Chasing kleptocrats' loot:
Narrowing the effectiveness gap

Jason Sharman

Anti-Corruption Resource Centre

U4

www.U4.no

Chasing kleptocrats' loot
Narrowing the effectiveness gap

Jason Sharman

Centre for Governance and Public Policy

Griffith University, Australia

Anti-
Corruption
Resource
Centre
www.U4.no

Contents

Abbreviations

AML	anti-money laundering
AusAID	Australian Agency for International Development
AUSTRAC	Australian Transaction Reports and Analysis Centre
CSP	corporate service provider
FATF	Financial Action Task Force
FIU	financial intelligence unit
G20	Group of 20
IMF	International Monetary Fund
NGO	nongovernmental organisation
OECD	Organisation for Economic Co-operation and Development
PEP	politically exposed person
PNG	Papua New Guinea
StAR	Stolen Asset Recovery Initiative
STR	suspicious transaction report
UNCAC	United Nations Convention Against Corruption
UNODC	United Nations Office on Drugs and Crime

All dollar amounts are US dollars.

1. Situating the issue: Development, kleptocracy, and money laundering

Despite heightened attention to the issue of corruption in the wake of the Arab Spring, there are still many failures and few successes in combating major corruption offences committed by senior public officials. In a large number of countries, officials are still able to launder the proceeds of corruption, at great cost to the development prospects of their countries and the welfare of their citizens. Since money laundering most often takes place outside the home countries of the officials involved, grand corruption requires an international response. Inward flows of development aid are often more than matched by outward flows of illicit money to be stashed or spent abroad, often in the very same countries providing development assistance (UNODC and World Bank 2007; Fontana 2011; Reed and Fontana 2011). In response to this challenge, a large majority of the world's states have now committed themselves to an extensive set of measures to find, freeze, and repatriate corruption proceeds.

Yet there is a conspicuous effectiveness gap in this area. Treaties, laws, and regulations have yet to demonstrate their effectiveness in tackling grand corruption among political leaders. Research on the problem must therefore start from the assumption that the existing system for addressing grand corruption (particularly through implementation of anti-money laundering standards) is ineffective, then proceed to diagnose the causes of this ineffectiveness and suggest solutions. The major challenge is not to pass more laws and regulations but to improve the implementation and enforcement of those already on the books.

This U4 Issue Paper explores ways to narrow the effectiveness gap, that is, the gap between the aims and the results of the emerging system of rules designed to counter the laundering of proceeds of grand corruption. The next section of the paper provides a brief summary of the global anti-money laundering and anti-corruption regime relevant to laundering the proceeds of kleptocracy. "Kleptocracy," which literally means "rule by thieves," is used here to mean major corruption offences perpetrated by heads of state and other officials in the ruling elite; it is interchangeable with the term "grand corruption." These crimes most often make use of shell companies and international banks in the world's leading financial centres. The remainder of the paper assesses the current level of effectiveness of this system of rules, diagnoses the causes of their ineffectiveness, and proposes solutions.

The final section of the paper advances recommendations to narrow the effectiveness gap and improve compliance with the global set of standards aimed at reducing kleptocracy. In particular, the paper proposes that policy impact can best be understood and improved through the use of audit studies and field experiments. Rather than relying on observational data derived from the few unrepresentative cases of grand corruption that are prosecuted, both these approaches directly test whether or not private financial institutions are applying rules designed to screen corrupt clients. They do so by having researchers impersonate more or less risky customers, with audit studies targeting particularly suspect institutions, while field experiments apply distinct tests to control and treatment groups. These direct approaches are cheap and simple and provide a far more reliable guide to policy effectiveness than other measurements. They should be understood not as law enforcement "stings" but rather as scientific methods, which hold great but underused potential in exploring the effectiveness of measures to combat grand corruption.

1.1 International anti-money laundering and anti-corruption rules

Corrupt practices and efforts to hide the illicit origins of money derived from crime have existed for centuries. The systems of international rules to counter money laundering and corruption, however, are

at most a couple of decades old. Anti-money laundering (AML) and anti-corruption systems arose independently of one another. But they have considerable overlap, given the close links between grand corruption and money laundering and their combined effect on development.

Both the Stolen Asset Recovery (StAR) Initiative, a joint effort of the World Bank and the United Nations Office on Drugs and Crime (UNODC), and the G20 Anti-Corruption Working Group have identified corruption by senior public officials as a major obstacle to achieving development goals. Scholarly research strongly reinforces this message. For example, Reed and Fontana (2011) convincingly argue that illicit flows, primarily from corruption, are one of the most important factors behind negative development outcomes (see also Reuter 2012; Goredema 2011; Chaikin 2010). The Fourth High Level Forum on Aid Effectiveness recently emphasised that combating corruption-related illicit financial flows is an essential part of the development agenda (Busan Partnership 2011, 11).

Compliance with international anti-corruption standards requires simultaneously meeting international AML standards, and the complementarities in responding to these related types of financial crimes have been increasingly recognised and formalised in international conventions. This legal overlap is most obvious in the 2003 United Nations Convention Against Corruption (UNCAC). The Convention calls on state parties to criminalise money laundering, set up systems to apply due diligence to the customers of financial institutions, institute a reporting regime for suspicious transactions, set up financial intelligence units to gather and collate financial data to pass on to the police, and follow the recommendations of international AML bodies (see especially articles 14, 23, 52, and 58). UNCAC further calls for steps such as setting up arrangements to monitor cross-border movements of cash; including sender and receiver information on wire transfers; applying extra scrutiny to the finances of public officials; and ensuring cooperation among judicial, law enforcement, and financial regulatory authorities. Other United Nations conventions, such as those devoted to fighting the drug trade (the 1988 Vienna Convention), organised crime (the 2000 Palermo Convention), and the financing of terrorism (2002), also call upon signatories to adopt the principal components of AML policy.

More recently, the Group of 20 (G20) has directed the Financial Action Task Force (FATF), the world's AML standard setter and enforcer, to be more attentive to corruption issues. The FATF, a Paris-based organization founded in 1990, initially consisted of developed countries but now includes strategically important developing countries as well. For most of the last two decades the FATF has shown little or no interest in corruption issues, apart from commissioning a 2007 report on corruption and money laundering (Chaikin and Sharman 2007). Fortunately, however, it is now showing more interest in the relevance of AML policy for fighting corruption.

Attacking money laundering requires mechanisms for gathering large volumes of financial intelligence, the provision of powerful legal instruments to confiscate the proceeds of crime, and new means of international cooperation for tracing and responding to financial crime. These three features of AML systems, briefly outlined in the following paragraphs, are also potentially powerful tools for addressing corruption.

Fiscal transparency

Corruption is a crime that depends on secrecy, and one where the victims typically are unaware of their loss. To the extent that parties involved in corruption can render their financial dealings opaque to the outside world, the chances of detecting them or deterring others with similar inclinations drop dramatically. As a result, countering corruption may be viewed as a problem of information. Because most corruption, and nearly all grand corruption, involves the transfer of money or assets, gathering and analysing large quantities of financial information is vital. This can result in significantly improved (though far from perfect) financial transparency that serves to deter or detect corruption.

Capacity to confiscate assets

To comply with international standards, those administering the global AML regime must be able to expeditiously freeze funds connected with ongoing investigations. It is even more effective when laundered money, including that deriving from corruption offences, can be confiscated (Kennedy 2006). Given the vast sums of money involved, recovered assets may make a significant contribution to national development outcomes. In Nigeria, $505 million of the money stolen and sent abroad by Sani Abacha has been repatriated, in addition to $800 million recovered within Nigeria. The Philippines recovered $624 million stolen by former President Ferdinand Marcos and his family (UNODC and World Bank 2007, 10–11). Such confiscations may act as a deterrent to other officials and provide much-needed funds to support other integrity initiatives (Transparency International 2004). They also send a strong signal of accountability to the general population.

International cooperation

The third way in which effective AML systems can assist the fight against corruption is through enhanced international cooperation. Particularly when it comes to grand corruption, successful investigations and asset recovery depend on unravelling international financial networks (Reed and Fontana 2011; Reuter 2012). A number of international organisations have declared the international recovery of assets to be a priority and have either published or commissioned work on this topic. The enhanced forfeiture powers provided by AML laws can be used in confiscating and returning the proceeds of corruption from a third country. Country A could thus provide evidence of the underlying predicate offence to enable country B to bring money laundering charges under its domestic criminal code, confiscate the money in question, and return it to country A in line with the principle enshrined in UNCAC of compensating the "victim" country.

