

The Global Kleptocracy

A few months ago, I was sitting across a charming Russian woman at a dinner party in New York. The discussion turned to politics, Putin, oligarchs and all that. Elena argued that the situation in Russia, with its high levels of inequality among its citizens and ongoing wars, was quite normal, historically speaking. Her thesis was that the socialist/communist period (1917-1990) was merely an accident of history. Accumulation of capital, crony capitalism, control of the media by economic interests have always been standard features of market capitalism which are commonplace in many countries.

Not that communism was much better, mind you. Since the middle of the 20th century, we learned about weary emigres from the Eastern bloc, with their accounts of brutal life after the Bolshevik revolution, the gulags, and the different phases of the Soviet 80-year "experiment". According to Elena, the ideological discourse and the Cold War rhetoric used on both sides of the Iron Curtain were merely smokescreens that were used by governments and their associated elites to gain power and amass vast amounts of wealth in the process.

What the leaking of the Panama Papers suggests, then, is that the practice of the powerful to extract wealth by means of crony "capitalism", no-bid contracting, control of banks and industries via relatives and proxies, has always existed and will continue. Moreover, the leak suggests that power-induced theft is not limited to any particular country, political party or ideology: it is the one thing that unites most countries in the world. The Panama Papers reveal that the "globalization of kleptocracies" is alive and well in the 21st century.

The existence of a Global Kleptocracy means that there are standard ways in which stolen money can be laundered by means of offshore companies to conceal its origins. In the Panama Papers scandal, the firm of Mossak Fonseca, operating in Panama with offices in other countries, specialized in the manufacturing of anonymous companies, which were built to the needs of its clients. It is interesting to go through the client list of MF and see how offshore finance can make strange bedfellows: a star football player of the Spanish league, the president of a Latin American country, a large fraction of elected officials of another Latin American country, the godfather of Vladimir Putin's older daughter, Hafez Al-Assad (president of Syria), the Prime Minister of Iceland, and the list goes on. In many cases (like Argentina) one would never have imagined that the different people involved shared the same international tax lawyers, since they were avowed political adversaries. In Brazil, the people accused of stealing money from Petrobras and obtaining bribes from construction companies used the same law firm in Panama than those who are presently prosecuting them for those crimes. They belong to the same club, so to speak. Enter the club of Global Kleptocracy.

Global Kleptocrats, even though associated with different political ideologies, follow the same behavioral patterns, like a tribe (think of the 'jet set' of the 1960-70's). They have lawyers in

Panama and Geneva, offshores companies in the British Virgin Islands, Cyprus and Jersey and pied-a-terres in New York, London, Paris and Miami. They send their children to elite schools and collect art using art advisors, hire home builders and interior decorators and real estate agents and, generally speaking, want "the best of the best" and are willing to pay for it, usually in cash.

The best way to begin to understand Global Kleptocracy is to see what a "normal person", i.e. one without any distinguishable skills, or perhaps with not a lot of education, would do if he or she would have won a large lottery. Anonymity becomes important: these people do not want others to know that they have money. Hence, the manufacturing of an "offshore identity" to protect oneself.

Second: the money needs to be spent somewhere. The lottery winner can buy houses for each parent or sibling, but this does not begin to "move the needle" in terms of spending. It is always better to move to a place where one can live anonymously and mingle with "normal wealthy people", presumably others who may not be from one's own country or that are not also Global Kleptocrats as well. But not all people are like that: some may need toys, such as a mega-yacht. Mossak-Fonseca has a yacht practice, which is convenient. Your yacht can have a BVI flag and visit different ports in the Caribbean or the Mediterranean where you would board with your friends for some happy times. Or, the yacht can be used for corporate business or, even better, leased out when you don't use it.

One interesting aspect of Global Kleptocracy is real estate transactions in the United States. Most Americans (Jack and Jill Smith) buy a house using credit and Fannie Mae mortgages. This is not the way GKs acquire property. In fact, it would be silly for a GK to take out a mortgage, since he or she has to spend cash as part of legitimizing its ownership. Enter the "all cash" transactions. Many people know that the expression "all cash transaction" in the US real estate market provokes deep feelings of happiness among brokers and home sellers. There is probably nothing "sexier" than an all-cash real-estate transactions. On a closer examination however, the economic benefit of an all-cash transaction versus a mortgage is the same for the seller (who will receive the full amount for the sale upon closing, either way). The broker will also receive the commission whether the deal is "all cash" or "financed".

So why all the hoopla about all-cash? Because (a) the buyer is foreign (b) there will be no need for a bank to approve the loan (c) it is assumed that the buyer will pay the offering price and will not haggle because he or she is rich. It seems now that more and more U.S. residential real estate deals are done by foreigners with all cash deals, and that many of them use LLCs (limited liability corporations) which may in turn be owned by an offshore entity. It is known that this approach to buying property in the U.S. has a benefit relative to buying the property in the name of an individual. This advantage has to do with estate-taxes. Ownership of apartments or houses can be held in shares of the LLC and the tax liability would be much less than if the title of the property is transferred from parent to siblings as part of an estate.

