# The Oligarch's Offshore Dilemma*

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**Abstract**

How do oligarchs protect their wealth from state predation? By routing ownership of their domestic assets through offshore shell companies, individuals can become *de jure* foreign investors in their home markets. Engaging in such "roundtripping" of investments not only reduces an oligarch's tax burden but also provides access to international investment treaties that were created for foreign investors. Roundtripping then allows oligarchs to sue their own sovereign in neutral venues. Analyzing nearly 300,000 offshore incorporations, we find that oligarchs generally *avoid* structuring their wealth in a way that provides access to investment treaties: seeking protections could signal to a sovereign that the oligarch intends to mount a political challenge, inviting the threats that these protections seek to deter. However, we find evidence of treaty shopping via the multilateral Energy Charter Treaty. The paper contributes to debates on the effects of globalization on political development and the IPE of Oligarchy.

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# 1 Introduction

Offshore finance was key to Mikhail Khodorkovsky's success. He set up shell companies in places like the British Virgin Islands and the Isle of Man to ensure Yukos, his oil company, minimized its tax burden and accumulated hard currency. In 1999, amid a heated battle with minority shareholder and fellow billionaire, Kenneth Dart, Khodorkovsky hatched up a plan that would make even the most audacious accountants blush—he planned to invert the entire ownership structure of Yukos to turn it into a fully foreign company (Hoffman, 2011). He would leave Dart and Yukos's other creditors with an empty shell of a company. With that move, the second largest oil company in Russia would become a *de jure* foreign corporate. Khodorkovsky largely succeeded. But when he lost his political battle with Vladimir Putin, Yukos's complicated ownership structure provided an additional benefit: access to an international agreement designed to provide extra protections for foreign investors. Since Khodorkovsky used offshore shell companies to make Yukos appear to be a foreign company, his fellow Russian shareholders were able to sue the Russian state in international arbitration courts that were designed for foreign investors—they claimed nearly $100 billion dollars in damages (Nougayrède, 2015).

What determines how oligarchs hide and protect their wealth from state predation? While we generally think of offshore finance as a mechanism to avoid paying taxes, recent scholarship highlights that moving money abroad also has political benefits. Setting up companies in places like Malta or the Seychelles makes it harder for the state to track down and seize an individual's wealth and gives individuals access to legal institutions that are stronger than those in the average emerging market (Sharman, 2012; Pistor, 2019). We focus on two underappreciated structuring features of offshore finance: how "roundtripping" of investments interacts with international investment law.

First, plutocrats exploit tax havens to become foreign investors in their own country. When making an investment, individuals can choose how to route the transaction. The most straightforward way would be to move money directly from their home location to where they intend to produce or sell goods. But plutocrats frequently route even their *domestic* investments through offshore shell or holding companies, sending the money abroad before sending it straight back to their home jurisdiction (Kalotay, 2012). This changes the *de jure* nature of their investments as it will now show up in national accounts as foreign investment (Linsi and Mügge, 2019; Zucman, 2015). Plutocrats can even change nationality well after the initial investment decision by selling ownership rights over their companies to their own offshore vehicles, as Khodorkovsky did in the '90s.

Second, such "roundtripping" of investments can change the sites of conventionally domestic political contestation. If a plutocrat has structured their business empire through offshore companies, and more specifically using entities in jurisdictions that have an investment treaty with their home state, the losers from a political clash can argue they are foreign investors and then attempt to use international arbitration venues to compensate for their losses. They can use the neutral venues designed for multinational corporations in order to extend a political conflict through international means, as Khodorkovsky's associates did against their home state, Russia (Nougayrède, 2015). We label this phenomenon an "extraterritorial arbitration".

We assess how the potential for extraterritorial arbitration influences how oligarchs structure their wealth. We do so at different levels of analysis that balance out some of the standard non-transparency issues with studying offshore finance. We first analyze the incorporation of 275,000 entities in 44 offshore jurisdictions based on the series of leaks compiled by the International Consortium of Investigative Journalists (ICIJ), examining whether a tax haven having an investment agreement with a plutocrat's home country affects the number of incorporations in the tax haven. While the ICIJ data gives us unprecedented access to what is considered a nominally hidden world, it lacks data on the full-ownership chain and does not include data on the industry or amounts of money at stake. As a complement, we then analyze over 10,000 entities from 41 European home states and 65 offshore jurisdictions using qualitative and quantitative information on the entire wealth chain via corporate services provider Bureau Van Dijk. To the best of our knowledge, both datasets are the most comprehensive versions of their kind.

We find that increased potential for extraterritorial arbitration *reduces* the likelihood of plutocrats utilizing a given tax haven. We expect that this is driven by the signaling effects associated with seeking protections abroad. Plutocrats in weakly institutionalized environments are always forced to fear state predation - placing money in a jurisdiction that could give a plutocrat additional protection may (inadvertently) signal to the ruler that the plutocrat is weighing up a challenge, inviting the very threat that seeking investment agreement protections would seek to deter. Seeking the ability to sue the state would then blowback on a plutocrat. This negative effect holds for all the legal avenues a plutocrat could use to initiate an extraterritorial arbitration with one exception. Signing up to the The Energy Charter Treaty (ECT) - a multilateral investment treaty signed by more than 50 jurisdictions that gives energy investors access to Investor-State Dispute Settlement mechanisms - spurs plutocrats to roundtrip through an ECT covered haven. This can be explained by the multilateral nature of the treaty as it diminishes the potentially negative signal to an individual's home state. The multilateralism obfuscates a plutocrat's intentions.

The paper then identifies a new set of distributional consequences associated with the international investment regime (Wellhausen, 2016). Research on the regime has generally focused on whether or not its treaties live up to their aims by increasing foreign direct investment. Moreover, they tend to focus primarily on Bilateral Investment Treaties (BITs) rather than incorporating the whole swath of treaties that can influence business-government relations. Here, we expand the legal focus while shifting the analysis toward understanding how the regime not only impacts economic flows, but also alters political flows. In line with how other international institutions are often exploited, strategic, *de facto* domestic actors can leverage international investment tools for their own domestic ends. But doing so comes with a cost, which illustrates a need for political economy scholars to examine the liabilities generated by an oligarch protecting her property be it through offshore vehicles or more traditional forms of non-market strategy.

Moreover, our findings call for further work bridging the gaps between international regimes. While regime complexity is now a focal agenda for IR scholars, issue arenas are frequently theorized and assessed in isolation (Clark, 2021). Far less attention is paid to how decisions intended to benefit actors in one regime can spillover, and even change the purpose, of an alternate regime. The way oligarchs are able to exploit rules in the tax arena to access the resources of another regime indicates that regimes are more dynamic than our theories expect (Thrall, 2021). Moreover, it suggests that when a regime relies on nationality as a key access criteria, it will create loopholes that change the bargaining leverage of the transnational oligarchic class.

Finally, the paper illustrates one way that the rules of the global economy can create both benefits and liabilities for plutocrats (Cooley and Sharman, 2017). While the institutionalization of international trade and finance has no doubt improved living standards, the gains have not been distributed equally. A wave of recent scholarship across subfields examines the apparent backlash to globalization's imbalanced outcomes. But to comprehensively understand the populist wave we need to fully theorize the winners from the status quo. Emerging market oligarchs is a class of winners that are rarely discussed in such scholarship, but we hope that the paper continues building momentum around a research agenda focused on the IPE of Oligarchy (Cooley and Heathershaw, 2017).

# 2 The Political Economy of Extraterritorial Arbitration

We start from the premise that two systemic features distinguish emerging markets from their developed peers. First, ownership in large firms tends to be substantially more concentrated in emerging markets where single individuals or families have controlling ownership stakes in the majority of a country's most lucrative companies (Freund, 2016). This is a broadly agreed upon stylized fact in political economy scholarship and has important political implications. Rather than a purely profit motivated firm being the key player in the economy, individuals with large amounts of wealth are frequently part of the economic and political elite and directly impact both nominally independent systems. The second distinction is the relative weakness of the institutional environment. Emerging markets, beyond simple definitions of GDP per capita, usually have fewer checks and balances, weaker property rights, and weaker courts. In emerging markets, billionaires are then in a position to more effectively wield their wealth to attain political power, creating a class of oligarchs or plutocrats (Winters, 2011).