2. Finding the gap: Quantitative measures and a case study of Papua New Guinea and Australia

This section presents evidence for the effectiveness gap in fighting kleptocracy. It begins with a brief review of the quantitative literature seeking to establish the scale of the problem. The main conclusion is that, although there are no reliable numerical estimates of these illicit flows, even under the most optimistic assumptions only a tiny fraction of criminal money is intercepted. Because of the fundamental uncertainty in these estimates, it is not possible to use monetary estimates to measure policy effectiveness (Reuter and Truman 2004; Levi and Reuter 2006; Reuter 2007).

The section next presents an original case study of kleptocracy. Instead of recounting the oft-cited but highly atypical "happy ending" stories in which at least some stolen assets are recovered—for example, the cases of Marcos and Abacha, as well as that of Peru's Vladimir Montesinos—this paper considers the relatively unknown but far more typical example of Papua New Guinea. This country's record of endemic corruption among its ruling elite is coupled with a history of almost complete failure in holding these elites to account for their crimes. Neither the country's own government nor governments of the foreign countries that hold the looted wealth have taken effective action, a pattern far more typical than the anti-corruption success stories. This case study confirms the key findings of other studies that stress the role of foreign haven countries (in this case Australia) in receiving funds looted from developing states.

2.1 Quantitative evidence for the effectiveness gap

A persistent question among policy makers devoted to fighting corruption, money laundering, and illicit financial flows in general is how to estimate the total sum of money involved. Reliable estimates of dirty money would not only establish the scale of the problem, but also provide an indicator of the success of policy efforts to counter criminal finance. Despite some heroic efforts, however, the estimates available are more suitable for attracting media and policy attention than for providing definitive knowledge of illicit flows (Andreas and Greenhill 2010). Although numbers tend to suggest scientific exactitude and objectivity, that impression is often misleading; they may be little more than wild guesses.

The most commonly cited estimate of total money laundered is 2 to 5 per cent of gross world product, suggested by the International Monetary Fund (IMF) in 1998. No justification for this figure was produced at the time or subsequently. But it has since become accepted as "fact" by dint of repetition and has been highly useful to those looking to advance the cause of AML as a policy priority. Subsequent estimates depend heavily on the assumptions or definitions used to create them. For example, does tax evasion count as a predicate offence for money laundering? The decision of the FATF in early 2012 to count tax evasion in this way vastly increases the estimate of money laundered without reflecting any objective change in the flows. Peter Reuter provides persuasive critiques of estimates calculated by John Walker and Raymond Baker (Reuter 2007, 2012; Levi and Reuter 2006; Walker and Unger 2009; Baker 2005). Later estimates from Global Financial Integrity (which build on Baker's earlier work) and from Ndikumana and Boyce (2008) do not seem to have overcome the basic obstacles to producing robust numbers on illicit financial flows.

Because of the uncertainties attached to even the best of the estimates, they are too blunt as measurement instruments to usefully inform judgments about policy effectiveness. For example, it would be impossible to tell whether a 20 per cent variation in the figures represented a real change in the underlying variable of interest (illicit financial flows) rather than errors or other variations in the measurement technique. For this reason, the FATF abandoned its effort to come up with a quantitative estimate of total money laundered worldwide.

Nevertheless, quantitative estimates are useful in giving a very broad indication of the ineffectiveness of the current international system of rules for combating corruption and money laundering. Even if the estimates are wrong by an order of magnitude, and even if we use the most optimistic assumptions, they show that only a tiny proportion of the proceeds of corruption or other crimes are ever restrained or recovered.

A case in point is the recent report *Estimating Illicit Financial Flows from Drug Trafficking and Other Transnational Organized Crimes*. In this report, the United Nations Office on Drugs and Crime estimates the amount of money laundered in the period 2001–2010 at between 2.1 and 4.0 per cent of world product annually (UNODC 2011, 7). This expansive range nevertheless depends on a host of assumptions. The proportion of laundered criminal money that is subsequently frozen or confiscated (the "interception rate") is estimated at under 1.0 per cent, and most probably 0.2 per cent. Furthermore, rather than reflecting any recent decline in effectiveness, this depressingly low figure has stayed relatively constant, despite the massive and costly expansion of the global AML policy apparatus.

Critics of the quantitative estimates, such as Reuter and Levi, nevertheless agree with the basic point that the level of illicit financial flows, however defined, is very large, and that effectiveness in combating financial crime is therefore very low. The following qualitative study of grand corruption in Papua New Guinea, and of Australia's role in hosting the stolen wealth, reinforces this conclusion.

2.2 A gaping effectiveness gap: Kleptocracy in Papua New Guinea

Papua New Guinea (PNG), the eastern half of the island of New Guinea, has a rapidly growing population of 6.3 million. After achieving independence from Australia in 1975, the country now exhibits most of the classic signs of systemic corruption. This is especially apparent from the mismatch between growth in government revenue and macroeconomic progress, on the one hand, and declining social, health, and governance indicators, on the other. Recent strong economic growth is overwhelmingly based on a minerals and energy boom focused on gold, copper, and oil. A planned liquid natural gas project with Exxon is touted as having the potential to double the size of the national economy. There are thus strong similarities with other developing countries experiencing the "resource curse" and associated endemic corruption.

Two leaked US government cables from 2006 and 2008 described the PNG government as an example of "Ponzi politics," in which mineral wealth and $400 million in annual Australian aid payments have served "more to enrich the political elite than to provide social services or infrastructure." The PNG government was said to represent "an appalling spectacle of disregard for governance . . . this government, and the current crop of leaders on the national scene, have presided over a steady, nationwide deterioration of services—closure of health centres and schools, collapse of effective policing and a steady rise in violent crime."[1] The country is a textbook example of how a long-standing and generously funded development aid program can be rendered ineffective by corruption.

Up to half of the taxes owed to the government are never collected, thanks to corruption-enabled tax evasion (PNG FIU 2010, 2). Furthermore, estimates from local police officials suggest that up to half of the government's revenue that is collected is then stolen by senior public officials ("Billions Lost to Fraud, Says Yakasa," *The National*, 16 February 2011). A 2009 report from the PNG Parliamentary

---

[1] See http://wikileaks.org/cable/2006/07/06PORTMORESBY274.html# and http://wikileaks.org/cable/2008/11/08PORTMORESBY222.html.

Public Accounts Committee, reporting the findings of an inquiry on financial year 2006, gives some indication of the scale of corruption:

> Illegal and/or improper practices were rife—particularly in the very Department responsible for fiscal management, the Department of Finance, but also across the entire spectrum of Government at every level—National, Provincial and Local. . . . Governments and law enforcement agencies failed to grapple with the problem and this failure emboldened the misusers, who moved in a few years from small scale opportunistic misappropriation to the organized diversion of huge sums of public money—with apparent immunity and impunity. (PNG PPAC 2009, 11)

Corruption thus explains the spectacular and disastrous development disconnect whereby gross domestic product has grown strongly while social indicators have at best stagnated and have most often gone backwards. Although the government's recently convened Task Force Sweep has begun to indict some senior officials for corruption offences, the overall picture is still one of general impunity.

Corruption in PNG fits many of the patterns of kleptocracy elsewhere. Although there are problems with corruption at all levels of government, including the police force, it is the corruption of senior public officials that poses the greatest challenge. There is often very little artifice or complexity in corruption in PNG. Given the climate of almost complete impunity, senior officials have felt little need to hide the fact that they are stealing state funds, accepting bribes, trading in influence, engaging in self-dealing or nepotism, or committing related crimes (PNG FIU 2010). Previously a large majority of stolen funds were spent domestically, in cash, on consumer goods, paralleling the pattern found in Malawi and Namibia by a recent World Bank study (Yikona et al. 2011). However, as the scale of corruption has increased, the country's ruling elite has become more inclined to send illicit funds overseas.

The open nature of corruption in PNG recalls the experience of countries like Nigeria, where only recently have senior corrupt officials taken precautions in laundering their illicit wealth.[2] The redeeming feature of this unhappy situation is that because corrupt officials have taken so little care to disguise the money trail, even a modestly resourced investigative effort could provide significant insight. A recent report by the PNG Financial Intelligence Unit describes two typical methods by which funds are diverted (PNG FIU 2010).

