make a difference. This approach runs directly counter to the basic maxim, common to science and the social sciences, that scholars should seek out tough tests that would tend to disconfirm their hypotheses (Popper 1968; King, Keohane and Verba 1994: 100). The participation approach taken in this paper constitutes just such a tough, direct test of rule effectiveness.

This study follows in the foot steps of Drezner (2007) and Haas, Keohane and Levy (1993) in avoiding the formalistic notion of compliance to instead concentrate on effectiveness. Effectiveness is whether international rules have in practice worked to stop behavior proscribed in such agreements, even if the ultimate resolution of the underlying policy problem remains unknown. Thus for both these works an international rule banning the production of cloroflurocarbons (CFCs) would be effective if the production of CFCs was made difficult or impossible as a consequence, even if the ozone layer continued to be degraded as a result of other causes. This paper asks whether international rules banning the formation of anonymous companies and their participation in the global banking system have been effective in terms of making it difficult or impossible as a result, even if financial crime continues due to other causes. Because the central conclusion of this paper is the magnitude of rule ineffectiveness and non-compliance, this negative finding obviates the need to establish whether rule-following behavior

would have occurred even in the absence of the rules themselves. A further parallel with the two works cited above is the need to look at national policy and non-state actors as the ultimate targets of rules. In connection with the environment, Haas et al. state that "National policy responses, because they directly affect the behavior of actors relevant to the environment, constitute a necessary condition for improvement in environmental quality" (1993: 8). Similarly, most of the other international rules that comprise the substance of global governance, from trade to human rights, seek to affect the behavior of entities below the level of the state, rather than just the state as a unitary actor (Drezner 2007).

ANONYMOUS SHELL COMPANIES AS A POLICY PRIORITY

Discovering who is really behind corporate vehicles and their bank accounts may sound like a trivial, esoteric accounting matter. In fact, it is the linchpin of some of the most important global governance initiatives. These include the fight against tax evasion, efforts to stem corruption and corporate malfeasance, and the campaign to counter money laundering. This section illustrates the importance of efforts to penetrate the corporate veil in two ways. The first makes reference to a number of reports by major international organizations all converging on the importance of getting behind the corporate veil to combat financial crime. This is to establish that individual countries and international organizations have recognized the matter of anonymous corporate vehicles as a serious policy problem. Because the issue is relatively technical, attention from governments and international institutions is unlikely to be just insincere rhetoric reflecting only a desire for favorable publicity. Crusades centering on slogans

like "Ban the bomb!" or "Make poverty history!" may grab headlines and motivate governments to play to the gallery; "Establish the beneficial ownership of corporate vehicles and associated bank accounts!" is unlikely to have the same effect. Secondly, this section briefly looks at some exemplary instances of financial crime: tax evasion by US citizens with reference to the Swiss bank UBS, and bribery with the alleged activities of arms company BAE Systems. These examples illustrate how anonymous corporate vehicles can be useful for financial criminals.

One of the first reports to put the issue of anonymous corporations at center stage was commissioned by the United Nations in 1998 on the tenth anniversary of the first international convention against money laundering, in this case connected with the illegal drug trade (the Vienna Convention). Financial Havens, Banking Secrecy and Money Laundering explains that 'Despite a myriad of complications, there is a simple structure that underlies almost all international money-laundering activities.... The launderer often calls on one of the many jurisdictions that offer an instant corporation manufacturing business.... Once the corporation is set up in the offshore jurisdiction, a bank deposit is made in the haven country in the name of that offshore company' (1998: 2). The title of the report notwithstanding, the authors emphasize that secrecy regarding the ownership of a corporation is a much more serious obstacle to countering money laundering than banking secrecy as such (1998: 31). The report estimated that at time of writing there were over a million anonymous corporations in existence. Currently there are more than 2 million offshore shell companies, and more than double this number of onshore shell companies. Subsequent analysis by the Financial Action Task Force on money laundering (FATF) has reiterated this conclusion that shell companies and other vehicles, set up by

Corporate Service Providers like those contacted in this study, are fundamental to money laundering (FATF 2006).