But the weaker institutions cut both ways, as they imply that the state is often in a position to expropriate, directly through seizure or indirectly through cumbersome taxation or regulation, the wealth of elite business people (Haber and Razo, 2003; North et al., 2013; Arel-Bundock, 2017). How plutocrats resolve this threat is one of the main research agendas for comparative political economy scholars who have found plutocrats, and their firms, can leverage a variety of non-market strategies. We frequently see plutocrats try to directly align themselves with state actors, substituting formal institutional protections with informal political connections (Haber and Razo, 2003). In major economic powers like China and Russia, we even see plutocrats run for office themselves, with substantial economic returns for the firms they control (Szakonyi, 2020). The bulk of scholarship has focused on the domestic tools that plutocrats use to protect their property but recent work has turned to the transnational tools at a plutocrat's disposal. Oligarchs can try to team up with with foreign firms to gain additional political allies, and they can list their companies abroad to garner more attention and alter corporate governance rules (Betz and Pond, 2019; Markus, 2016; Logvinenko, 2019). We theorize the potential benefits and costs of leveraging the international environment to protect one's domestic property.

## 2.1 Offshore Finance and Property Protection

The move toward studying the transnational sources of property protection is an important step forward but has generally developed independent of debates on the role of offshore finance in global politics. This is unsurprising given that much of comparative and international political economy scholarship on offshore finance is fundamentally focused on economic arbitrage. The biggest winners from offshore havens are generally regarded as multinational corporations (MNCs) who, with the aid of the major accounting firms, are able to efficiently route their investments and claim their profits in low tax jurisdictions like Ireland, Luxembourg, and the Cayman Islands (Arel-Bundock, 2017). A variety of recent work documents that emerging markets experience relatively high levels of capital offshoring. Countries like Russia, Venezuela, and Saudi Arabia have seen the largest proportion of domestic wealth moved into tax havens despite many emerging markets already operating with low corporate taxes (Tørsløv, Wier and Zucman, 2022; Zucman, 2014).[1]

Part of this pattern can be explained by economic arbitrage. Consider the choice set of an Indian oligarch when deciding to build a new factory at home. They could simply pay money to domestic construction companies and materials suppliers through their onshore balance sheets. Or they could move the money to Mauritius, which has a favorable tax treaty with their home government, and then move the money back to India. Because of how it is routed offshore the money will show up in India as foreign investment and lock in a lower tax rate for the construction project. This "roundtripping" is rampant across emerging markets and helps explain why Mauritius is historically one of the top sources of FDI for India and why Cyprus continues to take a higher spot for investments into Russia (Aykut, Sanghi and Kosmidou, 2017; Ledyaeva et al., 2015). In line with the work of by Katarina Pistor (2019) , roundtripping illustrates that the consequences of capital are a result of how it is legally constructed. By changing its *de jure* location, plutocrats can reap substantial economic returns even when only *de facto* investing in their home market. Such actions have been shown to heavily bias many of our core macroeconomic indicators and thereby distort our understanding of the global economy. More generally, it indicates that plutocrats, much like multinational corporations, can create a portfolio of nationalities by choosing how to route their investments and where they place their wealth (Cooley and Sharman, 2017).

[1] On the development of rules dealing with financial flows from corrupt behavior see Sharman (2017*b*).

But a number of researchers have called attention to the political gains from placing money abroad, and in particular how it facilitates institutional arbitrage (Sharman, 2012). By moving money into tax havens, investments become *de jure* governed by the laws of the foreign jurisdiction. Plutocrats may gain access to the domestic courts in these jurisdictions and if a rival, be it a fellow oligarch or a state, wants to seize one's wealth that is placed abroad, they would need to go through the domestic legal system of the tax haven. Not only does that add greater transaction costs, and generally ensure more liberal treatment compared to the home legal system, the opacity of these jurisdictions often mean that rivals may not know the money has been placed there. It is often "hidden" wealth. Most importantly, for our purposes, systematic quantitative work has confirmed the insights of a number of early offshore finance scholars. Bayer et al. (2020) show that more offshore companies are registered in tax havens when the threat of expropriation rises in an emerging market. Using a variety of micro data, Earle et al. (2019) find that Ukrainian oligarchs with the weaker political connections are more likely to obfuscate their wealth through tax havens.

We link these two schools of thought on offshore finance to help us better understand how plutocrats can protect their wealth in weakly institutionalized settings. Tax havens all generally offer zero tax rates and strong institutions, but they are not created equally. They vary in terms of their global engagement, and that has important consequences for the *international* property protections they can provide. More specifically, they have different degrees of integration into the international investment regime, which should condition a plutocrat's strategic toolkit.

## 2.2 The Investment Regime and the (Potential) Internationalization of Intra-Plutocratic Conflict

Since its inception in the late 1950s, the modern international investment regime has grown to be comprised of 3,000 investment agreements. When two states sign a Bilateral Investment Treaty (BIT), they make a commitment to apply a certain set of protections to each other's foreign investors; for example, they promise not to expropriate assets without compensation or pass domestic regulations that discriminate against their partner state's investors. Further, if a BIT-protected foreign investor believes that the host government has violated one of these protections, they are able to sue for damages in international arbitration courts through a process called investor-state dispute settlement (ISDS). ISDS is specifically considered the bedrock of the regime; it has also been incorporated into major trade agreements like the North American Free Trade Agreement (NAFTA) and it is a core feature of the Energy Charter Treaty (ECT), a multilateral, energy sector-specific investment agreement with more than 50 signatories including the European Union. ISDS awards are binding; if governments fail to pay, investors may lawfully seize state-owned assets to recoup damages.

By giving foreign investors the ability to sue their host governments, the general aim of these treaties was to spur foreign direct investment in emerging markets (Wellhausen, 2016).

However, existing evidence suggests that BITs have failed to meaningfully affect firms' investment decisions, and the regime has come under increasing scrutiny from mainstream political parties and civil society groups (Brada, Drabek and Iwasaki, 2020). Most cases in the past decade have not dealt with outright expropriation claims that the regime was designed to deter, but instead focus on indirect situations where governments attempt to pass new (often democratically supported) regulations (Pelc, 2017).

Under the regime states have limited recourse against infringements by multinational corporations, and seminal work on the regime suggests that states did not fully understand what they were signing up for (Poulsen, 2015). The playing field is made even more asymmetric because of offshore finance. As scholars like Gray (2020) and Thrall (2021) have documented, MNCs exploit their multi-jurisdictional structure to treaty shop—they can use their subsidiaries to file cases against a host government even if their main home government does not have an investment treaty with its host state. Even if firms who adopted their multi-jurisdictional structures primarily to lower their tax burdens, they can still benefit from third-party investment treaties. Thrall (2021) gives the example of an American firm, Columbia Capital LLC, that routed its Indian assets through a Mauritian subsidiary (CC/Devas). Adopting this structure allowed the parent firm to lower its withholding tax rate from 20% to 10%, and—when a dispute arose with the Indian government—Columbia Capital used its Mauritian subsidiary to file an ISDS case against India.

Such "shopping" is possible because of 2 interacting features. The key governing principal of the investment regime is discrete nationality (van Os and Knottnerus, 2012); if you are registered in a jurisdiction, you gain access to its investment treaty provisions independent of how the rest of your business may be structured. Second, MNCs by definition have a portfolio of nationalities, which are already set up for normal business or tax purposes, which they can then choose to file cases with.

### 2.3 The Transnational Political Benefits of Roundtripping

As we've discussed, emerging market plutocrats also frequently create such portfolios and they regularly take advantage of offshore structures for de facto domestic investments. Our contention is that plutocrats from emerging markets, and their legal teams, recognize the potential for international institutional arbitrage that MNCs exercise when they treaty shop. Routing investments through offshore vehicles can give them access to international treaty provisions that their home states lack. More importantly, roundtripping investments puts plutocrats in a position to challenge their home state. Because of the investment regime's nationality principal, disputes that are *de facto* domestic can then be adjudicated via international venues.