The first method is as follows. One or more senior officials within a government department draw up documents requesting a feasibility study or consultancy report in connection with a tender. The officials then use a person outside the department to pose as a consultant and bid for the tender, which is often ostensibly connected with construction or agriculture. The outsider is then awarded the contract to produce the study or report, with payment made up front. Payment is by government cheque, with a request from the Department of Finance that the cheque be issued without any of the usual clearances. The payment is deposited into the corporate account of a recently established shell company that has no business history and no other activities. Sometime later the outside "consultant" hands in a 50- to 60-page document that has no connection with the initial terms of reference, stating that although the project is going well, additional funds are required. These are again issued by cheque, once more in an expedited manner. No more is heard of the project. The money transferred to the outside partner's shell company is divided between the consultant and the officials within the relevant department, with a smaller sum for those who approved the expedited issuing of government

---

[2] Author's interview, Serious Organised Crime Agency, London, 8 September 2011.

cheques. This distribution of misappropriated funds is usually done via personal cheques, but sometimes in cash. The shell company is dissolved and the corporate account closed. There is no investigation of either the missing funds or the unfulfilled contract, and the perpetrators are free to repeat the same scam (PNG FIU 2010).

The second common method involves fraudulent land compensation claims. The perpetrators first identify an area subject to a land dispute or compensation claim (such areas are readily available thanks to the country's mix of common law and customary land ownership). They draw up a compensation claim signed by an individual who may be only loosely connected with the land in question. The perpetrators then obtain the collusion of a senior official in the Department of Lands and Resources to approve the thinly documented claim. Once it is approved, the perpetrators take the claim to the Department of Finance for payment by cheque, promising a bribe to expedite the payment. The proceeds are distributed among the original perpetrator, the "landowner," the Department of Lands and Resources official, and the Department of Finance official by cheque or cash.

In both of these corrupt schemes, the final step is often to transfer the proceeds overseas. Very often the destination is Australia, the main aid donor. Although there is no evidence of large sums of aid money being stolen directly, there is an ironic circularity in the financial flows between Papua New Guinea and Australia: large aid payments go north, while large flows of illicit wealth go south. This case study thus further reinforces the conclusion that "corruption will remain a profitable crime in developing countries as long as counterparts in rich countries are willing to hide stolen resources" (Fontana 2011, 1).

2.3 Australia as a host for proceeds of corruption from Papua New Guinea

In general, corrupt elites from former colonies look first to the former colonial power as a haven for their illicit funds, for both economic and cultural reasons. Thus, Nigerian corrupt leaders are partial to laundering corruption proceeds in London, while those from Francophone Africa maintain extensive holdings of luxury real estate in Paris and elsewhere in France. A common language is an obvious connecting factor, while the legal systems are also generally very similar. Members of the elite have often gone to school or university in the metropolitan country, and the resulting personal ties are cemented when their children are educated in the same institutions. Economically, the former colonial power provides a large, well-developed financial centre with a stable currency and many advisors offering wealth planning and asset protection strategies. It also offers a multitude of options for conspicuous consumption, whether in terms of real estate, consumer goods, or lavish socialising. Finally, the former colonial power may provide a convenient location for exile in case a kleptocrat experiences a sudden political reversal at home.

As a result of former colonial ties, PNG enjoys close links with Australia. The language of the PNG elite is English, the country's law is based in part on Australian law, and most air routes from PNG to third countries pass through Australia, particularly through Brisbane and Cairns. Cabinet ministers and other senior officials have often been educated in high schools, universities, or military institutions in Australia, a pattern that is replicated among their children. Although Australia is not a global financial hub like London or New York, it is the world's 14th-largest economy and the largest financial centre in the South Pacific. The nearest rival is Singapore, which has also enjoyed some popularity with Papua New Guinean elites, though it is much farther away. Many current and former PNG ministers have established second homes in Australia, and indeed their families may spend as much time in Australia as in Papua New Guinea.

As noted, reports from the PNG police, supported by interviews conducted by the author with Australian officials seconded to the PNG government, indicate that up to half the national budget is

stolen by politicians and senior officials. Confidential interviews with Australian and other foreign officials working in PNG further suggest that it is an open secret that corrupt PNG officials hold their illicit wealth in Australia. The head of an anti-corruption task force in PNG referred to Australia as "another Cayman Islands," a place where corrupt officials can launder their illicit funds (Elapa 2011). This verdict is supported by testimony before the Australian Senate by AUSTRAC (Australian Transaction Reports and Analysis Centre, the financial intelligence unit), which noted:

> AUSTRAC considers the Pacific a priority region for regulatory engagement and information exchange given the large number of Australian financial institutions operating branches across the Pacific and the level of money laundering, crime and corruption in the Pacific. Australia is a significant destination country for funds derived from corrupt activities within the region. (AUSTRAC 2008, 3)

Australia's role in hosting proceeds of corruption from PNG is most notable in two areas: banking and real estate. Senior PNG officials generally hold accounts with Australian banks in PNG and in Australia proper, and they often use either their own or their lawyers' accounts to make real estate purchases. These banks are covered by extensive reporting obligations to AUSTRAC, and they have a strict legal duty to perform "know your customer" procedures with respect to new and existing account holders. Australia's banking sector is highly concentrated around four major institutions, each of which spends tens of millions of dollars on compliance and risk management. As a result, Australian government officials interviewed by the author on the record maintain that, because any significant flows of corruption funds would have to go through the banks, and because the banks are well regulated, corruption proceeds are not a significant problem for Australia. But confidential interviews, as well as experience from equivalent foreign jurisdictions discussed elsewhere in this paper, suggest that this complacent attitude is fundamentally mistaken.

Australian bankers indicated privately to the author that they believe the federal government does not take the issue of holding the proceeds of foreign corruption seriously, and so the banks take a correspondingly relaxed view of this risk. Similarly, these bankers indicate that they take a tolerant view of accepting the proceeds of corruption in their Southeast Asian and South Pacific subsidiaries and branches, including PNG. Once the funds are accepted at an overseas branch of an Australian bank, it is a relatively simple matter to transfer them to Australia. Indeed, this may happen in the course of the bank's normal operations. Especially when it comes to their private banking presence, Australian banks suggest that this aspect of their operations would simply be uneconomical if they were to take rigorous precautions to screen out suspect wealth. Even when they are flagged as being high-risk, corrupt officials from PNG are able to launder their stolen wealth in the Australian financial system by sending wire transfers to and from their lawyers' accounts and by using shell companies.

Many senior PNG officials maintain extensive luxury real estate holdings in the Australian state of Queensland (just across the Torres Strait from PNG) that are out of all proportion with their official salaries and legitimate assets. Such real estate purchases are often arranged by the officials' lawyers, who may use their trust accounts to make and receive wire transfers. Many of the law firms represented in Papua New Guinea are originally Australian, and in some cases senior PNG officials practised for these same firms. An official may transfer funds from his personal account to his law firm's trust account in PNG, which then transfers these funds to the trust account of its Australian counterpart office. The funds are then used to buy property. In such case it is very unlikely that the bank transfers would be flagged as suspicious and thus come to the attention of the AML system. Law firms' trust accounts often have a high volume of funds from different clients passing through, and therefore even quite large transfers for property purchases are unlikely to stand out, especially in the case of large law firms.

A specific example reported in the Australian press involved the use of shell companies to transfer $50 million of corruption proceeds from PNG to Australia. In 2009 the PNG state-owned Motor Vehicles

Insurance Ltd. sold 500 million shares in the PNG-based Bank South Pacific to the company Nominees Niugini, with the resulting funds ending up in Australia in the account of the company Woodlawn Capital. The sale was illegal under the terms of the PNG Independent Public Business Corporation Act, but it had been approved nonetheless by the minister of public enterprises at the time, Arthur Somare. Somare is the son of then Prime Minister Sir Michael Somare, deposed after a constitutional crisis in 2011. The ultimate control of Woodlawn is not confirmed, but press reports allege that it is controlled by members of the Somare family. The current PNG government is now trying to recover the funds. In this case it is telling that while the PNG government publicly broke the story on 24 November 2011, at which time it was reported in the media, AUSTRAC only queried the bank about the source of the funds several days later. The Australian AML system had thus failed to detect the movement of $50 million of illegal funds from PNG to Australia.[3]

2.4 Operational lessons from the Papua New Guinea–Australia case study

This case relates to several general points. First, the impunity of PNG officials, who have suffered neither prosecution nor confiscation of their stolen wealth, reinforces the observation that kleptocracy is made possible by criminal successes on the one hand and law enforcement failures on the other. As in other parts of the world, corrupt elites in PNG seek to launder their funds in the advanced financial centres hosted by the former colonial power. The use of wire transfers is essential, whether by the officials themselves or by law firms using lawyers' accounts. Shell companies are used both in the initial theft of public money and in later efforts to disguise the illicit origins of these funds.