In 2000 the European Commission published the study *Euroshore: Protecting the EU*Financial System from the Exploitation of Financial Centers and Offshore Facilities by

Organized Crime. Receiving the most emphasis in the report is the centrality of establishing the beneficial ownership of companies: "company law is the most essential factor in the transparency of a financial system" (2000: 14). Encapsulating the rationale for the design of this study, the report goes on to say:

According to the type of regulation, company regulation produces the greater transparency or greater opacity of the financial system, thereby influencing the other sectors of regulation and determining the effectiveness of police and international judicial co-operation. This is the "domino effect" of company law: if this type of regulation seeks to maximize anonymity in financial transactions, enabling the creation of shell or shelf companies whose owners remain largely unknown... such anonymity will be transferred to other sectors of the law. Thus the names of ultimate beneficial owners or the beneficiaries of financial transactions will remain obscure, which thwarts criminal investigation and prosecution... if company law maximizes anonymity, then the ineffectiveness of criminal law and police and judicial co-operation is inevitable. The same effect arises in banking law, where bank secrecy becomes a marginal issue owning to the anonymity enjoyed by the companies operating the bank accounts under surveillance (2000: 16).

Despite the European Commission's premise that the problem was offshore, the report finds that on average EU members do worse than offshore centers in the transparency of their company law, and thus need to "clean up their act" before lecturing others (2000: 15).

In 2001 the OECD released the report from which this article takes its title, *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*, responding to a request from the Financial Stability Forum to investigate the problem of anonymous corporations. The report was subsequently endorsed by the G7 finance ministers (2001: 3). Corporate entities where the beneficial ownership is obscured are said to be central to all economic crimes: tax evasion, money laundering, fraud, corruption, insider trading and others. It is said that they may in the aggregate even imperil the stability of the global financial system (2001: 7; see also G20 2008). Offshore centers are said to be particularly at fault through their provision of shell corporations (2001: 24). Evidence is drawn from individual contributions by OECD member states as well as from various parts of the OECD secretariat.

More recently, a 2009 World Bank study authored by Richard Gordon sought to discover how corrupt heads of state and other senior politicians disguise the illicit origins (that is, launder) of the bribes they receive. The study analyzes 21 cases such as Sani Abacha, Alberto Fujimori and Asif Ali Zadari. The two key features identified in the report are anonymous shell companies and wire transfers made from accounts linked with such entities (2009: 15 and 22), confirming the empirical focus of the participation exercise at the heart of this paper. Echoing others, Gordon notes that the most common alibi for these funds is "consultancy fees" (2009: 18). Like the Euroshore report referred to above, Gordon notes that it is just as likely for onshore vehicles

and banks to facilitate the laundering of the proceeds of grand corruption as those in small island offshore centers (2009: 16).

The discussion above demonstrates that the issue of anonymous corporations has been widely identified as crucial in combating a range of high-priority international problems: the drug trade, organized crime, money laundering, tax evasion, corruption and systemic financial instability. In each area, however, it is not so much a case of introducing new international principles and standards as making those already on the books effective. A slew of global standards mandate the imperative for financial institutions to "Know Your Customer," meaning that beneficial ownership of corporate vehicles must be established (see Table 1 for a sample). There is no question that the formal rules are in place; the great unknown is their effectiveness.

TABLE 1: INTERNATIONAL PROHIBITIONS ON ANONYMOUS COMPANIES

Body	Instrument	Clause
United Nations	Convention Against Corruption	Article 52
OECD	Principles of Corporate Governance	Chapter V A 3
FATF	40+9 Recommendations	Recommendations 5, 33
Basel Committee	Basel Core Principles	Basel Core Principle 18
IOSCO	Multilateral Memorandum of Understanding	Paragraph 7 b (ii)

