



Statement before the Senate Committee on the Judiciary
On "Combatting Kleptocracy: Beneficial Ownership, Money Laundering, and Other Reforms"

American Leadership in the Age of Authoritarian Corruption

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Chairman Graham, Ranking Member Feinstein, and distinguished Members of the Committee, thank you for inviting me to testify on what I believe to be one of *the* most important economic and security topics of our time—kleptocracy and how to mitigate it using economic transparency.

Ending the anonymous shell company is a key first step. Doing so requires a national beneficial ownership registry, which should be made available only to law enforcement agencies with proper Congressional oversight and professionals that can be held accountable for misuse or mishandling of the registry. Over time, beneficial ownership transparency that maintains strict privacy rights will produce the following benefits:¹

- More effective economic sanctions enforcement²
- More efficient law enforcement in money-laundering cases³
- More level playing field for American small businesses⁴
- Decreased compliance costs for US financial institutions⁵
- Decreased perceptions of corruption in the United States⁶

What is the overall strategy?

Economic transparency is a non-violent, asymmetrical weapon in the growing clash of democracy and authoritarianism. It is a powerful tool that is in lockstep with the character of our nation and is something we must come to understand as strategic in the post-Cold War era. Rapid interconnectivity brought by technological advances and globalization incubated a nexus of authoritarianism and corruption that threatens liberty everywhere. The best strategy for combatting this nexus is to begin taking small steps toward increasing economic transparency at home, with the goal of consolidating gains in liberty where it already exists.

Why greater economic transparency now?

The end of the Cold War was the beginning of a new era, one where conflict occurs less in proxy wars and grand ideologies, and more in trade wars and boardrooms. For the foreseeable future, turmoil around the world will be driven by competition between free societies and corrupt authoritarianism. Rightly so, the checked and balanced nature of decision-making in America has delayed our official entry into the fight, but the tipping point is coming.

The effects of authoritarianism are amplified and obfuscated by growing economic

¹ Dependent on larger economic trends and periodic adjustments to the registry.

² Kenneth A. Blanco, "Testimony for the Record," testimony before the Committee on Banking, Housing and Urban Affairs, US Senate, May 21, 2019, <https://www.banking.senate.gov/imo/media/doc/Blanco%20Testimony%205-21-19.pdf>.

³ Steven M. D'Antuono, statement before Committee on Banking, Housing, and Urban Affairs, US Senate, May 21, 2019, <https://www.banking.senate.gov/imo/media/doc/D'Antuono%20Testimony%205-21-19.pdf>.

⁴ Small Business Majority, "Opinion Poll: Small Business Owners Support Legislation Requiring Transparency in Business Formation," April 4, 2018, <https://smallbusinessmajority.org/sites/default/files/research-reports/040418-Corporate-Ownership-Disclosure-Poll.pdf>.

⁵ American Bankers Association, "Joint State Association Letter to HFSC re: Support H.R. 2513, Corporate Transparency Act of 2019," June 10, 2019, <https://www.aba.com/Advocacy/Grassroots/WINNDocs/joint-trades-support-aml-bo-061019.pdf>.

⁶ Clay R. Fuller, "Dealing with Anonymity in Business Incorporation," AEIdeas, March 29, 2019, <http://www.aei.org/publication/dealing-with-anonymity-in-business-incorporation/>.

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interconnectivity. Illicit economic activity now crosses sovereign borders, spreads corruption, and funds nefarious activities within the United States and other rule of law-based democracies at unprecedented levels. Combatting authoritarianism and addressing the dark networks that support its consolidation are unavoidable strategic challenges to global security.

Greater economic transparency under the rule of law is the best strategy for fighting authoritarian corruption without sacrificing the democratic values that make the American spirit a beacon of hope for oppressed people around the world. Rules-based economic transparency is one of the many ways that America displays moral leadership, and it is what makes our nation one of the most prosperous on earth.

What is kleptocracy?

Corruption is woven into the institutional fabric of all authoritarian regimes.⁷ But what is meant by the statement that authoritarian systems are institutionally corrupt?

Political leaders everywhere prefer to stay in office. To stay in office, leaders must provide a defined group with some package of either public or private goods in exchange for their support.⁸ Leaders in democracies, such as the United States, need the support of large numbers of voters. This is why elected officials offer voters public goods in the form of good policies—education, national defense, tax cuts, or health care—in competition for votes. Free and fair elections allow for open debate and competition between proposed or previously enacted policy packages.