The only positive point is that such an extensive lack of accountability for corruption among senior public officials implies that they have made little effort to hide their crimes. As a result, modest resources devoted to anti-corruption action could generate significant returns. For development agencies, especially AusAID, the major shortcoming at present is the inclination to treat corruption within PNG as only a domestic problem, ignoring the international aspect. As this case study and others have established, efforts to tackle grand corruption must follow the money trail. An agency that is serious about addressing the endemic corruption problems that blight PNG's development prospects must engage with the overseas havens that host this wealth—especially Australia.

Specifically, this would mean taking a sceptical view of Australian banks' public protestations of "zero tolerance" for overseas corruption. More consistent action by banks could provide substantial information on accounts held by shell companies. There could also be an immediate large boost in accountability if PNG public officials' asset declarations were publicly disclosed, since Australian property registries are fully available at no cost online and senior PNG officials currently maintain extensive real estate portfolios in their own names. Given the importance of lawyers and law firms in the international transfer of suspect funds, greater scrutiny of trust accounts is also needed.

AusAID, as well as other bilateral development agencies in different countries, can be proactive by focusing on the international aspects of corruption. This can be achieved without entering into areas they are not familiar with, such as law enforcement. A example is the effort sponsored by the UK Department for Development (DfID) to trace Nigerian corruption funds held in London; the promising results obtained so far illustrate how bilateral development agencies can work on this problem without adopting any kind of law enforcement role. As long as corruption remains a major—or, as in PNG, *the*

---

[3] See Motor Vehicles Insurance Ltd. versus Woodlawn Capital Pty Ltd., Timothy Patrick Breen and Timothy James McNamara, Supreme Court of New South Wales, Case Number 2012/83523, 15 March 2012.

major—obstacle to development, it is perverse for development agencies to avoid addressing corruption through action in their own countries as well in the developing countries they work with.

3. Explaining the effectiveness gap: Bank transfers and shell companies

Recent research on grand corruption has documented the importance of following the money trail to determine where corrupt senior officials hide their stolen assets (UNODC and World Bank 2007; Greenberg et al. 2009; Does de Willebois 2011). Judging from available evidence, the answer is generally that wealth looted from developing countries is held in rich countries with large stable financial centres, particularly those that share colonial or other historical ties with the victim country. Evidence to support this conclusion has been collected by the World Bank/UNODC Stolen Asset Recovery (StAR) Initiative, as well as by Global Witness and the US Senate Permanent Subcommittee on Investigations.

Yet, as shown above, there is a large effectiveness gap between how anti-corruption and anti-money laundering policies work in theory and how they work in practice. Among the mechanisms used to launder large sums of money, the two most important are probably wire transfers from international bank accounts and shell companies used to hide the real owners of the funds. These are the two key areas of vulnerability in the existing system that help explain the disconnect between the impressive formal rules to counter illicit flows and the limited effectiveness of these same rules in practice. The G20 Anti-Corruption Action Plan confirms these current areas of major weakness:

> To prevent corrupt officials from accessing the global financial system and from laundering their proceeds of corruption, we call upon the G20 to further strengthen its effort to prevent and combat money laundering, and invite the Financial Action Task Force (FATF) to continue to emphasize the anti-corruption agenda [. . .] and update and implement the FATF standards calling for transparency of cross-border wires, beneficial ownership, customer due diligence, and due diligence for "politically exposed persons." (G20 2010)

A brief look at these two principal mechanisms used to launder money helps explain why existing measures have been ineffective in curbing them.

3.1 Banks and wire transfers

Although cash is the preferred medium for many sorts of corruption, beyond a certain point it becomes too bulky and heavy ($1 million in $100 bills weighs approximately 9 kilos). Cash is vulnerable to physical decay or damage. Because it is relatively hard to conceal in large amounts, it may arouse the suspicion of law enforcement or lead to predation by other criminal groups. For these reasons, wire transfers or other electronic transactions are generally preferred by those engaged in grand corruption. "Ultimately most of the methods involve, at least in some way, the use of financial institutions, particularly banks, in the laundering of ill-gotten funds" (Greenberg et al. 2009, 16). For those intent on obscuring the money trail, a series of wire transfers involving multiple jurisdictions has the added advantage of complicating efforts by investigators, who most often have to rely on time-consuming and labour-intensive processes of obtaining financial information from foreign jurisdictions in order to follow the links in the chain one by one.

Because wire transfers involve financial institutions, usually though not always banks, corrupt officials must find ways to evade regulations requiring banks to screen and identify suspicious financial behaviour on the part of their clients, especially those in high public office—so-called politically exposed persons (PEPs). In theory, these regulations should pose a serious obstacle to corrupt officials seeking to launder illicit funds. But this of course depends on how effectively banks implement the rules in practice. In particular, banks must have procedures for identifying common methods used by

PEPs to conceal the ownership of funds, such as corporate accounts for shell companies, the use of family members to stand in for the principal, and the use of lawyers acting for the principal (Greenberg et al. 2009).

The experience of countries with mature, highly regulated banking sectors long governed by standard AML prescriptions provides cautionary lessons that challenge the easy assumption that laws and rules on the books will translate into effective implementation. A series of high-profile cases in the United States has shown the delinquency of major US banks and financial institutions in this regard. For example, in March 2010 Wachovia Bank reached a deferred prosecution agreement and paid a $110 million fine for its failure to screen $378 billion according to proper AML procedures, despite repeated warnings from its own compliance division. This followed a string of other high-profile scandals involving complicity or negligence in the laundering of corruption proceeds by institutions like Bank of New York, Citibank, and Riggs Bank (US Senate 2004, 2005, 2010). In the case of Riggs Bank, its own officials actively connived in hiding the proceeds of corruption.

In the United Kingdom, the Financial Services Authority conducted a survey of the PEP screening practices of British banks. The report, *Banks' Management of High Money-Laundering Risk Situations*, was released in March 2011, 10 years after British banks had been shown to exhibit a pattern of witting or unwitting complicity in hosting and laundering the proceeds of the Abacha loot. The report's findings make for disturbing reading. Three-quarters of the banks surveyed did not properly establish the legitimacy of the funds deposited by PEPs; over half failed to apply enhanced due diligence to high-risk PEPs; and over a third "appeared willing to accept very high levels of money-laundering risk" from PEP clients.

Global Witness, a nongovernmental organisation (NGO), has also revealed spectacular instances in which major international banks accepted corruption funds even when the illegal provenance of these funds was obvious (Global Witness 2009). After reviewing international rules instituted to deny corrupt officials access to the global banking system, the StAR report on PEPs draws the gloomy conclusion that "the reality . . . is that the distance between international commitment and visible effective action and impact remains wide" (Greenberg et al. 2009, 16).

3.2   Shell companies

Compared to banks and wire transfers, shell companies play a role that may be less obvious and thus require somewhat more explanation. The "shell" appellation refers to the fact that the company does not engage in any substantive business, does not produce any good or service, and has no employees. Shell companies are nevertheless legal "persons" and can hold bank accounts and own other assets. Such companies are cheap to set up, with the costs ranging from a few hundred to a few thousand dollars.

The website for Wyoming Corporate Services, one of thousands of corporate service providers that establish shell companies for clients, summarises the appeal: "A corporation is a legal person created by state statute that can be used as a fall guy, a servant, a good friend or a decoy . . . A person you control . . . yet cannot be held accountable for its actions. Imagine the possibilities!" (Carr and Grow 2011). Corrupt officials are well aware of this option, which makes it possible to create an ostensibly independent legal person that in reality is only an instrument used to conceal the identity of those engaged in behaviour they would like to keep secret. The use of shell companies in laundering the proceeds of corruption is discussed in depth, with many examples, in the 2011 StAR Initiative report *The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About it* (Does de Willebois et al. 2011; see also Gordon 2009).

The report concludes that unless the screening or veiling function of shell companies can be countered with an ability to "look through" the company structure to identify the real person in control—known

as the "beneficial owner"—then little progress can be expected in following the money trail in large-scale corruption offences. This need to identify the beneficial owners of shell companies and similar corporate structures is widely recognized, for example in the G20 Anti-Corruption Action Plan (G20 2010). The relevant international standard in this area is succinctly contained in the International Standards of the Financial Action Task Force, which state: "Countries should take measures to prevent the misuse of legal persons for money laundering or terrorist financing. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities" (FATF 2012).