Before turning to the results gained from soliciting and establishing anonymous shell companies, it is germane to look briefly at two applied examples of the utility of anonymous shell corporations. The first relates to large-scale tax evasion carried out by US citizens assisted by UBS, using intermediary shell companies. This involved 19,000 undeclared accounts holding about \$20 billion, earning UBS \$200 million a year in fees (Senate 2008: 10). Although the UBS scheme did involve some genuinely innovative stratagems (e.g. smuggling diamonds inside tubes of toothpaste, "Ex-UBS Banker Pleads Guilty to Tax Evasion," New York Times 20 June 2008), much more conventional was establishing offshore vehicles for US citizens and transferring their accounts to the new shell entities. UBS and their US clients then collaborated in the fiction that the accounts were held by non-US persons, and thus that assets and income passing through was not liable for US tax (Senate 2008: 88). An example of such a UBS client is Igor Olenicoff, fined \$52 million for tax evasion in 2008. On the advice of UBS, in 2001 Olenicoff opened an account with UBS in Switzerland in the name of Guardian Guarantee Corp, a Bahamian shell company under his control, with Olenicoff and his family as signatories on the account. Both UBS and Olenicoff identified the beneficial owner of the \$89 million in the account as Guardian Guarantee Corp. to evade US taxes on the interest, even though they knew that in reality the owner was Olenicoff himself. Consistent with Olenicoff's over-riding priority of maintaining anonymity and escaping US tax (Senate 2008: 106), UBS then assisted with a \$40,000 re-structure to add further layers of secrecy: Guardian Guarantee Corp. was re-incorporated in Denmark as New Guardian Bancorp, which was put under the ownership of a Liechtenstein trust, with new accounts opened at UBS Switzerland under New Guardian Bancorp. But the principle of hiding the real owner

behind the corporate veil to evade tax remained the same. The same tactic has similarly been identified as a major fiscal concern for the members of the EU and OECD (EU 2008; OECD 2006).

Moving from a tax evasion to a corruption scandal, in December 2006 the UK government cancelled a corruption probe into an \$86 billion dollar arms deal between BAE Systems and Saudi Arabia. The decision followed threats from the Saudi government that it would suspend all intelligence co-operation with the UK and cancel the deal if the investigation were not quashed. The OECD Anti-Bribery Working Group strongly condemned this decision (OECD 2007), and the US Justice Department began its own investigation into money laundering associated with the affair. As in the UBS case above, details of BAE's allegedly corrupt activity had only come to light from a former employee, followed up by two investigative reporters, David Leigh and Rob Evans. The scheme is described by Leigh and Evans as follows ("BAE's Secret Money Machine," Guardian, 9 July 2007). BAE allegedly paid bribes to officials from Saudi Arabia and elsewhere in return for arms contracts using agents, the latter being separated from both BAE and bribe recipients by shell companies. The first intermediary company was Novelmight, until 1999 incorporated in the UK before then being re-incorporated in the British Virgin Islands. A second company, Red Diamond, was set up to channel payments via accounts in New York (Chase Manhattan), London (Lloyds TSB) and Switzerland (the ever-obliging UBS) to agents, and thence to officials from the governments purchasing BAE's wares. These payments were excluded from mention in the public contracts but included in parallel covert contracts for the same deals. Once more, maintaining the corporate veil was key: British police had just obtained crucial documentation elaborating on beneficial ownership of corporate bank

accounts when the government cancelled the investigation, citing "a lack of evidence" as well as national security concerns.

Before concluding this section it must be noted that just because the scale of UBS and BAE's operations were huge (BAE's Saudi deal described by the *Financial Times* as "the biggest sale ever of anything to anyone"), does not mean that the same basic principle of obscuring an owners' identity by interposing an anonymous corporate vehicle can not work on a much smaller scale. Even Olenicoff's relatively complicated structure cost only \$40,000 to establish, while companies like BAE's Red Diamond can be had for less than a tenth of this sum, as the following sections demonstrate.

SOLICITING AND PURCHASING ANONYMOUS SHELL COMPANIES

The first step in the participation exercise was to compose a short approach letter (email) to Corporate Service Providers. This letter was designed to mimic the profile of a representative would-be miscreant, based on recurring elements identified in the reports of the international organizations referred to above. The first is the anonymous corporate vehicle itself; the approach letter asked for the provision of some such vehicle, and emphasized the need for confidentiality and tax minimization (parallel to the UBS clients). The second is the nature of the business activity: international consultancy. Consulting fees are often a useful cover story for illicit cross-border flows (World Bank 2009: 18). Because there is a very large volume of legitimate money being moved around for this purpose, such transactions do not stand out as being unusual. Consulting fees may be very large, providing an alibi for large sums of criminal proceeds.