The gains from choosing an offshore haven that has an investment treaty with a plutocrat's home government go above and beyond those from simply placing money offshore. A plutocrat's wealth could still be obfuscated regardless of the location choice, and they are going to have access to stronger domestic institutions. But when a conflict arises with the

Table 1: **Top 10 recipients of ISDS claims: extraterritorial arbitration vs. all others**

| Extraterritorial | Other |
|---|---|
| Russia (7) | Argentina (58) |
| Czechia (6) | Venezuela (35) |
| Egypt (6) | Spain (28) |
| Turkey (6) | Czechia (27) |
| Spain (5) | Canada (25) |
| Venezuela (4) | Mexico (23) |
| Kazakhstan (3) | Poland (23) |
| Ukraine (3) | Ecuador (21) |
| Panama (2) | Egypt (20) |
| Albania (1) | India (16) |

home state—the primary threat to most plutocrats' wealth—many offshore sites would leave them with limited recourse. A case filed against a sovereign state in the courts of places like the British Virgin Islands or Singapore courts would almost certainly fail on jurisdictional grounds because of sovereign immunity. But by claiming to (legally) be a foreign actor, and using the provisions contained in 95% of modern BITs,[2] plutocrats can sidestep those issues through international arbitration venues.

We label this phenomenon, when a plutocrat turns a conflict with their home state into an international arbitration via his nationality portfolio, an extraterritorial arbitration (or EA). They've steadily become a central feature of the international investment regime with 58 different EAs initiated between the 1980 and 2015. While representing 8% of the total number of ISDS cases filed in that time period, they represent a whopping 41% of the damages claimed. In addition to the Yukos Affair outlined in the introduction, Russia was the respondent in a claim from Sergei Pugachev who was frequently referred to as the "Kremlin's Banker." After a public fallout with the regime, he claimed that his bank was expropriated and thereby sought $12 billion in damages (*Pugachev v. Russia*) (Belton, 2020).

As Table 1 illustrates, extraterritoriral arbitration is not a solely Russian phenomenon. Mukhtar Ablyazov was the primary challenger to Kazakhstan's multi-decade ruler Nursultan Nazarbayev. After being imprisoned in the early 2000s, he struck a bargain with the state, leaving the country to re-build his wealth. He returned a handful of years later as the chairman of BTA Bank. The latter was eventually nationalized in the midst of the great financial crisis, which Ablyazov claims was a veneer for the regime to dispose of its clearest threat (Cooley and Heathershaw, 2017; Burgis, 2020). Ablyazov used thousands of offshore vehicles to protect his wealth (Nougayrede, 2017), and settled on using a shell company in the Netherlands to make an ISDS claim worth $1.5 billion (*KT Asia v. Kazakhstan*). Similarly, after clashing with Erdogan in the early years of his tenure, the Turkish Uzan family may have inspired Khodorkovsky. They used the Energy Charter Treaty to strike back against

[2]Source: author calculations based on data from the IIA Mapping Project.

their home government, seeking 3.5 billion for the cancellation of electricity concessions and the seizure of their conglomerate's assets (*Uzan v. Turkey*).[3] These additional examples highlight how political clashes become extended through ISDS. If plutocrats are seeking to use offshore vehicles to gain protections against their sovereign we should then observe the following:

*H1: Plutocrats will be more likely to incorporate companies in jurisdictions that share an investment agreement with their home country because that would allow them to initiate international arbitration claims against their home state.*

## 2.4 The Domestic Political Liabilities of Roundtripping

At the same time, plutocrats need to be concerned with the potential signaling effects that come with roundtripping. In line with our assumptions, and a variety of work in Comparative Politics, the power of plutocrats coupled with the weak institutionalized environment of emerging markets creates a commitment problems between the state and the economic elite (North et al., 2013; Haber and Razo, 2003; Tompson, 2005). Even if they are nominally aligned, they cannot fully trust each other because their interests are frequently in opposition - the state wants to assert control over the plutocracy while the latter will want to increase their rents and mitigate the threat from the state (Winters, 2011; Albertus and Menaldo, 2012). The state may want to take over their assets for its own gain or to send a message to other potential rivals. The lack of institutional safeguards frequently leads to political clashes. Roundtripping investments through an investment agreement protected haven could exacerbate the commitment problem and increase the likelihood of those clashes.

In general, when plutocrats send money abroad they can conceal the ownership and origins by routing them through layers of shell companies. But the effectiveness of such concealment reduces when it comes to roundtripped entities - when the money gets sent back home, it will register in the state's national accounts and governments will then learn where part of the money is hidden (Ledyaeva et al., 2015; Kalotay, 2012). Even if the plutocrat is able to avoid fully revealing the ownership structure when shares or money are roundtripped, the individual's wealth structure could still come into the public, or at least, the state's eye. When a plutocrat gets involved in a major legal fight, be it with the state or a private entity, the courts might force their hand and reveal ownership patterns as we commonly see with fraud claims (Kalyanpur, 2020). The information could simply leak to journalists, in line with the data that this paper relies on, which can have tangible economic and political consequences (O'Donovan, Wagner and Zeume, 2019). If the state really wanted to find out where a specific individual's assets are hidden, it could hire firms that specialize in asset tracing (Sharman, 2017*a*). As the economic response to the Russia-Ukraine invasion shows (Bremus and Hüttl, 2022), when governments want to track down hidden wealth, they have the means to do so.

[3]For details, see the Award on Respondent's Preliminary Objection: https://www.italaw.com/sites/default/files/case-documents/italaw8642.pdf.

The key point is that while much of the offshore world may be hidden, the methods used by plutocrats can be exposed, especially when it comes to the roundtripped investments necessary to gain investment agreement protections. When that information is revealed it could increase the threat from a plutocrat's home state. Governments are aware of the investment agreements they are party to, and given some of the major disputes discussed above, they know about the potential for extraterritorial arbitration. Given that powerful plutocrats present a potential challenge to the state, the latter will also be attempting to track their wealth. Plutocrats will be aware of the surveillance at least when it comes to round-tripped entities.

While tax evasion through offshore methods is often part of the state-plutocrat bargain (Logvinenko, 2019), and access to offshore is increasingly becoming a tool in authoritarian management (Cooley and Heathershaw, 2017), incorporating in a jurisdiction that allows a plutocrat to sue the state could be interpreted as the plutocrat taking political precautions. It will inevitably beg the question why the the plutocrat now sees herself as needing to take such measures. Even if nominally aligned, the interests of the state and the plutocracy are frequently in opposition (Winters, 2011; Tompson, 2005; Kalyanpur, 2020). Similar to the dynamics we see in inter-state conflict, taking political precaution could lead to a spiral and make the actor trying to avoid conflict worse off: the state may interpret seeking offshore protection as the foundation for an offensive move, which would incentivize the state to take action against the plutocrat be it via direct or indirect expropriation (Albertus and Menaldo, 2012) In other words, a plutocrat protecting herself abroad could increase threats at home.

In sum, plutocrats will then need to weigh the potential protection of extraterritorial arbitration against the negative signaling effect. The state knowing that the plutocrat has international legal recourse could serve as a deterrent to taking actions against the individual - that is the goal of the broader investment regime. But we expect that the negative signaling logic may prevail given the economic and procedural nature of ISDS. If the protections fail as a deterrent, and the plutocrat is then targeted, the likely next step is an expropriation. That would see the plutocrat losing access to her revenue streams. To get compensation, she would need to spend millions on lawyers, surpass challenges on jurisdictional grounds, convince arbitrators of the wrongdoing in a system that does not rely on precedent, and, if they win, find state assets that they can seize. Extraterritorial arbitration is then no silver bullet and comes with both political and economic costs. The cases in the previous section illustrate the point: Pugachev and the Uzans lost out on jurisdictional grounds while Ablyazov's case was resolved in favor of the state. Given the potential signaling costs, this leads to the following testable hypothesis:

*H2: Plutocrats will be less likely to incorporate companies in jurisdictions that share an investment agreement with their home country because that could increase the political threat from the state.*

In the following sections, we analyze whether plutocrats strategically search for investment agreement coverage with their offshore holdings or if the potential signaling effects outweigh the international protections.