This standard, however, is most often violated in practice. Most shell companies are established by corporate service providers (CSPs), which are in the business of creating and selling shell companies to their eventual owners. To the extent that information on the true identity of those who control shell companies is collected at all, as the FATF standard specifies it should be, this is done by the corporate service providers, as documented in the StAR Initiative publication cited above (Does de Willebois et al. 2011). In contrast, government company registries are most often simply archives that receive documents, neither requiring or verifying identity documentation from the buyers of the companies registered.

One can test the effectiveness of the corporate transparency regime, which is so fundamental to preventing, detecting, and punishing large-scale corruption offences, by investigating what CSPs do when they form companies for clients. In cases where they require customers to provide certified copies of identity documents (e.g., the picture page of a passport, a driver's licence, utility bills for proof of address) and then make these available to the appropriate authorities, it should be possible to trace the real owners of shell companies. If, however, CSPs do not require such identity documents, they are complicit in creating untraceable shell companies that provide financial anonymity for corrupt officials and a wide range of other criminals.

The World Bank research team for the 2011 *Puppet Masters* report employed an audit study to test what kind of documentation was required by CSPs. It found that anonymous and untraceable shell companies, while formally prohibited, are readily available in practice. In the audit study, the researchers sent e-mail solicitations to CSPs in which they posed as consultants seeking to incorporate anonymously in pursuit of tax savings, limited liability, and confidentiality. The premise was that if providers showed a willingness to set up shell companies without requiring identification documents, this was compelling evidence that the existing international rules mandating corporate transparency did not work.

The results of the audit study showed that approximately 40 per cent of the CSPs that responded to the solicitations were willing to form shell companies without conducting any due diligence on their clients. Often these CSPs were surprisingly direct in providing assurance that, because they did not collect any information on their clients, there was no danger of the clients ever being traced back through the "corporate veil." One firm responded:

> The anonymous structure we offer is totally secure since we manage the bank account on behalf of the owner. The owner's name appears nowhere. Using this structure, no investigator could determine the true ownership of the structure . . . We offer additional security by the fact that we could change the nature of the structure and relocate it to other jurisdictions literally within minutes if required . . . Having said that, we should make it clear that we will not engage in any illegal practices on behalf clients. However, what is illegal in one country may not be illegal in another. (Sharman 2011, 88)

Furthermore, in contrast to the policy consensus in such bodies as the G20, FATF, and the Organisation for Economic Co-operation and Development (OECD), providers in developed countries

on the whole were quite willing to provide untraceable shell companies—more willing, in fact, than their counterparts in developing countries. Moreover, among the sampled countries, jurisdictions known as tax havens were more compliant with regulations than non–tax haven developed and developing countries. Because of their failure to effectively implement corporate transparency standards, developed country governments are thus the principal source of risk for untraceable shell companies, with the United States being identified as the single worst performer.

3.3 How policy ignorance breeds policy ineffectiveness

Much of the effectiveness gap relating to banks and shell companies arises because the existing system of international assessments focuses on putting laws and regulations in place, rather than ensuring their implementation. This approach reduces effectiveness in two ways. First, it fosters ignorance about the actual impact of policy, which makes it difficult to identify areas to target for improvement. Second, it encourages policy makers in developing countries to focus on impressing outsiders by passing laws and declaring policies rather than on actual resolving problems of corruption. This problem of formalism persists, even though bodies like the FATF and OECD have attempted to reorient their assessment procedures for AML and anti-corruption rules to measure actual effectiveness. As a consequence, there is actually very little knowledge about the effectiveness or cost-effectiveness of AML policy (Reed and Fontana 2011).

The FATF has successfully spread its AML recommendations worldwide, with over 180 countries officially committing to these standards. Together with its regional satellite organisations and the World Bank and IMF, the FATF runs an extensive program of AML policy assessment. This program grades each country against each of the recommendations, judging it as compliant, largely compliant, partially compliant, or noncompliant. The initial approach was to concentrate the evaluation process on legislation and regulations, looking at basic factors such as whether money laundering had been criminalised, whether countries had a financial intelligence unit (FIU), and whether they were able to engage in international mutual legal assistance.

While this formal-legal orientation makes sense as one component of the evaluation process, it is clearly insufficient. Just having a law against money laundering provides no indication of whether this law is actually effective, which is the real question of interest. Learning from the evaluation procedure developed by the OECD Working Group on Bribery, the FATF has thus sought to incorporate measures of policy effectiveness. But in doing so it has tended either to equate inputs with effectiveness or to choose other questionable measures as proxies of success. The first approach privileges such measures as the size of the financial intelligence unit, the number of suspicious transaction reports (STRs), the number of training exercises and audits conducted, and so on. Using such an input model is like trying to measure the effectiveness of an aid program by the amount of money disbursed. Russia has the world's largest FIU, while Chinese institutions make the largest number of STRs. But such measures have no obvious correlation with the effectiveness of their AML programs.

The problem with this focus on inputs is that it can result in goal displacement, making the means valued as ends in themselves while the original goal is marginalised or forgotten. For example, in many developing countries the point of collecting STRs is to satisfy international assessments, not to fight money laundering. Some developing-country FIUs diligently enter STRs into software that they then cannot search, meaning the information is practically useless (Sharman 2011). A training seminar may be held primarily to meet an external requirement on a "tick the box" logic, rather than to improve skills to counter financial crime. The level of inputs tells us little or nothing about effectiveness, and this focus may cause AML to be an expensive distraction from other priorities.

Another approach that may initially seem more plausible is to measure the number of convictions and total criminal assets seized and frozen. Such results uniformly suggest that only a trivial portion of

criminal money is frozen or confiscated (Levi and Reuter 2006). Even discounting this fact, however, there are conceptual problems in using such measures. For example, should we consider a very high number of convictions for money laundering, corruption, or related crimes to be good news, indicating the effectiveness of the system, or bad news, indicating the widespread prevalence of these crimes? The United States presents such data as examples of success. But countries such as Singapore, with very few convictions for money laundering and corruption, argue in contrast that low numbers are a sign of success, indicating that their efforts at prevention have been so successful that there is little financial crime to prosecute.

The shortcomings of these measurement methods mean that in fact we have little idea of how effective AML policy may be in reducing corruption offences or any other kind of predicate offence. Furthermore, while both anecdotal evidence and quantitative estimates suggest that the system is highly ineffective, there is no good guide to where or how improvements should be made. Relying on a "box-ticking" mentality of listing measures taken without examining their results actually undermines effectiveness.

In the next section, we argue that audit studies and field experiments provide superior means by which to assess policy impact and improve effectiveness, with all the positive development implications this entails. Results from sample studies confirm both the ease and the utility of these methods with respect to the formation of shell companies.

4. Narrowing the gap: Audit studies, field experiments, and the risk-based approach

This section explains how audit studies and field experiments work in assessing policy effectiveness in general, and then presents the method and results of a field experiment testing the availability of untraceable shell companies. Audit studies report empirical results from testing a policy on a set of cases, while field experiments take the additional step of separating treatment and control groups to compare the results. Field experiments in particular can be an important tool in advancing the fight against corruption by identifying the causes of the compliance gap and indicating solutions. Both audit studies and field experiments are cheap, practical, and effective. They are suitable for use by development agencies, NGOs, and journalists, and even by individual citizens who are concerned or curious about the issue.

Causation is a complex question in the social sciences, and determining the effectiveness and impact of policy initiatives is no exception. Outcomes such as "development" and "good governance" are the result of many factors, and it is difficult to disentangle the effects that can be attributed to a particular policy or new policy initiative. The logic of causation requires researchers to compare the situation following a specific policy intervention with what would have happened had the policy not been introduced. Development economists, including several at the Massachusetts Institute of Technology Poverty Action Lab (Duflo, Glennerster, and Kremer 2007), have recently sought to apply the logic of experiments to investigate what works in development policy, looking at areas ranging from immunisations to school attendance.

A notable example of such a research question is whether free distribution of mosquito nets is more effective in reducing malaria rates than selling the nets at a subsidised low cost. An experiment conducted in western Kenya aimed to resolve this question by providing free mosquito nets to one randomly assigned set of villages (the treatment group) and making nets available at a subsidised low cost to a second randomly assigned set of villages (the control group). The random assignment allowed observers to confidently conclude that the lower malaria rates in the villages that had received free nets compared with the control group was caused by the free distribution and not other, extraneous factors (Cohen and Dupas 2010).