Because consultancy does not involve the exchange of physical goods, and unlike many other services does not require buyer and seller to be in the same location, it is very hard to prove that a consultancy arrangement was *not* in place. Legitimate consultancy arrangements are commonly governed by confidentiality arrangements, again giving an air of plausibility to the need for secrecy. Finally, even fees genuinely earned via international consulting can be linked to the criminal economy via tax evasion, as money earned outside an individual's home country may be hidden behind the corporate veil in a third jurisdiction to avoid tax obligations at home. The letter involved a permutation of the author's real name. This was done so as to avoid the legal consequences of signing financial documents in a fake name, but also to complicate the efforts of corporate service providers to link the person in the approach letter to the author's earlier related academic publications.

After designing the approach letter, the next step was to identify relevant Corporate Service Providers, those firms whose business it is to establish and provide basic administration for shell companies, trusts, foundations and so on. The aim here was to include service providers from a range of countries that are regarded (or at least regard themselves) as leaders in Know Your Customer standards like the United States and Britain, as well as countries that have commonly been stigmatized as offshore financial centers. Specific providers were identified through advertisements in the *Economist*, through Google searching, and in offshore finance magazines like *Offshore Investment*. There was an effort to sample a range of both on- and offshore centers in terms of the location of the service providers, and the specific corporate entities they offered (there is no necessary reason for providers to offer companies only from their home jurisdiction). Fifty-four service providers were contacted, of which 45 returned valid

replies. In the valid replies, service providers recommended one or more corporate structures that could achieve the goals set out in the approach letter, together with a pricing schedule. Responses commonly included a brochure specifying further services, and encouraged further contact, which was wherever possible carried out via email. These replies were tabulated in terms of whether the service provider would supply anonymous vehicles, and then whether this anonymity could be maintained in establishing an associated bank account (see Table 2 at the end of the paper).

Where the response made provision of the company and/or bank account conditional on notarized copies of a passport together with birth certificate, utility bills and the like to establish identity and residence, this was coded as not anonymous. It would have been impossible to shield true identity short of falsifying these documents (i.e. committing fraud). Where the corporate service provider required only name, address, credit card details etc. to be entered into an online form without any supporting documentation this was coded as anonymous (remembering that credit cards can be issued for corporate vehicles or supplied by a third party). By definition where the third party has no information as to the real owner, they cannot hand over any information to investigating authorities, representing a guarantee of anonymity. In relation to five bank accounts, providers asked only for an electronic scan of an identity document like a driver's licence, but there was no requirement to have it notarized or certified as a true copy. These are individually noted in Table 2. While indicating some concern with establishing beneficial ownership, this does not meet the international standards in Table 1. Rather than stopping with offers of anonymous entities and bank accounts, it was necessary to go through and make the purchase from the service providers offering financial anonymity. Several providers that had

earlier advertised anonymous products had clauses in the fine print required provision of identification documents.

FINDINGS

Table 2 presents the aggregate results of approaches to different service providers. Of the 54 Corporate Service Providers approached, 45 indicated a willingness to provide a shell corporation, the first step. Of these, 28 required identification before establishing companies (a notarized copy of a passport, usually complemented by utility bills as proof of residential address, as well as sometimes bank or professional references), while 17 were content to form the company without any independent confirmation of identity, requiring only a credit card and a shipping address for documents. Although the cost varied, in all cases establishing an anonymous shell corporation is cheap proposition, ranging from \$800 to \$3000 as an up-front cost followed by a slightly smaller amount on an annual basis. The cost variation is generally explained by the optional extras, in particular the extra layers of secrecy, but also various corporate accessories and accoutrements (mail- and phone-forwarding, brass plate, rubber stamp, letter head, embossed seal, etc.). Relative to the corporations requiring identification checks, the anonymous vehicles were slightly cheaper, depending on the accessories purchased. In six cases, service providers recommended holding the ownership of the shell company in an overarching common law trust or civil law foundation. This would present investigating authorities with one more obstacle in seeking to find the beneficial owner: tracking the bank account to the company, the company to the trust or foundation, and then control of the trust or foundation to the author via the service

provider, with each link in a different jurisdiction, as in the Olenicoff example above. No doubt following the money trail in such cases would be difficult, time-consuming and expensive, especially for governments with limited resources and a shortage of qualified legal expertise.