# 3 IIA Coverage and Strategic Corporate Structures

In order to determine whether oligarchs strategically structure their assets to gain IIA protection, we draw on two complementary data sources. First, we use data on over 275,000 secretly-created offshore entities and their owners that was compiled by the International Consortium of Investigative Journalists (ICIJ) from four separate data leaks. Second, we use a smaller (but more richly detailed) sample of round-tripped investments that analytics firm Bureau van Dijk compiled from publicly available sources such as corporate registries. For both public and private samples, we use the staggered adoption of new IIAs over time to identify the effect of IIA coverage on new offshore incorporations at the bilateral level.

## 3.1 Evidence from Offshore Leaks

Nontransparency is an obvious barrier to the systematic study of offshore wealth. For oligarchs, anonymity is a primary benefit of the foreign shell company. ISDS cases offer us a window into the offshore vehicles maintained by certain oligarchs, though it is a small and selected sample: extraterritorial arbitrations necessarily occur only once a dispute between oligarch and host government has already begun. In order to make more general inferences about why (and where) oligarchs choose to hold their capital abroad, we make use of formerly secret data from offshore service providers and national registries that was leaked to the ICIJ.

### 3.1.1 ICIJ Leaks: Background

The ICIJ, an organization composed of journalists who collaborate on large investigations, was made famous in 2016 when it published the Panama Papers—a massive data leak from law firm and offshore service provider Mossack Fonseca which named thousands of secret shell companies and linked them to their owners. The leak made headline news due to its exposure of the scope of global tax avoidance as well as the exposure of Mossack Fonseca's high profile clients (which included, among others, Saudi Arabia's King Salman and former Ukrainian President Petro Poroshenko).[4] While the Panama Papers attracted the most media attention, it was not the only major offshore data leak published by ICIJ; the organization also broke the "Offshore Leaks" leak (2013), the Paradise Papers (2017), and the Pandora Papers (2021), containing a combined total of over 600,000 offshore entities.[5]

The ICIJ leaks offer an unprecedented opportunity to study the offshore political economy: hundreds of thousands of offshore entities are linked with their beneficial owners, allowing for the study of both the destinations and the origins of offshore capital. Further, the leaked documents include the date of incorporation for each entity, allowing for longitudinal analysis. A number of past studies have used data from the Panama Papers to study the origins of the wealth held in tax havens (Alstadsæter, Johannesen and Zucman, 2018),

[4] Michael S. Schmidt and Steven Lee Myers, "Panama Law Firm's Leaked Files Detail Offshore Accounts Tied to World Leaders", *New York Times*, 03 April 2016.

[5] The ICIJ also published the Bahamas Leaks, in 2016. However, since the incorporation dates for the entities in this leak are unknown, it is not possible to perform longitudinal analyses with this data.

the effects of expropriation on future offshoring (Bayer et al., 2020), and the effect of being implicated in the leaks on public firms' value (O'Donovan, Wagner and Zeume, 2019).

### 3.1.2 ICIJ Leaks: Data and Research Design

Our goal is to study whether oligarchs from state $i$ incorporate more (or fewer) entities in offshore jurisdiction $j$ after states $i$ and $j$ form an IIA together. To do so, we begin by taking several steps to process the data provided by ICIJ. The ICIJ offshore leaks data contain one entry for each unique entity-owner pairing, as well as information on the jurisdiction in which the entity was incorporated and the nationalities of the owner(s). We first remove owners that are listed as having more than three nationalities; this is usually a sign that ICIJ cannot accurately determine an individual's true nationality, and including these observations would likely add measurement error. We then remove owners who are associated with over 1,000 entities, as these are owners are typically offshore service providers themselves rather than true beneficial owners.

Figure 1: **Aggregating the Offshore Leaks data.**

**1. Entity-Owner format (original)**

| Firm | Year | Jurisdiction | Owner (Nat) |
|---|---|---|---|
| Firm A | 2007 | Panama | Mx. X (Turkey) |
| Firm A | 2007 | Panama | Mr. Y (Russia) |
| Firm A | 2007 | Panama | Ms. Z (Russia) |
| Firm B | 2007 | Panama | Mr. J (Russia) |

**2. Entity-Nationality format**

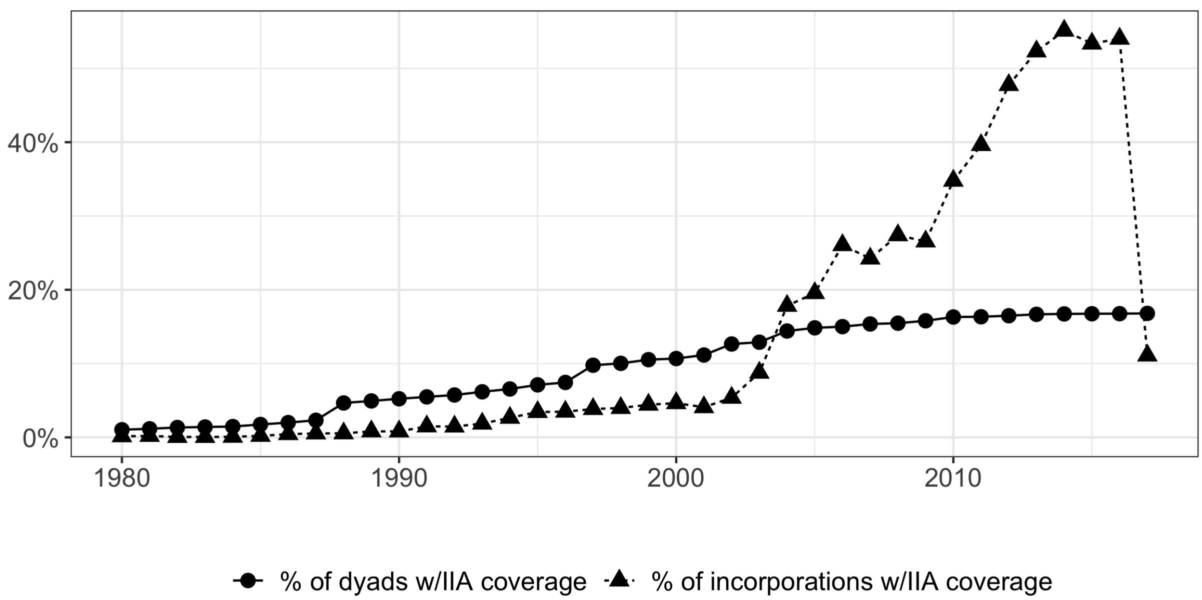
| Year | Jurisdiction | Owner Nat |
|---|---|---|
| 2007 | Panama | Turkey |
| 2007 | Panama | Russia |
| 2007 | Panama | Russia |

**3. Dyad-Year format (final)**

| Year | Jurisdiction | Home state | # Incorps |
|---|---|---|---|
| 2007 | Panama | Turkey | 1 |
| 2007 | Panama | Russia | 2 |

Next, we aggregate the data up from the entity-owner level to the entity-nationality level. For example, Firm A (as depicted in Figure 1), a Panama-incorporated entity with two Russian owners and one Turkish owner, would be aggregated to one observation for Panama-Russia and one for Panama-Turkey. We take this simplifying step under the assumption that the number of entities incorporated, rather than the number of owners per entity, is a better measure of the strength of the bilateral linkage between home states and offshore jurisdictions. Finally, we aggregate the data again to the dyad-year level by counting the number of entities incorporated in offshore jurisdiction $j$ that are linked to an owner from state $i$ in year $t$. The resulting variable—the number of entities incorporated in jurisdiction $j$, in year $t$, with at least one owner from state $i$—is our primary dependent variable.