The all-cash transactions in real estate using the LLC owned by a foreign offshore entity can be used to take money out of other countries, obtained through corruption, bribes or other means and transferred to the foreign entity and invest it in U.S. real estate. The practice opens a wide avenue for money-laundering in the U.S.

With its benign tax code, a system of justice which protects individual rights, excellent universities and hospitals and general openness towards other cultures, the United States is a very desirable destination for Global Kleptocrats wanting to carry on a "normal life". After establishing a U.S. residence and domicile for his family, the GK can transform himself into a pillar of the cultural life in American communities, bringing that *je ne sais quoi* (accent, sense of humor, generosity, social ability) which will make him a fixture of cultural life. It is, for the lack of a better expression, a win-win situation for the GK and the host.

One should hasten to add that the U.S. is not the only destination of Global Kleptocrats. For many years, Switzerland and the United Kingdom were natural destinations. The advantage of the latter countries were friendly and secretive banking systems, providing anonymity and proximity to Europe without being located specifically in the heavily regulated and taxed European nation-states.

In the 21st Century, the classic tax havens of the U.K., Switzerland, Cyprus, and the Principality of Monaco have become too obvious and, I believe, too small, to satisfy the demands of the new Global Kleptocrats. One has read many stories about African fortunes based on "blood diamonds" residing in Swiss cantons, of hidden accounts containing Nazi treasures, and of sheiks and princesses going on wild Harrods's shopping sprees. But it appears that the old tax shelters of the 20th century will not suffice to satisfy the new Global Kleptocracy's need to launder money.

Independent estimates for the annual amount of money-laundering which takes place in the world suggest a headline number of USD one trillion. Of this amount, half comes from the People's Republic of China. The other half comes from various countries, with Latin America and Russia providing the bulk of the flows. One trillion is a large amount of money. The U.S. GDP is approximately 12 trillion. The GDP of Spain is approximately 1.3 trillion. This means that the Global Kleptocracy is an economy as large as Spain. It also means that the U.S. economy is large compared to the Global Kleptocracy.

How can you hide a Spain-sized economy from plain view? Mossak-Fonseca Esq. represents a building block of this very large endeavor. Reading various articles on the internet, I learned that MF can produce companies domiciled in Caribbean islands or on the Indian Ocean, or in Cyprus which are starting points to other companies which will be cascading, finally, into that innocuous LLC which will buy a condo on Brickell Avenue, Miami, USA, or a house in Aspen, CO. I think that we are beginning to get the general idea, without knowing the small details.

Occasionally, this Spain-sized ghost economy, the Global Kleptocracy, reveals itself. A few years ago, for example, Cyprus, a member of the European Union had a run on its banks. The situation

was delicate because in principle these banks would have benefitted from the assistance of the EU. It was then found that the Cyprus banks were mostly holding Russian offshore deposits.

The Mossak-Fonseca leak is the most recent symptom of the continued activity of the GK. What is interesting about it is that it is in the form of a historical record: in other words, it contains shell companies which are alive and others that lived and died of a natural cause. The latter, would have never been revealed from examining the current roster of shells administered by MF. Journalists and investigators will be able to establish time-lines of companies formed by MF and their owners, present or past.

Another interesting thing about the MF leak is that there appear to be few U.S. nationals involved. Why so? Are we nicer people? While there are no direct answers for this, I conjecture that the reason is that we are the destination, not the origin, of the Global Kleptocracy. Our real estate and business structures are, apparently, GK friendly. Some cynics may believe that this represents a (short-term) advantage to the U.S. but, clearly, it will be a disadvantage going forward.

Why so? Setting aside moral consideration (theft is a crime and hiding funds makes you an accessory) the problem with Global Kleptocracy is that it really goes against the principles upon which America was built. A country of essentially made of religious refugees, populated by poor immigrants, slaves and indigenous people, one may argue that the virtues of the US lie in its industrious and simple people. Many, like myself, came to the US to study in land-grant state universities and were transformed in the experience. America is the country that invented the airplane, the telephone, the telegraph, the light bulb, the VCR, the personal computer, e-commerce, social media – you name it. This spirit is powered by the strong feeling that invention and creative business, combined with very hard work and public capital markets, will result in a better society and in an increased standard of living. The proposal of becoming a tax-haven for the Global Kleptocracy, whether in the towers of Manhattan or the condos of Miami and everywhere else, does not bode well will our project as a nation. In other words, we should avoid as much as possible being seduced by cash, even of the size of the Spanish economy, for this is not who we are. America needs to give solace and pay more attention to people who are truly willing to invest themselves and their families into the fabric of our great country in the purest sense of the word. And it's a better message to leave to our children. And I think Elena would agree.

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