Yet no matter how complex, where the service provider has proof of the individual's identity, the veil of secrecy is vulnerable to being pierced. First because the hosting jurisdictions are vulnerable to pressure from outsiders to hand over client identity documentation. For example, after repeated public assurances that the Cayman Islands would not join the EU's tax information exchange program, Britain successfully obtained a reversal by threatening to suspend the Caymans' self-government and pass the legislation from London (Sharman 2008). Second, service providers themselves are vulnerable to the same sort of outside pressure. Here the case in point is UBS, which only a few years after sending its US clients a soothing email guaranteeing them that it would never pass their details to the IRS, passed over the details of 19,000 clients to the IRS in order to avoid criminal prosecution (Senate 2008). Service providers can become careless: after leaving sensitive documents behind in a hotel room, a traveling Swiss-based representative of a Jersey firm had his laptop seized by police in Australia, containing all the details of hundreds of tax-shy clients ("Jet Lag Snares a Tax Haven Tout," Sydney Morning Herald, 2 August 2005). Finally, rogue employees of the service provider like Heinrich Kieber of Liechtenstein's LGT bank may leak sensitive material (in Kieber's case relating to 4,500 accounts in return for Euro 4.2 million from the German intelligence service). Clearly, however, if the service provider has no information to disclose, these threats to the integrity of the corporate veil are all obviated. From a more legalistic point of view, the standards in Table 1 specify that it must be possible to establish the beneficial ownership of any given entity, and thus

even with chains of corporate vehicles the letter of the law is observed, even if in practise enforcing it may be difficult.

The results in Table 2 show that forming an anonymous shell company is an easy proposition, requiring little money and even less time searching on the internet. Following from this, the rules directly prohibiting such arrangements from a variety of powerful international organizations and states (see Table 1), are ineffective. An analysis that assumed that the mere presence of formal international rules prohibiting anonymous shell vehicles indicated that such vehicles were impossible, or even difficult, to obtain, would be wrong. Despite the near-universal coverage in terms of the countries that have committed to these rules, a significant number have merely adopted sham standards. As explained above, this finding is consequential because of the number of global initiatives against various financial crimes that have made financial transparency a central aim. It is difficult to see that this finding could have been obtained via a less direct approach. Even looking through the national legislation implementing the international standards is ambiguous, typically stating that "reasonable care" should be taken to establish beneficial ownership (see FATF Recommendation 5 [b]).

Perhaps even more striking than the ease with which this rule can be violated, is the pattern of jurisdictions that routinely violate this rule. Here the results are the reverse of what might be expected: service providers in major OECD economies are much more likely to offer anonymous shell companies than those in classic tax haven jurisdictions. Thus attempts to incorporate anonymously with providers in the Bahamas, Bermuda, the British Virgin Islands, the Cayman Islands, Dominica, Nauru, Panama and the Seychelles all met with failure, in that these agents refused to proceed without proof of identity. In nearly all cases these agents