Figure 2: **Trends in the percentage of dyads and entities with IIA coverage.**




The resulting sample consists of 196 home states and 44 offshore jurisdictions, resulting in roughly 8,500 dyads observed annually from 1980 to 2017.[6] Figure 2 demonstrates the growth in IIA coverage[7] among these dyads over time, as well as the percentage of all incorporated entities that are covered by an IIA. While virtually no dyads had IIA coverage at the beginning of the sample period, nearly 20% are covered by the end of the period. Further, while a smaller than expected percentage of entities are incorporated in an IIA-covered dyad prior to 2004, in the post-2004 period this relationship reverses and a greater than expected percentage of entities have access to an IIA—for the 2013-2016 period, this figure exceeds 50%.

Our goal is to estimate the effect of treatment (gaining access to an IIA) on offshore incorporations at the bilateral level. Since the treatment is applied to different dyads in different years, the standard two-way fixed effects regression approach is unlikely to produce unbiased estimates (Goodman-Bacon, 2019). For this reason, we instead use Imai, Kim and Wang (2020)'s PanelMatch estimator, which extends the difference-in-differences framework to cases in which different units are treated at different times.

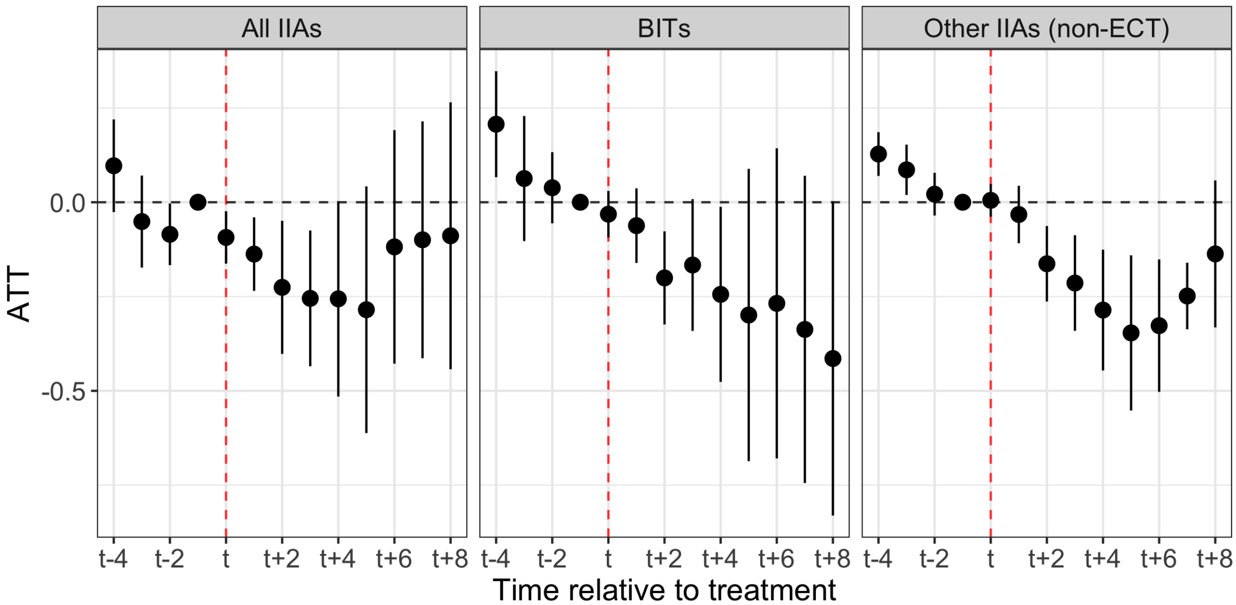
The PanelMatch estimator requires two pre-processing steps prior to estimation: first, each treated observation *it* is matched with a set of other observations $M_{it}$ that had the same treatment status as *it* for the previous $L$ time periods but were *not* treated at time $t$.[8] Next,

[6] A full list of jurisdictions can be found in Appendix Table A.1. Note that, as most of the offshore jurisdictions also serve as home states, some dyads are directed (e.g., B.V.I. → Netherlands and Netherlands → B.V.I are treated as two separate dyads).

[7] A dyad is considered to be covered by an IIA if both home state and offshore jurisdiction are party to an international agreement that offers access to ISDS.

[8] $L$ is a researcher-determined parameter.

Figure 3: **On average, new IIAs *reduce* offshore incorporations between signatories.**

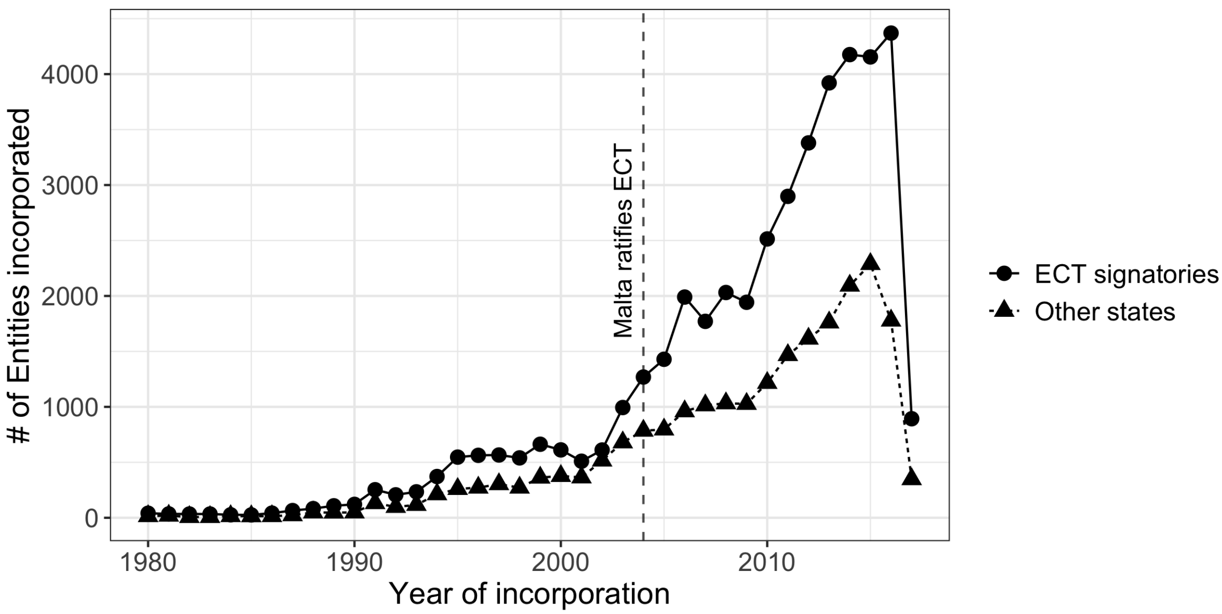



to ensure that the observations in the matched sets can serve as a plausible counterfactual for the corresponding treated observations, the matched sets are pruned (or "refined") to remove or downweight observations that have covariate or outcome histories that are too different from those of the treated observations. Once the matched sets have been refined, the following estimator is applied to recover the average treatment effect on the treated (ATT):

$$\hat{\delta}(F, L) = \underbrace{\frac{1}{\sum_{i=1}^{N} \sum_{t=L+1}^{T-F} D_{it}} \sum_{i=1}^{N} \sum_{t=L+1}^{T-F} D_{it}}_{\text{Average over all treated observations}} \underbrace{\left\{ (Y_{i,t+F} - Y_{i,t-1}) - \sum_{i' \in M_{it}} w_{it}^{i'} (Y_{i',t+F} - Y_{i',t-1}) \right\}}_{\text{Treated observation-specific diff-in-diff estimate}}$$

Each matched set serves as counterfactual group for the corresponding treated observation, allowing for the calculation of treated observation-specific difference-in-difference estimates. The IKW estimate is simply the average of these treated observation-specific estimates. We set $L = 4$ and report estimates for each value of $F$ between $-4$ and 8. We also use propensity score weighting to refine our matched sets, allowing us to select counterfactual units that are similar on several relevant covariates. Specifically, we adjust for the regime type and political risk level of the home state; the corporate income tax rate (logged), GDP per capita (logged), and legal system of the offshore jurisdiction; and the presence of a bilateral tax treaty between the home state and the offshore jurisdiction.