Leaders in authoritarian regimes, such as Russia,⁹ need the loyalty of smaller groups to stay in power, which allows them to offer loyalists customized packages of private goods—such as cash, homes, or access to state resources—instead of good (and costly) public policies. When authoritarian leaders cannot purchase loyalty with private goods, they turn to violence. All authoritarian regimes are, to some degree, a form of kleptocracy. The concentration of political power in any system of government leads to theft and corruption.

Therefore, elected leaders in democracies face a double-standard. Even though they pursue political power by advocating for good public policies, when voters perceive misbehavior, elected leaders are more easily removed from office (whether by scandal or by vote) than authoritarians. Meanwhile, authoritarian

⁷ This statement is not intended to imply that all authoritarians are our enemies. Nor is it meant to imply that no authoritarian cares about the people he rules—some do very much. For a detailed account of this, see Calvert W. Jones, “All the King’s Consultants: The Perils of Advising Authoritarians,” *Foreign Affairs*, April 16, 2019, <https://www.foreignaffairs.com/articles/persian-gulf/2019-04-16/all-kings-consultants>.

⁸ For a full treatment of “selectorate theory,” see Bruce Bueno de Mesquita, Alastair Smith, Randolph M. Siverson, and James D. Morrow, *The Logic of Political Survival* (Cambridge, MA: MIT Press, 2003). For a more popular account, see Bruce Bueno de Mesquita and Alastair Smith, *The Dictator’s Handbook: Why Bad Behavior is Almost Always Good Politics* (New York: Public Affairs, 2011).

⁹ We should not conflate the people that live under authoritarian rule with their governments or their leaders. Russian and Chinese people are exactly the same as Americans and Brits. The differences are in the moral character of governments.

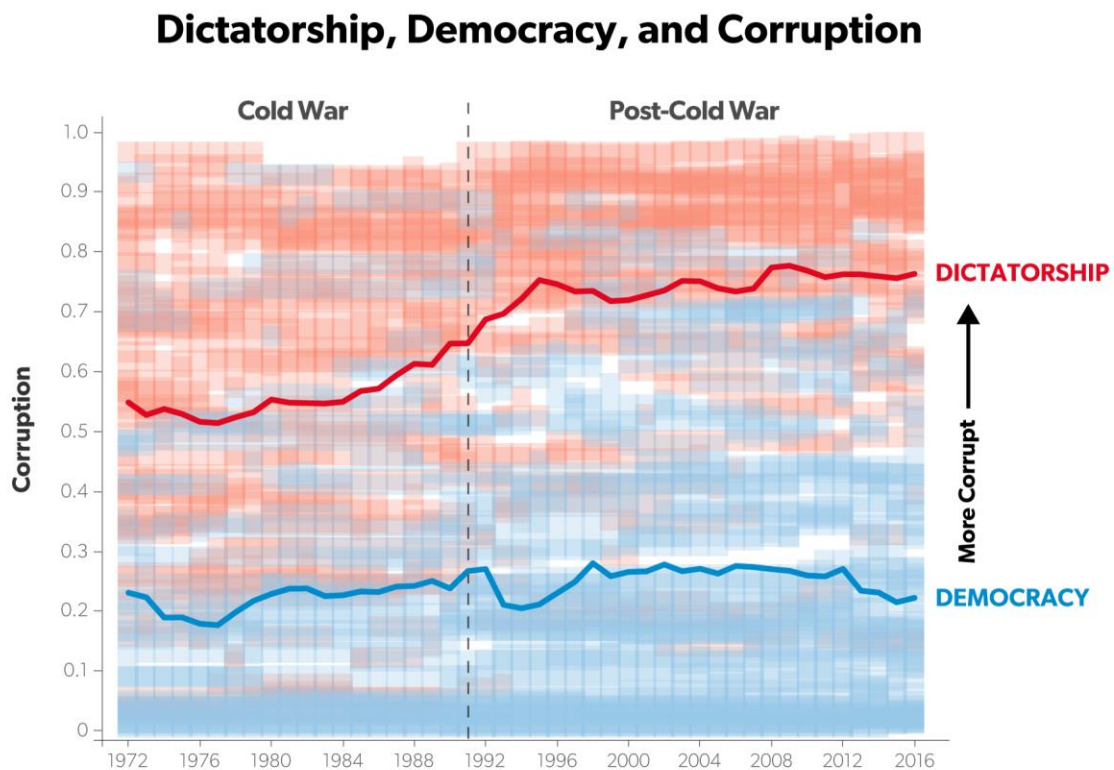
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leaders need to amass ever-larger amounts of personal wealth to stow in rainy-day, discretionary funds—ideally located in democracies, like the United States or UK, where markets are deep, fluid, and the fund is protected by the rule of law. Corruption is the disease. Kleptocracy is patient zero.