explicitly noted that anti-money laundering regulations necessitated their keeping this information on file. This applied even when providers indicated they promised total confidentiality. Thus from one email response "An IBC [International Business Company, i.e. shell company] would suit you fine. There you would get total confidentiality and a tax holiday for the first twenty years of its operation. No one would know you owned the IBC. Your name would appear nowhere else but with us your agent and we cannot by law disclose the information to anyone." Even the Liechtenstein-based agent of the Somali International Financial Center required notarized passport copies (though they were much less fastidious about bank accounts, see below). One provider in Belize offered to incorporate a Belize shell company without identity documents, as did another in Uruguay for Seychelles companies, and two from Hong Kong regarding Delaware and other tax haven-domiciled companies. Yet of the 17 providers in OECD countries approached, no less than 13 agreed to form shell companies without requiring identification documents. These comprised seven the UK, four in the United States, one in Spain, and one in Canada (the sole Swiss and Czech providers responding were more scrupulous). Of these 13 providers, only one limited its stock to offshore shell companies (from Belize), three of the US providers offered only American companies, while the remaining US, the Canadian and all the British providers sold a mix of onshore and offshore vehicles, in some cases from more than 30 jurisdictions. In every case, whether or not identity documentation was required was a function of the location of the provider, not the domicile of the legal entity created (i.e. a British Virgin Islands company created from Britain would be anonymous, whereas one established from the Bahamas would not be). In combination, these findings suggest that the problem of financial opacity is one for which the G7 countries, particularly the United States and Britain, are

responsible, not palm-fringed tropical islands. While not an unprecedented finding (see Euroshore 1998; IMF 2005: 3; and to a lesser extent World Bank 2009), this does diametrically contradict the initial premises of important global regulatory campaigns. Although nearly all offshore centers regulate Corporate Service Providers, Britain and the United States have chosen to leave them unregulated. The consequences are clear.

An example of one shell company set up for this paper, André Pascal Enterprises, may prove illustrative. The company is an England and Wales Private Company Limited by Shares (with bearer shares) set up by a UK provider. Upon payment and submission of the order, the provider electronically lodged the application with UK Companies House. The provider became the initial shareholder of the company and subscriber to the Memorandum and Articles of Association for the purposes of the government records. Upon receipt of signed documents from the author (once again, without the need supporting identification), the provider issued bearer share warrants to the author, erasing the provider's name from the share registry without substituting any other. André Pascal Enterprises has a nominee director and nominee secretary (once more courtesy of the provider), again providing separation from the beneficial owner (the author). The incorporation process took less than a day, filling out the on-line forms took 45 minutes and the total cost was GBP 515.95. The new legal person is the kind of classic anonymous shell corporation so important for perpetrating a wide range of financial crimes, and which is almost impossible to obtain from offshore providers. The bonus is that as a corporate citizen of the UK, André Pascal avoids the taint associated with offshore companies while securing much tighter secrecy, an advantageous combination remarked upon by a number of

other providers. Significantly, until 2006 the same UK provider offered corporate accounts at a Latvian bank without the need for any supporting identity documentation.

Given that an anonymous shell corporation is generally a prerequisite for entering the international banking systems while keeping one's identity secret, the 17 providers offering anonymous corporations became the target sub-set. In seeking to purchase a bank account associated with an anonymous company the author soon ran into requirements for proper identity documentation from all but five providers. Thus the general effectiveness of the prohibition on anonymous accounts is substantially higher relative to that regarding anonymous shell companies. But the pattern of ineffective rules for providers in G7 states compared with those in tax haven largely remains. At first glance this high level of overall effectiveness (40 from 45) may seem to rehabilitate global standards on financial transparency; if a shell company is redundant without access to a banking system, and if anonymous companies are barred from the banking system, then the failure to prohibit corporate secrecy is much less serious, particularly for delinquent countries like the US and UK. The difficulty of obtaining anonymous corporate accounts does mark an important change from the situation a decade ago (UN 1998). But even without direct access to the banking system, anonymous vehicles can be useful in financial crime. One of the most common forms of international tax evasion is holding share portfolios in the name of a foreign shell company so as to avoid capital gains tax that would be due at home. More importantly, in a chain of corporate entities even one anonymous vehicle (e.g., a company acting as a director of another company or as a trustee) can disrupt the effort to establish the true owner at the end of the chain, rendering the whole structure opaque. Companies can be redomiciled or transferred to re-establish anonymity broken in the process of setting up an account.

Finally, however, the fact that it is difficult to retain corporate anonymity while opening a bank account is not to say it is impossible.