Figure 4: **After Malta ratified the ECT, it became a more popular offshore jurisdiction for ECT signatories.** This graph plots the number of new incorporations in Malta, over time, by ECT signatory status of the owners' home states.




#### 3.1.3 ICIJ Leaks: Results

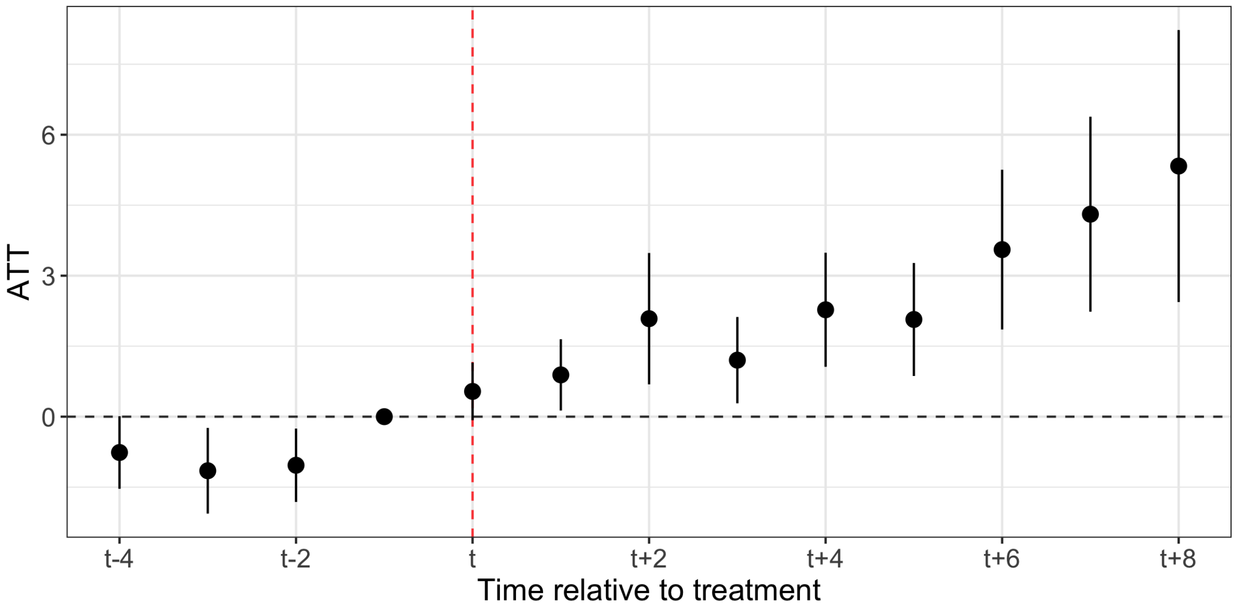
Figure 3 presents the results for three different treatment definitions: first, all IIAs (BITs, the ECT, and other IIAs); second, BITs only; third, IIAs other than BITs or the ECT. Across all three definitions, new IIAs appear to have a *negative* short-term effect on offshore incorporations between signatories. The average number of incorporations per dyad-year in the sample is 0.85, meaning that the effect size of approximately $-0.25$ is modest but non-negligible—particularly given that it persists for several years.

Next, we turn to estimating the effect of the ECT on offshore incorporations. The ECT accounts for the majority of the IIA coverage in the sample beginning in 2004; this is primarily because Malta, an offshore jurisdiction that had its secret corporate registry leaked to the ICIJ in 2017, joined the ECT in that year.[9] As Figure 4 demonstrates, Malta became an increasingly popular offshore jurisdiction among owners from other ECT signatory states after ratifying the agreement, while the difference between signatories and non-signatories had previously been negligible. The raw trends suggest that, unlike BITs or other non-BIT IIAs (such as PTAs with investment chapters), oligarchs may be strategically structuring their assets to gain access to the ECT.

Figure 5 presents the PanelMatch estimates for the ECT. In contrast to the results presented in Figure 3, states who join the ECT are significantly more likely to host offshore

[9]Malta also joined the EU in 2004; to avoid potential confounding, we adjust for joint EU membership when estimating the effect of the ECT.

Figure 5: **The Energy Charter Treaty *increased* offshore incorporations between signatories.**



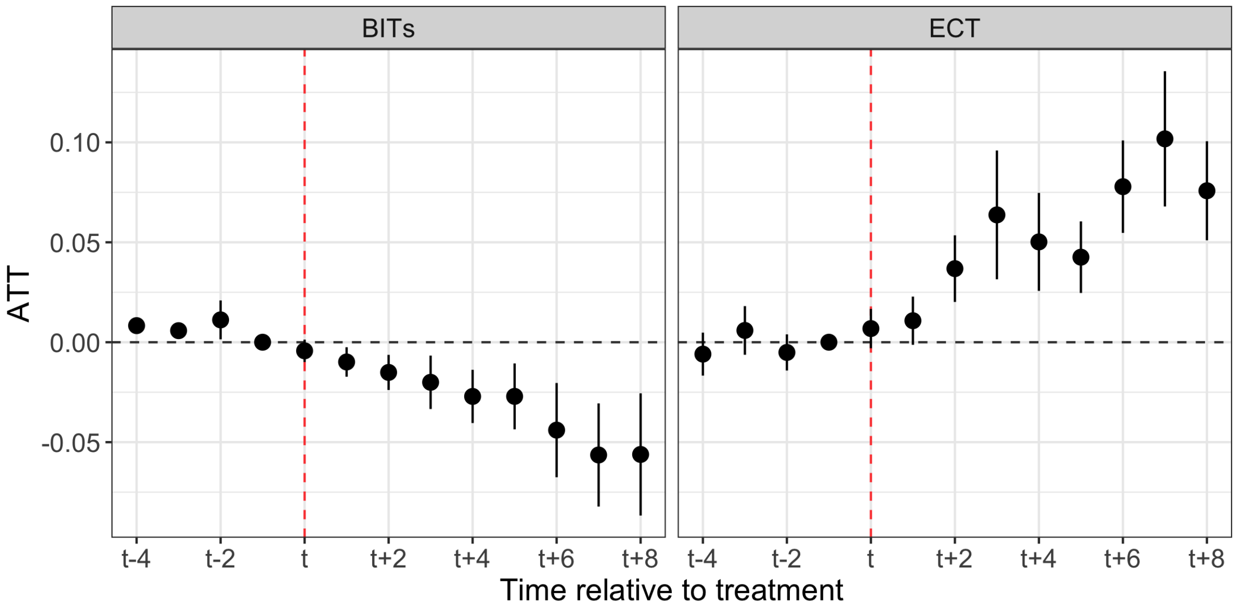

entities created by owners from other ECT signatory states. The effect is not only consistent but appears to grow larger in magnitude over time, reaching over one-third of a standard deviation at eight years after treatment. These results strongly suggest that oligarchs value ECT access when choosing where to incorporate their offshore vehicles. Even after controlling for tax factors, as well as other potential confounders such as EU membership, owners from ECT member states increase their offshore holdings in jurisdictions that join the ECT.

Using formerly secret data on oligarchs' offshore shell companies, we document a weak and transitory negative effect of IIA coverage on new incorporations. However, this pooled effect masks substantial heterogeneity: while BITs and other non-ECT IIAs have negative effects, the ECT has large and sustained positive effects. Next, we apply the same empirical approach to a smaller but more detailed sample of public (e.g., non-secret) offshore corporate structures.