Many national development agencies have made some use of such empirical methods to test policy effectiveness, but they have not yet been applied in the area of grand corruption. How might this logic apply in assessing the effectiveness of AML and anti-corruption policy? As explained above, a key question in this paper is when and why untraceable, anonymous shell companies are made available, given their widespread use in PNG and many other countries for laundering the proceeds of corruption. The most important actors are corporate service providers. If they fail to ensure that the companies they create can be linked back to the beneficial owners by collecting identity documents, no one else can do so either (Does de Willebois et al. 2011).

Audit studies take a first step by testing whether corporate service providers do or do not exercise such due diligence. They test this by actually submitting suspect requests to a sample of these providers and recording the responses. Such studies are generally superior to the methods used by either international organisations or national governments in assessing policy effectiveness in this domain. As discussed above, despite official commitments to concentrate on actual policy effectiveness in reviews, these reviews in fact often hinge on formal legal evaluations of legislation and regulation. Such data, however, provide no insight into the actual results of policy. Audit studies of corporate service providers, however, can provide data on whether or not due diligence is implemented. But they are limited in comparison to field experiments in that they use only a treatment group (corporate service

providers presented with suspect requests), with no control, and thus are less well suited to discovering causal relationships.

Audit studies are very cheap. The author conducted one by himself, sending 54 solicitations to corporate service providers in 22 countries and then paying to set up three shell companies (in England, the Seychelles, and the US state of Nevada) and three bank accounts (in Nevada, Cyprus, and Somalia). These 54 providers all received the same e-mail, reproduced in appendix 1. The solicitation part of the study involved no cost at all beyond the time involved (four to five weeks), while the total cost of creating the test companies and accounts was approximately $9,000. The results were summarised in the *Economist* ("Haven Hypocrisy," 2 April 2009) and presented in full in a World Bank report (Does de Willebois et al. 2011). Many agencies requested copies of the research—among others, the UK Financial Services Authority, US Senate Permanent Subcommittee on Investigations, Swiss Bankers Association, HSBC, and PricewaterhouseCoopers.

Such an audit study may provide a good idea of the magnitude and distribution of the problem, and its range can be increased by sending additional solicitations to a wider selection of companies. But it provides no comparative data on what factors may cause CSPs to be more or less likely to provide anonymous shells to clients. This aspect is particularly important, given that the approach most often employed by public authorities in regulating private financial firms is the risk-based approach. According to this principle, intermediaries such as banks and CSPs should screen their prospective and actual customers to look for "red flags," that is, factors that indicate they are at a higher risk of engaging in financial crime. A test of solicitations with and without red flags can show whether corporate service providers are implementing a risk-based approach.

In order to test this proposition, the author collaborated in setting up a field experiment in 2011. Like the audit study reported in *The Puppet Masters*, this involved sending e-mails to CSPs, soliciting offers for shell companies. Again paralleling the earlier study, the e-mails were purportedly from consultants, since, as in the Papua New Guinea example, consultancy arrangements are commonly used as cover for misappropriating and then laundering public funds. As in the audit study, the responses received were assessed by whether or not CSPs required identity documents in order to form a company (that is, whether they were in compliance with international standards), or whether they were prepared to go ahead with the transaction without performing any such due diligence (that is, violating international rules by supplying untraceable companies).

But in this case, two different e-mails were sent. As noted above, a field experiment compares two randomly assigned groups, one receiving the treatment condition and the other not, while an audit study has only one group, all of whom receive the same treatment. In a field experiment, since the groups are randomly composed, any subsequent differences between the two groups can be ascribed to the causal effect of the treatment. For the field experiment with corporate service providers, the author created treatment and control groups by varying the content of the e-mails, with the treatment e-mail containing signs of corruption risk and the control e-mail free of such red flags.

The text of the control e-mail was similar to that that reproduced in appendix 1, except that the consultants seeking incorporation were fictitious persons from a set of eight developed countries with low corruption risk. In the treatment (or "corruption") e-mail, the customer profile was changed to indicate a high and obvious corruption risk. This was done by locating the fictitious customers in countries ranked in the lowest quintile of the Transparency International Corruption Perceptions Index (it was assumed that if providers use any measure of corruption risk it is likely to be this one, despite concerns about its validity). Under the risk-based approach, the FATF and other organisations explicitly warn that customers from high-corruption countries should be subject to enhanced due diligence. If there is any sensitivity to corruption risk in the provision of shell companies, we would expect to see a significant difference in the way CPSs responded to the e-mails reflecting low and high corruption risk.

The field experiment was carried out on two samples, one of corporate service providers in countries other than the United States, and the other on providers in the United States. In the international sample, the control e-mail was sent to 268 service providers and the treatment e-mail to 276; in the US sample, the control e-mail was sent to 270 service providers and the treatment e-mail to 271. There is no definitive global list of corporate service providers, as they are unregulated in many countries, and so these providers were randomly selected from a larger list generated by extensive Internet searches.

The coding scheme was straightforward: responses from CSPs were categorised as no response, noncompliant, partially compliant, compliant, or refusal. Many providers did not respond at all to the e-mails, while some replied but refused service. Some proportion of the "no response" total may well have been a form of soft refusal, in that providers presented with a risky client might have chosen to avoid the risk by simply not corresponding. Refusal e-mails specified an inability or unwillingness to do business. Noncompliant responses were those that stated that no identification documents at all were required in order to form a company. In such cases the company would be in effect untraceable, as it would be impossible to obtain information on the beneficial owner. This is not only in direct violation of international standards, but is precisely the kind of company most commonly used to launder the proceeds of kleptocracy. Compliant e-mails, in contrast, specified the need for certified copies of picture identification and proof of residency, meaning that the company could be traced from the service provider to the actual owner. Partially compliant responses asked for some identity documents but did not meet the standard above.

Against expectations, the results of the experiment show that obvious signs of corruption risk made remarkably little difference to the willingness of CSPs to provide untraceable shell companies. This is evidence that the system does not work. Before discussing the quantitative results, it is useful to give a flavour of some of the e-mail responses received:

> *Example 1:* We don't need a whole lot of info from you. You can place the order on our website under starting your company. It should only take 10 minutes and that is all the information we need from you. (United States)

> *Example 2:* All that you need to do is to provide the name you want for your new company, that's it. (United States)

> *Example 3:* We have many international clients with the same confidentiality concerns so I am happy to tell you that you have found the right service provider for your needs! (United States)

Contrast these noncompliant responses with compliant ones:

> *Example 4:* Herewith, the requisite forms for you to complete. The identifying documents you must send are as follows: 1. Certified copies of the information pages of your passport or of your driver's license. 2. Certified copies of two utility bills or other, showing your usual place of residence. 3. Two reference letters, one from a bank and the other from a business or other associate. Have these sent directly to us from the persons giving the same. Please remit half of the fee at this time (see wire instructions below). (St. Kitts and Nevis)

> *Example 5:* By law, we are required to keep in our confidential records, a copy of the passport page containing a picture and biographical information of each director and shareholder in the International Business Company as well as a recent utility bill showing a current address, and a bank or attorneys letter of referral. Please note that all these documents must be duly notarized. This information is kept in our records. (Belize)

Moving from specific instances to the general picture, the tables below summarise the results of the international (non-US) sample of CSPs. The results suggest that the officially mandated risk-based approach is largely ineffective when it comes to even a very obvious corruption risk. The good news is that providers were less likely to reply to the corruption solicitation than to the low-risk control e-mail. However, the overall picture is more negative: those providers that did reply to the corruption e-mail were actually less likely to refuse service, less likely to ask for proof of identity, and more willing to supply untraceable shell companies than those that replied to the control.

Table 1: International Sample

Group		Total	No response	Non-compliant	Partially compliant	Compliant	Refusal
Control	Number	268	115	20	51	51	31
	Percent	100%	42.9%	7.5%	19.0%	19.0%	11.6%
Corrupt	Number	276	152	31	35	42	16
	Percent	100%	55.1%	11.2%	12.7%	15.2%	5.8%

There are some interesting contrasts in the US results for the same test. The response rate from US providers was much lower for both the control e-mail and the corruption e-mail. The reasons are not clear, since we do not know whether nonresponse was a de facto risk management technique or whether US firms are simply less interested in dealing with foreign customers. The most striking result, however, is that only one provider out of the 140 that did reply met international standards by requiring certified photo identification, and very few required any identity documentation at all.

Once again, the presence of an obvious corruption risk failed to induce higher rates of scrutiny as the risk-based approach says it should. There was no significant difference between the treatment and control groups in the rates of compliance, partial compliance, and noncompliance, and refusal rates were slightly lower for the corruption risk group than for the control.