Only a small number providers responding to author were deficient in requesting proper identification documentation. The first, and most flagrantly in breach of international standards was a US provider offering a Wyoming Limited Liability Corporation with a US bank account. The provider offered to use their employees' own Social Security Numbers in applying for an Employer Identification Number (EIN), the tax identification number for the corporate vehicle. As the provider breezily informed the author in an email: "You can open a bank account in any state in the nation. It does not have to be in Wyoming. You will need an EIN number for the LLC, which we may be able to get for you, if you elect the nominee tax ID service. There are no supporting documents required at this time, outside of your contact information." Disappointingly for would-be criminals, in the months between this receiving this email and going ahead with an attempt to buy this structure, the laws in Wyoming changed to prevent this particular service being offered. Yet of all the countries appearing in Table 2 the United States remains in dead last place in terms of corporate and banking due diligence, behind even Somalia. A revealing comparison chart from a service provider specifies the documentation necessary to open a bank account in various countries, along with an overall difficulty rating (http://www.offshoreinc.net/new_bankcomparison.shtml). This ranges from 'very high' (Seychelles, Jersey), to 'high' (Hong Kong, Singapore), to 'medium' (Cyprus, Dominica); the United States is the only country ranked as 'low,' allowing accounts to be opened with an unnotarized copy of a driver's license. Again, a separate US provider confirmed in 2009 that the author could open a corporate account for a Nevada LLC with only a scan of a driver's licence.

The third and fourth opportunities were from two UK providers. The first comprised an anonymous Seychelles corporation with accompanying Montenegran bank account (purchased by the author for \$2255 plus €350). The second offered a range of US and tax haven corporations with a bank account in St Vincent and the Grenadines. Both required a scanned copy of a passport, but the providers explicitly noted that unlike other banks, the copy did not have to be notarized. The final case, the Liechtenstein-Somali joint venture, is unusual in having stricter requirements establishing a company compared with opening an account. While setting up a Somali shell company explicitly requires a notarized passport copy, both the provider's website and email communications repeatedly note that, although they require a scanned copy of some piece of photo identification, there is definitely no need to get this notarized or certified as a true copy in opening a bank corporate account. The repeated emphasis on this last point suggests that, like the previous examples, the providers are broadly hinting at the possibility of a de facto anonymous account. In this case anonymity is achieved by matching an existing anonymous corporation from any one of the 17 providers that offer such facilities, with the Somalian bank account, as brokered by the service provider in Liechtenstein.

CONCLUSION

The article closes with two brief points of extension from the material presented above, the first relating to the significance of the substantive findings, the second concerning method. As noted above, commentators in International Relations looking at the effect of international rules have been distributed between two poles. At one end of the spectrum, some realists have

argued that the independent effect of rules on states' behavior is negligible (Carr 1939; Mearsheimer 1994/95). Towards the other extreme are those studying international law, regimes and global governance, who tend to argue that most international rules are effective most of the time (e.g. Chayes and Chayes 1995). The evidence for a pattern of partial effectiveness (low for the formation of anonymous companies, much higher for anonymous banking), but even so the more variation in national compliance (low by G7 countries, much higher amongst tax havens), argues for a more complex verdict. The relative effectiveness of international rules barring anonymous corporate banking mark a change from the situation outlined by the UN in 1998. But in relation to anonymous shell companies, unlike the Cayman Islands and Panama, the United States, United Kingdom and other OECD states have simply chosen not to comply with international standards they had a large hand in creating. Nor is uneven progress in making these rules effective a result of a race to the bottom driven by regulatory arbitrage, or a prisoner's dilemma, whereby all states share the same preference, but rational anticipation of others' defection causes actors to refrain from co-operation. The "do as I say, not as I do" position of the G7 states towards smaller states is a reasonable fit with a classic realist position concerning the power- rather than rule-governed nature of the international system, although it also can be accommodated within other traditions (e.g., critical theory accounts). But unlike recent realist accounts of international standard-setting and effectiveness, it is not a case of core states or a hegemon adopting rules and then inducing others to follow their example (Krasner 1991; Gruber 2000; Drezner 2007). Instead, the hegemon and core states induce other states to follow rules that the former are *not* following themselves, perhaps analogous to the nuclear non-proliferation regime. A possible implication may be that realist-influenced authors have actually understated

the influence of power in the selective application and impact of international rules.