## 3.2 Evidence from Round-Tripped Investments

The offshore leaks data provide a large sample with high external validity, and the fact that they were made public by a whistleblower reduces the likelihood of bias from sample selection. However, while the leaks data allow us to link offshore entities to their owners, they do not inform us about the holdings of the entities themselves. This is important, because an oligarch who simply holds assets in an IIA partner state does not gain the ability to file an ISDS case against his own home state; rather, the invest*ment* must be located in the home state, and the invest*or* must be located in the IIA partner state. To achieve this, oligarchs engage in round-tripping: creating an offshore entity in an IIA partner state,

Figure 6: **New BITs decrease round-tripping between partner states, while new ECT signatories increase round-tripping with other signatories.**




and giving that entity ownership of some of the oligarch's assets in the home state (Kerner, 2014). While it is highly likely that many (if not most) of the offshore entities in the leaks data were created for this purpose, we cannot directly observe their holdings.

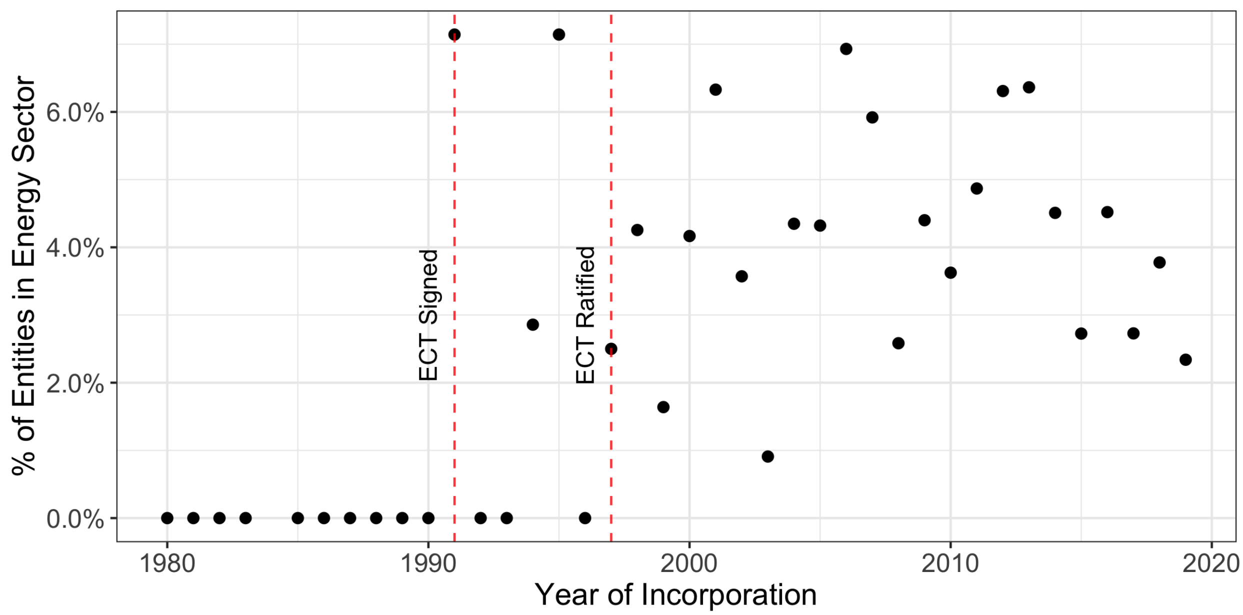
To complement the offshore leaks data and overcome this shortcoming, we therefore test for strategic corporate structuring in an additional sample of verified round-trip investments. To construct this sample, we draw on Bureau van Dijk (BvD)'s Amadeus dataset, which contains financial and ownership information about millions of European public and private firms. The Amadeus dataset, compiled from public sources such as corporate registries, tax filings, and investor reports, is useful in that it also contains information about the firms' intermediate and ultimate owners.[10] We identify round-tripped investments by filtering this data to include all subsidiaries (assets) with the same nationality as their ultimate owner (the oligarch) but with a different nationality from their intermediate owner (the offshore shell company). This exercise produces a sample of roughly 10,300 round-tripped investments made between the years of 1980-2019. To our knowledge, we are the first to use the Amadeus data to identify and study round-tripped investments in a rigorous way.

We take the same steps to aggregate the data as we did with the offshore leaks sample, creating a dyad-year structure. We also apply the PanelMatch estimator with the same parameter values, and adjust for the same covariates.[11] Figure 6 plots the results for BITs

[10] Note that, while all subsidiaries are European firms, the intermediate and ultimate owners have a wide range of national origins (U.S., U.K., China, Japan, etc).

[11] The only exception is that, since we know the full ownership chain for these investments, we can control for effective withholding tax rates as well (see Arel-Bundock (2017)).

Figure 7: **Round-tripping of firms in the energy sector increased after the ECT was signed and ratified.**




(left panel) and the ECT (right panel). The results are highly similar to those in Figures 3 and 5: oligarchs are *less* likely to round-trip their assets through their home state's new BIT partners, and *more* likely to route their assets through states that join the ECT (if their own home state is also an ECT signatory). While the nominal effect sizes are much smaller than those in the offshore leaks sample, this is primarily due to the fact that the Amadeus sample contains far more dyads and far fewer incorporations; the standardized effect sizes are highly comparable, though slightly smaller for the ECT.

Unlike the offshore leaks data, the Amadeus data contains industry codes for the round-tripped investments, allowing us to see what types of assets oligarchs are holding using offshore structures. This allows us to perform a descriptive robustness test for the ECT results: since the ECT only applies to investments in energy-related sectors,[12] we should see an uptick in round-tripping in these sectors following the creation and ratification of the ECT. Figure 7 shows that this is the case: zero energy-related assets appear in the Amadeus data prior to the ECT's signing in 1991, but regularly make up approximately 3-7% of the sample in the years following the treaty's ratification in 1997.

## 3.3 Discussion

We find that plutocrats generally avoid structuring their wealth to gain access to investment agreements that would allow them to sue their sovereign in neutral international venues. The results are consistent with our second hypothesis. While much of the offshore world is hidden, roundtripped investments are regularly revealed to a plutocrat's home state.

[12]For a more detailed explanation of the ECT's sectoral coverage, see Appendix Section A.2.

Seeking protection could invite future state predation as it suggests an individual is considering a political challenge and thereby be searching for the insurance provided by ISDS.

However, the average effect does mask important heterogeneity. While oligarchs forego tax havens who sign BITs with their home state, they appear to regularly seek out jurisdictions that would give them access to the Energy Charter Treaty and its associated property rights. The finding provides conditional support for H1: plutocrats do structure their offshore investments to gain access to investment agreements, but the type of investment agreement matters. Why favor the ECT over other conventional, bilateral treaties within the regime? We identify and discuss three potential mechanisms.