Table 2: United States Sample

Group		Total	No response	Non-compliant	Partially compliant	Compliant	Refusal
Control	Number	270	197	29	7	0	37
	Percent	100%	73.0%	10.7%	2.6%	0%	13.7%
Corrupt	Number	271	204	35	6	1	27
	Percent	100%	75.3%	12.9%	2.2%	0.4%	9.5%

This sort of information provides a better picture of policy impact and effectiveness than the studies usually used by government agencies and international organisations. Most importantly, these data show what corporate service providers do in their normal day-to-day business when interacting with prospective customers. Contrast this approach with self-reported data from reports by providers to local regulators or foreign evaluation teams, in which there is an incentive to tell the evaluators what they want to hear. The field experiment also provides a credible and much clearer answer to such basic

questions as "Is it possible to set up an untraceable shell company? If so, how difficult is it, and how much does it cost?" No study of laws on the books, amounts spent on risk management software, or hours spent in AML training seminars can provide similar insight into actual policy effectiveness in this realm.

The results are systematic and robust, rather than only anecdotal. Experimental data do not limit the universe of cases to those that have been investigated and publicised, which are by definition unrepresentative and atypical and thus unsuitable for impact assessment. Field experiments allow for the testing of particular propositions, in this case whether corporate service providers screen customers for corruption risk. Such experiments can provide comparative data on the relative performance of different countries and different categories of countries. Finally, experimental data are superior to standard observational, statistical data in revealing causation, as the random assignment in experiments "washes out" all the potentially confounding factors.[4] Often statistical analysis is based on highly unrealistic simplifying assumptions, whereas field experiments are much more true to life and thus superior for informing policy. These and other strengths of field experiments for development policy analysis have been extensively discussed by a number of scholars (e.g., Harrison and List 2004; Humphreys and Weinstein 2009).

How practical are field experiments for use by development agencies, or organisations such as NGOs that often partner with development agencies? The experimental results reported above are part of a larger project that would take one person working full time perhaps four months to replicate. The capital costs are very low, amounting to only a reliable Internet connection and a couple of computers to first conduct the searches for service providers, and then send and receive the e-mails. There is a small amount of skilled labour in designing the e-mail treatments, the manual for coding responses, and whatever statistical analysis is desired for the results. Most of the work, however, is simply a matter of sending out preassigned e-mails and recording the responses, which does not require any specialised skills or more than one day's training. It is also worth noting that the kind of audit and field experiment studies described above could quite easily be adapted to study the compliance of a wide range of other financial and nonfinancial businesses with AML rules in a similar fashion. These might include banks, law firms, casinos, alternative remittance businesses, and real estate agents.

In sum, although they are more costly in time and money than audit studies, field experiments are still very cheap, especially relative to the quality of the information they provide. They are not only well within the reach of Western development agencies with programmes on AML and anti-corruption, but are also feasible for moderately well-resourced NGO partner organisations in developing countries, given that the primary cost is the labour involved.

---

[4] This paper does not delve into the methodological debate over observational data and experimental data. Studies using experimental design (where possible) are generally regarded as superior to those based on observational data, which is why new drugs must be approved through randomized controlled trials. Studies based on observational data must fully specify all potential causes that might affect the outcome in question, and then try to isolate the potential causes of interest by statistically controlling for all the others. If researchers have failed to specify one or more potential causes, then the causal inference may well be inaccurate. Random assignment to control and treatment groups, on the other hand, acts to control for all other potential causes without needing to fully specify them. See Sherman (2003).

5. Conclusion

It is now widely accepted that grand corruption by senior public officials is one of the most important causes of development failure. As a result of this awareness, the last decade has seen a flurry of international rule making to combat this problem. But these rules do not seem to work. Kleptocracy remains common, and impunity for those engaged in such crimes is still the norm. Both rough quantitative estimates and case studies such as the one of Papua New Guinea show an enormous gap between the formal rules, even those that are apparently tough and comprehensive, and their results. In most cases, rules and regulations on the books are failing to have an impact in reducing corruption among senior public officials.

The problem, this paper has suggested, is not that we have the wrong rules or too few rules, but rather that the ones we have are often not enforced. In particular, banks dealing with PEPs routinely fail to establish the legitimacy of their wealth before opening accounts or making wire transfers. And major OECD countries have simply chosen not to enforce the international rule mandating that corporate service providers must collect certified identity documentation from clients for whom they establish shell companies. The examples summarised in this paper demonstrate that, despite international rules to the contrary, untraceable shell companies are in practice readily available. The risk-based approach that requires corporate service providers to apply enhanced customer due diligence where there is a high corruption risk is not being implemented.

These failures persist because of the lack of effective assessment of the impact of policies to counter money laundering and corruption. Assessment still focuses principally on determining what rules are on the books and on measures of inputs, such as the number of prosecutions. The priority instead should be measuring the impact of the rules in practice. Assessing the impact of anti-corruption and anti-money laundering rules is, of course, only one step towards closing the effectiveness gap. And such assessment requires not one but a set of continuing studies covering different geographic areas and institutions. But it is clear that audit studies can improve both policy assessment and policy effectiveness, and field experiments can provide additional depth by revealing casual relationships.

If development agencies and partner organisations were to make regular use of audit studies and field experiments, what specific contributions could this make to improving anti-corruption policy and ultimately development outcomes? At present, neither national bodies nor international bodies have much idea as to which policies work when it comes to AML and corporate transparency. This means that money is wasted on ineffective, often expensive policies in these areas. A better understanding of policy effectiveness would mean that policies that do not work and hence waste money could be discontinued, freeing up scarce resources in both donor and recipient countries to address other development priorities. Identifying particularly problematic areas for kleptocracy (e.g., enforcement of the requirement that banks and corporate service providers know their customers) would allow policy measures to focus strategically on these areas. Such prioritisation is of course particularly important for developing country governments with limited governance capacity, which are often overwhelmed by a plethora of demands to meet (often inappropriate) outside standards.

Comparative studies can reveal which policies do work, for example by looking at those countries in which "know your customer" requirements are widely implemented in practice rather than only in theory. This can then provide lessons and models for other countries. Notably, in the specific case of corporate transparency, the evidence from the studies in this paper shows that effective policy implementation is at least as likely in developing countries, including those known as secrecy jurisdictions and tax havens, as in rich OECD states. This result suggests that effective solutions are comparatively cheap (because some developing countries have them) and business-friendly (because tax havens cannot afford to be unattractive to outside investors).

For example, one successful measure is to license corporate service providers, regularly audit them to ensure they are identifying customers, and formally include them within the AML reporting regime. Applying such measures in rich countries that are the destination of a large proportion of the proceeds of corruption could have a significant impact. As a result, they may be a better use of resources than existing policy measures such as increasing the number of anti-corruption laws in developing countries. While the conventional wisdom calls for directing attention primarily to actions in developing countries, the potential impact of more serious regulation of banking institutions and corporate service providers in OECD countries has been largely overlooked. The empirical evidence, from audit studies and field experiments, makes clear that this has been a mistake.

Author's Interviews

Australian Federal Police, Brisbane, Australia, 20 April 2011

Asia-Pacific Group on Money Laundering, Sydney, Australia, 26 May 2011

Australian Attorney General's Department, Canberra, Australia, 27 May 2011

Transparency International, Berlin, Germany, 5 September 2011

Global Witness, London, UK, 7 September 2011

Serious Organised Crime Agency, London, UK, 8 September 2011

References

Andreas, Peter, and Kelly M. Greenhill, eds. 2010. *Sex, Drugs, and Body Counts: The Politics of Numbers in Global Crime and Conflict*. Ithaca, NY: Cornell University Press.

AUSTRAC (Australian Transaction Reports and Analysis Centre). 2008. *Inquiry into the Economic and Security Challenges Facing Papua New Guinea and the Island States of the Southwest Pacific.* Submission to the Senate Committee on Foreign Affairs, Defence and Trade. Canberra: Parliament of Australia.

Baker, Raymond W. 2005. *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System*. Hoboken, NJ: Wiley.

Busan Partnership. 2011. "Busan Partnership for Effective Development Cooperation." Outcome document of the Fourth High Level Forum on Aid Effectiveness, Busan, Republic of Korea, 29 November – 1 December.

Carr, Kelly, and Brian Grow. 2011. "A Little House of Secrets on the Great Plains." Article 1 in series "Shell Games: A Reuters Investigation." Reuters, 28 June. http://www.reuters.com/article/2011/06/28/us-usa-shell-companies-idUSTRE75R20Z20110628.