Concerning the field more generally, the conventional story of progress in political science emphasizes the move away from studying formal rules towards behavior, as well as the employment of increasingly scientific methods. Given this orientation and scale of values, direct approaches like field experiments and participation are curiously scarce. Such methods can potentially shed light on a class of questions of great interest to scholars, policy-makers and citizens: do rules work, i.e., are they effective? Their lack of employment in political science to compliment existing techniques seems to indicate much more a failure of imagination in the field than any inherent shortcomings. No doubt there are many areas of interest where participant and field experiment approaches are impractical, unethical and/or illegal. Attempting to solicit child pornography or an anti-aircraft missile via the internet in the way that this article has solicited anonymous shell companies would be worse than reckless. Yet speaking only of International Relations, the extent to which issues like legalization, global governance and international regimes have become major controversies in the field argues for the potential of similar approaches. Soft law standards are amenable to testing by breaking. Civil society groups, epistemic communities, private firms, international organization and states are relatively porous to scholars looking to learn by participating in their activities. The opportunities to advance scholarly and policy knowledge through direct approaches are there; more political scientists should seize them.

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TABLE 2: Results

Service Provider	Shell Company	ID Required?	Bank	ID Required?
Bahamas	Anguilla	Yes		
Bahamas	Bahamas	Yes		
Bahamas	Bahamas	Yes		
Belize	Belize	Yes		
Bermuda	Bermuda	Yes		
British Virgin Islands (BVI)	BVI	Yes		
Cayman Islands	Cayman Islands	Yes		
Cayman Islands	Cayman Islands	Yes		
Cyprus	BVI, Panama, St Vincent	Yes		
Czech Republic	BVI, Seychelles	Yes		
Dominica	Dominica	Yes		
Gibraltar	Turks & Caicos	Yes		
Gibraltar	BVI, Delaware, Gibraltar, Panama, Wyoming, etc.	Yes		
Hong Kong	BVI	Yes		
Hong Kong	BVI, Hong Kong, Seychelles, etc.	Yes		
Hong Kong	BVI	Yes		
Labuan (Malaysia)	Labuan	Yes		
Liechtenstein	Liechtenstein	Yes		
Nauru	Nauru	Yes		
Panama	Panama	Yes		
Panama	Panama	Yes		
Panama	Belize, Nevis, Panama, Seychelles, Vanuatu, etc.	Yes		
Sao Tome	Sao Tome	Yes		
Seychelles	BVI, Seychelles	Yes		

Singapore	Bahamas, BVI, Delaware	Yes		
Singapore	Singapore	Yes		
Switzerland	BVI, Delaware, Panama	Yes		
Belize	Belize	No	Belize	Yes
Canada	BVI, Ontario, Panama, Wyoming, etc.	No	Latvia, Panama	Yes
Hong Kong	Delaware	No	Hong Kong	Yes
Hong Kong	BVI, Hong Kong, Seychelles	No	Hong Kong	Yes
Spain	Belize	No	Belize	Yes
UK	Belize, BVI England, Nevada, Panama, etc.	No	Isle of Man	Yes
UK	Belize	No	Hong Kong	Yes
UK	Cyprus	No	Cyprus	Yes
UK	Belize, BVI, Delaware, England, etc.	No	Hong Kong	Yes
UK	England (A. Pascal)	No	Latvia	No (pre-2007), Yes
Uruguay	Seychelles	No	Hong Kong, Panama	Yes
US	Wyoming	No	US	Yes
US	Nevis	No	Belize	Yes
Liechtenstein	Somalia	Yes	Somalia	Yes (unnotarized)
UK	Belize, BVI, Delaware, Nevada, Panama, etc.	No	St Vincent	Yes (unnotarized)
UK	Seychelles	No	Montenegro	Yes (unnotarized)
US	Nevada	No	US	Yes (unnotarized)
US	Wyoming	No	US	No (pre-2008), Yes (unnotarized)