The fundamentals of kleptocracy

Because authoritarian states are internally less transparent and less competitive, they tend to rely on the exchange of private goods for loyalty.¹⁰ This corrupt dynamic of authoritarian rule is universal; it exists regardless of the presence of seemingly democratic institutions (such as rubber-stamp legislatures or rigged elections) or membership in international institutions (such as the World Trade Organization).¹¹ The tendency of authoritarian systems to use corruption as a survival tool is not going to change any time soon. In fact, in the post-Cold War era it has only intensified (see Figure 1).

Figure 1.



Note: "Dictatorships" are categorized as "Not Free" and "Democracies" are categorized as "Free" according to Freedom House. Source: Freedom House, "Freedom in the World"; Varieties of Democracy, "Public Sector Corruption Index"



However, authoritarian systems are sovereign states. Whether free peoples want to

¹⁰ For a full treatment of the dismal state of authoritarian politics, see Milan W. Svobik, *The Politics of Authoritarian Rule* (Cambridge, UK: Cambridge University Press, 2012).

¹¹ Dawn Brancati, "Democratic Authoritarianism: Origins and Effects," *Annual Review of Political Science* 17 (2014): 313-326.

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admit it or not, authoritarians ultimately have “the right” to steal from their own people in their own lands. They do not, however, have the right to abuse the liberty of America’s political and economic systems in the commission of such corruption.

Why start at home?

Domestic policy plays a key role here because the goods that dictators require to retain loyalty are more often than not the products of democracies: dollars, euros, patents, real estate, art, and prestigious degrees. Some elites in every country are willing to lie, steal, or commit violence in exchange for these goods. But in authoritarian states, elites willing to bend or skirt the rule of law are artificially concentrated and curated in a systematic effort to enhance regime survival.

Free peoples are more often keenly aware of problems with corruption because corruption is investigated by independent authorities, prosecuted in a court of law, and then broadcasted to the world via a free press. That does not mean that problems with corruption in democracies are similar in scale to those in dictatorships. Indeed, it indicates that democracies fight corruption more effectively, precisely because they are more transparent. This is democracy’s comparative advantage.

As free societies work to uphold the impartial rule of law in a global economy, authoritarians increasingly depend upon transnational networks of non-state actors, enablers within democracies, and outright theft in order to obtain the goods necessary for survival. Corruption is the Achilles’ heel of authoritarian governments. As it spreads, the best defense is to take small steps towards increasing economic transparency at home that will allow for deeper cooperation with our democratic allies. Here, the US Congress can lead the charge and set the global standard.

Leadership: leveraging beneficial ownership to fight kleptocracy

The best first step in dismantling the authoritarian-corruption nexus is to begin dealing with the problem of anonymous shell companies. The standard shell company plays a legitimate role in market activity, but when it is anonymously owned it facilitates crime, corruption, terrorism, and authoritarianism.¹² Privacy rights are vitally important to markets, democracy, and foreign policy, but pathways to anonymity—especially the ease with which an anonymously owned shell company can be created in the United States—are a weak spot being exploited by America’s state and non-state adversaries.

It is apparent that many other democracies around the world are ready and willing to pursue beneficial ownership transparency and uphold the rule of law. According to a June 2018 report by the Tax Justice Network, the following jurisdictions had already approved beneficial ownership registration requirements in some form:

¹² Clay Fuller, “The Business of Funding Terrorism Threats,” *National Interest*, June 3, 2019, <https://nationalinterest.org/feature/business-funding-terrorism-threats-60882>.