Chaikin, David A. 2010. *International Anti-Money Laundering Laws: Improving External Accountability of Political Leaders*. U4 Brief 4. Bergen, Norway: U4 Anti-Corruption Resource Centre.

Chaikin, David A., and Jason Sharman. 2007. "APG/FATF Anti-Corruption/AML/CFT Research Paper." Presented at Financial Action Task Force Plenary, Paris, 12 October.

Cohen, Jessica, and Pascaline Dupas. 2010. "Free Distribution or Cost-Sharing? Evidence from a Randomized Malaria Prevention Experiment." *Quarterly Journal of Economics* 125, no. 1: 1–45.

Does de Willebois, Emile van der, Emily M. Halter, Robert A. Harrison, Ji Won Park, and J. C. Sharman. 2011. *The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It.* Washington, DC: World Bank.

Duflo, Esther, Rachel Glennerster, and Michael Kremer. 2007. *Using Randomization in Development Economics: A Toolkit*. London: Centre for Economic Policy Research.

Elapa, Jeffrey. 2011. "Sweep 'Uncovers Syndicates.'" *Malum Nalu* (blog), 11 December. http://malumnalu.blogspot.ca/2011/12/sweep-uncovers-syndicates.html.

FATF (Financial Action Task Force). 2012. *The FATF Recommendations: International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation*. Paris: FATF.

Financial Services Authority. 2011. *Banks' Management of High Money-Laundering Risk Situations*. London: Financial Services Authority.

Fontana, Alessandra. 2011. *Making Development Assistance Work at Home: DfID's Approach to Clamping Down on International Bribery and Money Laundering in the UK*. U4 Practice Insight 5. Bergen, Norway: U4 Anti-Corruption Resource Centre.

Global Witness. 2009. *Undue Diligence: How Banks Do Business with Corrupt Regimes*. London: Global Witness.

Gordon, Richard. 2009. *Public Corruption and Money Laundering*. Washington, DC: World Bank.

Goredema, Charles. 2011. *Combating Illicit Financial Flows and Related Corruption in Africa: Towards a More Integrated and Effective Approach*. U4 Issue Paper 12. Bergen, Norway: U4 Anti-Corruption Resource Centre.

Greenberg, Theodore S., Larissa Gray, Delphine Schantz, Carolin Gardner, and Michael Latham. 2009. *Politically Exposed Persons: Preventive Measures for the Banking Sector*. Washington, DC: World Bank.

G20. 2010. "G20 Anti-Corruption Action Plan: G20 Agenda for Action on Combating Corruption, Promoting Market Integrity, and Supporting a Clean Business Environment." Annex III of the G20 Seoul Summit Document, 12 November 2010. http://www.g20.utoronto.ca/2010/g20seoul-anticorruption.html.

Harrison, Glenn W., and John A. List. 2004. "Field Experiments." *Journal of Economic Literature* 42, no. 4: 1013–59.

Humphreys, Macartan, and Jeremy Weinstein. 2009. "Field Experiments and the Political Economy of Development." *Annual Review of Political Science* 12, no. 1: 367–78.

Kennedy, Anthony. 2006. "Putting Robin Hood Out of Business: A Proceeds of Crime Case Study." *Journal of Money Laundering Control* 9, no. 1: 19–26.

Levi, Michael, and Peter Reuter. 2006. "Money Laundering." In *Crime and Justice: A Review of Research*, edited by Michael H. Tonry, vol. 34, 289–375. Chicago: University of Chicago Press.

Ndikumana, Leonce, and James Boyce. 2008. *New Estimates of Capital Flight from Sub-Saharan African Countries: Linkages with External Borrowing and Policy Options*. Political Economy Research Institute Working Paper 166. Amherst: University of Massachusetts.

PNG FIU (Papua New Guinea Financial Intelligence Unit). 2010. *Fraud Methodology Report*. Port Moresby: Financial Intelligence Unit.

PNG PPAC (Papua New Guinea Parliamentary Public Accounts Committee). 2009. "Inquiry into the Public Accounts of the Government of Papua New Guinea for the Financial Year 2006: Report to the National Parliament." Port Moresby: Parliamentary Public Accounts Committee.

Reed, Quentin, and Alessandra Fontana. 2011. *Corruption and Illicit Financial Flows: The Limits and Possibilities of Current Approaches*. U4 Issue Paper 2. Bergen, Norway: U4 Anti-Corruption Resource Centre.

Reuter, Peter H. 2007. "Are Estimates on the Volume of Money Laundering Either Feasible or Useful? Comments on the Presentation by John Walker." Paper presented at the Tackling Money Laundering Conference, Utrecht University, Utrecht, Netherlands, 2 November.

———, ed. 2012. *Draining Development? Controlling Flows of Illicit Funds from Developing Countries*. Washington, DC: World Bank.

Reuter, Peter, and Edwin M. Truman. 2004. *Chasing Dirty Money: The Fight Against Money Laundering*. Washington, DC: International Institute of Economics.

Sharman, J. C. 2011. *The Money Laundry: Regulating Criminal Finance in the Global Economy*. Ithaca, NY: Cornell University Press.

Sherman, Lawrence W. 2003. "Misleading Evidence and Evidence-Led Policy: Making Social Science More Experimental." *Annals of the American Academy of Political and Social Science* 589: 6–19.

Transparency International. 2004. *Global Corruption Report: Political Corruption*. Berlin: Transparency International.

UNODC (United Nations Office on Drugs and Crime). 2011. *Estimating Illicit Financial Flows from Drug Trafficking and Other Transnational Organized Crimes*. Vienna: UNODC.

UNODC and World Bank. 2007. *Stolen Asset Recovery (StAR) Initiative: Challenges, Opportunities, and Action Plan*. Washington, DC: World Bank.

US Senate. 2004. *Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act: Case Study Involving Riggs Bank*. Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs. Washington, DC: US Government Printing Office.

———. 2005. *Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act: Supplemental Staff Report on US Accounts used by Augusto Pinochet.* Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs. Washington, DC: US Government Printing Office.

———. 2010. *Keeping Foreign Corruption Out of the United States: Four Case Histories*. Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs. Washington, DC: US Government Printing Office.

Walker, John, and Brigitte Unger. 2009. "Measuring Global Money Laundering: The 'Walker Gravity Model.'" *Review of Law and Economics* 5: 821–53.

Yikona, Stuart, Brigitte Slot, Michael Geller, Bjarne Hansen, and Fatima el Kadiri. 2011. *Ill-gotten Money and the Economy: Experiences from Malawi and Namibia.* Washington, DC: World Bank.

Appendix I

Dear Sir,

I am writing to enquire about the possibility of setting up an international company or other corporate vehicle as part of my freelance consultancy work.

I am a resident of Australia doing consultancy work for foreign governments and international organisations. Thus far I have done this work as a private individual, in the future I think I may need to incorporate for the reasons given below, and I would be grateful for any advice you might be able to provide me with concerning your products.

1. In the initial stages of my work the relatively small sums under consideration meant that Australia's very high personal income taxes seemed less of a problem than the cost and trouble of looking at international incorporation options. Now with more and more business this balance is shifting, particularly as I gather that one should take the necessary steps before rather than after particular deals are in train.

2. Although I have only been in the business for 5 years, the contracts I now sign are increasingly large and complex. With these larger sums and my need to subcontract I am keen to limit my liability if things go wrong.

3. I have a strong desire for business confidentiality which I understand is more easily accomplished through incorporation rather than as a natural person.

Having not had much experience in these matters before, perhaps you might be able to suggest a range of options that may be appropriate. Thank you for your help, I should be grateful for any advice you might be able to offer.

Yours faithfully,

J. Campbell Sharman

INDEXING TERMS:

Australia	Papua New Guinea
Kleptocracy	Tax havens
Money laundering	Secrecy jurisdictions
FATF evaluation	Grand corruption

Photo by
Tom Wolf | Photography on flickr.com

International measures to counter the laundering of looted wealth have not had a significant impact, despite their apparent strength. Evidence, including an original case study of Papua New Guinea, suggests that only a small fraction of funds derived from corruption are intercepted. This effectiveness gap is caused principally by the laxity of banks in controlling wire transfers and the willingness of corporate service providers to supply untraceable shell companies. Current policy evaluation fails because it equates inputs with effectiveness and does not include clear measurement of results. This can be remedied by testing the ease of making suspect transactions or forming shell companies, using either audit studies or field experiments. Two such studies of shell company formation show that rules mandating sensitivity to customer corruption risk are ineffective. Such studies are cheap, practical, and suitable for use by development agencies and their partners in developing countries.