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Austria, Belgium, Bermuda, Brazil, British Virgin Islands, Bulgaria, Cayman Islands, Costa Rica, Croatia, Curacao, Czech Republic, Denmark, Dominican Republic, Estonia, Finland, France, Germany, Ghana, Gibraltar, Guernsey, Hungary, Isle of Man, Italy, Jersey, Latvia, Lithuania, Malta, Portugal, Slovenia, Sweden, Turks & Caicos Islands, Ukraine, United Kingdom (UK), and Uruguay.¹³

By 2020, the following jurisdictions are expected to join them:

Anguilla, Cyprus, Greece, Ireland, Luxembourg, Montserrat, Netherlands, Poland, Romania, Slovakia, and Spain.¹⁴

In June 2016, the UK launched a public beneficial ownership register—the first of its kind. A year later, the UK’s overseas territories and crown dependencies, launched their own registers. The UK is currently considering legislation that would establish a new, public beneficial ownership register for foreign entities seeking to purchase or lease property in the UK.¹⁵

In December 2018, Canada approved legislation to create new beneficial ownership requirements for corporate entities.¹⁶ Beginning last Thursday (June 13, 2019), Canadian corporations are now required to maintain an internal beneficial ownership register, accessible to the company’s shareholders, creditors, and federal authorities.¹⁷ Canada is also considering establishing a national beneficial ownership register to aggregate the information.¹⁸

There is also movement on beneficial ownership transparency in Africa.¹⁹ African leaders repeatedly complain about the adverse economic and political effects of illicit financial flows often facilitated by insufficient transparency. Ghana, Kenya, and Liberia have committed to developing public registers, while Nigeria promises to create a private register of beneficial ownership. In November 2018, Senegalese President Macky Sall reaffirmed Senegal’s 2016 pledge to establish a public beneficial ownership register.²⁰

¹³ Andrew Knobel, Moran Harari, and Markus Meinzer, “The State of Play of Beneficial Ownership Registration: A Visual Overview,” Tax Justice Network, June 27, 2018, 12, <https://www.taxjustice.net/wp-content/uploads/2018/06/TJN2018-BeneficialOwnershipRegistration-StateOfPlay-FSI.pdf>.

¹⁴ Knobel, Harari, and Meinzer, “The State of Play of Beneficial Ownership Registration,” 12.

¹⁵ <https://www.lexology.com/library/detail.aspx?g=2e067f1c-d194-42c6-ac6b-6282d6ce0575>

¹⁶ Brett Capstick, “Efforts to Combat Snow Washing: Canada Moves Towards a Beneficial Ownership Registry,” HillNotes, February 5, 2019, <https://hillnotes.ca/2019/02/05/efforts-to-combat-snow-washing-canada-moves-towards-a-beneficial-ownership-registry/>.

¹⁷ Corporations Canada, “Register of Individuals with Significant Control (ISC),” last updated April 2, 2019, <http://corporations.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs08216.html>.

¹⁸ Bruce Ball, “New Beneficial Ownership Rules Are Coming in June. Are You Ready?” Chartered Professional Accountants Canada, April 9, 2019, <https://www.cpacanada.ca/en/business-and-accounting-resources/taxation/blog/2019/march/beneficial-ownership-rules-start-preparing-now>.

¹⁹ Transparency International, “Recommendations on Beneficial Ownership Transparency for Open Government Partnership National Action Plans,” July 17, 2018, https://www.transparency.org/whatwedo/publication/recommendations_on_beneficial_ownership_transparency_for_ogp_national_actio.

²⁰ Macky Sall, “Opening Address at the Beneficial Ownership Conference” (speech, Africa Conference on Beneficial Ownership Transparency, Dakar, Senegal, October 31, 2018), <https://eiti.org/document/president-of-senegal-macky-sall-opening-address-at-beneficial-ownership-conference>.

The high levels of corruption in many developing countries pose immense risks for American banks. These risks make financing more costly and these countries often turn to China to finance development projects. But it is not just opaque Chinese finance or illicit finance that feeds kleptocracy, it is also illicit trade. A 2019 OECD study found that over 75 percent of all globally seized counterfeit goods originate from China and over 75 percent of the patent holders for those goods are American or European.²¹ Additionally, a recent study by Global Financial Integrity found that India lost \$13 billion in 2016 alone due to trade misinvoicing.²²

Regarding beneficial ownership registries specifically, there is still reasonable debate among our allies over whether or not such registries should be made available to the public. I have suggested here and elsewhere that registries should remain strictly private, as they appear to be in the Corporate Transparency Act of 2019, recently approved by the House Financial Services Committee.²³ The issue of public versus private registries is one area where the United States has the opportunity to set a global standard and lead the free world on this issue.

In summary:

American leadership on beneficial ownership legislation means setting an example of pragmatism and principled leadership on issues of fairness, privacy, and transparency in an increasingly global economy. Transparency is often viewed as sunlight, and people tend to reflexively agree that more is always better. More is not always better—sometimes more is just more. Occasionally there is an unintended dark side to transparency for its own sake.²⁴ Before enacting new transparency laws, such as a beneficial ownership registry, America should carefully consider who will benefit, who will pay costs, and what the ultimate goals of increased transparency are. In other words: what is the strategy?

The costs of waiting too long are that many real and potential allies are turning to China and Russia on economic matters because they misperceive these authoritarian states as equals or lower cost alternatives to the United States. What our friends do not always realize is that such cooperation invites a corrosive new form of authoritarianism.²⁵ Furthermore, the longer the US waits to act on these issues at home, the more powerful non-state criminal and terrorist networks grow,

²¹ Organisation for Economic Co-operation and Development, "Trade in Fake Goods Is Now 3.3% of World Trade and Rising," news release, March 18, 2019, <https://www.oecd.org/newsroom/trade-in-fake-goods-is-now-33-of-world-trade-and-rising.htm>.

²² <https://gfintegrity.org/issue/illicit-financial-flows/>

²³ Corporate Transparency Act of 2019, H.R. 2513, 116th Cong., 1st sess., § 5333, <https://www.congress.gov/bill/116th-congress/house-bill/2513>; and Clark Gascoigne, "House Committee Advances Bipartisan Bill to End Abuse of Anonymous Companies," FACT Coalition, June 13, 2019, https://thefactcoalition.org/house-committee-advances-bipartisan-bill-to-end-abuse-of-anonymous-companies?utm_medium=press/news-releases.

²⁴ James D'Angelo and Brent Ranalli, "The Dark Side of Sunlight," *Foreign Affairs*, April 16, 2019, <https://www.foreignaffairs.com/articles/united-states/2019-04-16/dark-side-sunlight>.

²⁵ Center for International Private Enterprise, "Channeling the Tide: Protecting Democracies Amid A Flood of Corrosive Capital." September 2018. <https://www.cipe.org/events/corrosive-capitals-threat-to-democracy-how-china-and-russia-undermine-rule-of-law-through-foreign-investment-and-development-strategies/>

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on our dime.

The benefits of a national beneficial ownership registry include leaner and more effective law enforcement, easier legal cooperation with other democracies, reduced compliance burdens on US financial institutions, and increasing global and domestic confidence in the rule of law.

Additional Recommendations:

Though a potent tool, a private beneficial ownership registry would not be sufficient to defeat the threat of authoritarian corruption. Because of the amorphous and interconnected threat we face, the US must continue slowly pursuing complementary reforms, such as:

1. Providing more funding, staff, and direction to the Financial Crimes Enforcement Network (FinCEN) while increasing Congressional oversight of its mission. Federalizing FinCEN by requiring all 50 states to create a Financial Intelligence Unit (FIU) connected to the FIU in Treasury (FinCEN) is one way in which this could be accomplished, spreading the costs and giving each state a say in their own unique markets.
2. Providing a yearly list of the fifteen most high-risk foreign trade zones (FTZs) (also called special economic zones or SEZs) worldwide and sanctioning the worst offenders each year. Additionally, the US should gather more information on America's own FTZs, their role in combatting trade-based money laundering (TBML) schemes, and the ways in which they could be better equipped to counter trade in fakes (counterfeits) from China.
3. Amending the Foreign Corrupt Practices Act (FCPA) in an effort to level the playing field and give the private sector a greater role in anti-corruption efforts worldwide. American companies that do business in countries with high levels of corruption should be rewarded for efforts to boost transparency and strengthen representative government in those places. Business partnerships with local, nongovernmental organizations, media campaigns aimed at educating the public, as well as private or public partnerships geared toward practical steps at addressing issues of corruption in the markets those businesses cater to, are already squarely in the interests of those companies. However, these actions should be explicitly rewarded by US law.