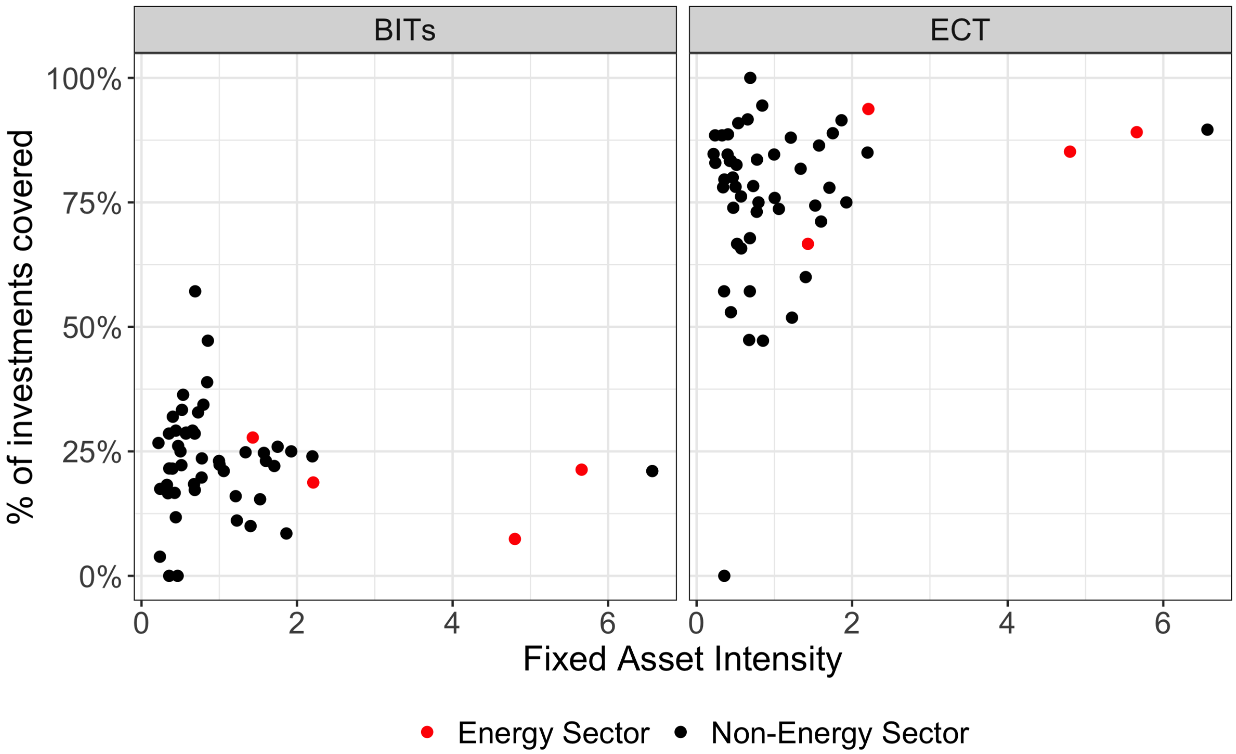
First, the positive result might be a function of the nature of the assets covered by the ECT. As the name implies, the Energy Charter Treaty only extends to energy related investments. A large body of scholarship in political economy and management argues that highly fixed assets tend to be the ones most at risk of expropriation (Kerner and Lawrence, 2014). Energy investments rank in the highest echelon of risk as per these theories and thereby make the projects most in need of international institutional coverage. The positive effect of the ECT on offshore incorporations could then be driven by the nature of assets under a plutocrat's control rather than by any particular feature of the ECT itself.

To assess the plausibility of this mechanism, we make use of the more fine-grained information included in the Amadeus dataset. While we do not have data on the fixed asset intensity of individual investments, we can measure industry-level fixed asset intensity (defined as fixed asset stock as a proportion of annual output) using publicly available data from the U.S. Bureau of Economic Analysis. We plot, in Figure 8, industry-level fixed asset intensity against the proportion of round-tripped investments that give the oligarch access to a BIT (left panel) or the ECT (right panel). We find no correlation between fixed asset intensity and treaty coverage for either BITs or the ECT, though we do find that energy-related sectors have some of the highest levels of ECT (but not BIT) coverage. In sum, it is unlikely that oligarchs' preference for the ECT over other investment agreements is driven by the high fixed asset intensity of energy-related sectors.

Second, plutocrats may simply be more aware of the ECT and its value compared to other investment agreements. The treaty might be much better known amongst the plutocratic class because some of highest profile extraterritorial arbitrations have occurred through the ECT. Roughly 30% of EAs have been filed via the treaty, including the most notorious one - the Yukos Affair which opens our paper. While there is likely some truth to the logic, it does not make sense for the case to only raise the salience of the ECT and not correspondingly increase the salience of other investment agreements.

If it were a matter of salience, once plutocrats learn of the ECT's potential value, they would instruct their lawyers to begin setting up shell companies in ECT signatories and route their investments through their new vehicles. Their highly remunerated lawyer's will recognize what their client is trying to do and be able to direct them to the full menu of investment agreement options. In other words, increased salience of the ECT should lead to

Figure 8: **Fixed asset intensity is not correlated with strategic offshore structuring at the industry level**.




more roundtripping for protection across all the legal options, as salience of all IIAs would increase, which is inconsistent with our results.

Only the ECT pushes oligarchs to increasingly route their investments through a given tax haven. The ECT is unique compared to BITs or PTAs with investment chapters. Gaining access to a BIT with your home government will only give access to ISDS against your home government while a PTA might give you the ability to sue a handful of governments at best. But the ECT has been signed by roughly 50 different governments including the European Union. Gaining coverage not only allows you to sue your own government but also dozens of others.

The multilateral nature of the ECT and thereby its possibility for obfuscating an oligarch's motives is the third and most logical mechanism. When a plutocrats roundtrips via a jurisdiction with only BIT coverage, her intention becomes relatively clear - the movement of the money is a result of seeking protections against her sovereign. But plutocrats do have multiple financial interests. Many have investments in dozens of jurisdictions some of which will be for business purposes related to their core commercial interests and others could be more financial investments for their own personal accounts. By placing ownership of assets in an ECT related jurisdiction a plutocrat could in theory be seeking to safeguard herself against the some of the other 49+ actors that are party to the treaty where they may (intend to) have investments. That process would still provide them protections against their home government but their intentions would be clouded by the broader layers of their commercial interests. While we cannot directly assess the mechanism, its logic is consistent with our findings of only ECT sign-ups leading to increased incorporation while BITs or PTAs have negative signaling impacts. The fact that we see the searching out of the ECT in both the leaked data *as well as* the clear roundtripped investments indicates that it is not just parties searching for protection against foreign governments. Moreover, a third of extraterritorial arbitrations, despite only applying to energy investments, have been a result of the ECT.

# 4 Conclusions

Plutocrats can and have taken advantage of tax havens to exploit the international investment regime. Setting up shell or holding companies offshore and then routing the money back home de jure turns a domestic plutocrat into a foreign investor. When those tax havens have an investment treaty with an individual's home country, they can then sue their own governments using provisions intended for foreign corporations. But the prospects of initiating an ISDS against one's home state can come with political costs. While we think of the offshore world as fundamentally opaque, roundtripping an investment can reveal how plutocrats have structured their wealth to their home government. Seeking out such protections may signal to the state that an individual is planning to mount a political challenge - why else might they need to acquire a political insurance mechanism? That would heighten the threat from the state. Acquiring protections could then invite the the predation that offshoring seeks to deter.

Analyzing close to 300,000 company incorporations in tax havens, we find that plutocrats factor in the potential signaling ramifications of seeking ISDS protection against their home state. Once a haven signs an investment treaty with a plutocrat's country of origin, incorporations in the haven decline. The findings is consistent across analyzing leaked offshore shell company data and public data on roundtripped entities that includes information on the entire wealth chain. We hope the finding pushes scholars to consider how investing in non-market strategies and political capital - essential aspects of business in weakly institutionalized environments - can actually create their own liabilities.

One exception is with the Energy Charter Treaty, which appears to be an avenue that plutocrats use to proactively seek out the option to sue their own sovereigns. We expect the multilateral nature of the treaty provides cover for plutocrats and mitigates the political signaling impact of offshore incorporation. Since the treaty would allow a plutocrat to sue multiple states, not just their home state, they have plausible deniability around any domestic political ambitions. With increasing regime complexity, several arenas of the global economy are now characterized by such a mix of bilateral and multilateral treaties. Our findings suggest the need for scholars to continue analyze the politics of international forum shopping, but with a focus on the distributional consequences of engaging with different types international institutions that operate within the same regime.

In this vein, we hope that the manuscript pushes other scholars to continue developing and testing theories that factor the international institutional environment into models of domestic elite conflict (Farrell and Newman, 2014). A number of theories of political development expect plutocrats to be the driving force behind political development, be it liberalization or democratization (North and Weingast, 1989; North et al., 2013; Albertus and Menaldo, 2014). The general logic is that the development of the rule of law and competitive elections will bind the state from expropriating the wealth of the plutocracy. But we illustrate the conditions under which way globalization allows elites to arbitrage the institutions that they traditionally pressured the state to provide. This should plausibly reduce their incentives to fight for reform in their home jurisdictions. We are not the first to indicate a potentially deleterious effect between capital mobility and political development (Pistor, 2019; Sharafutdinova and Dawisha, 2017). But prior work has not incorporated the role of global (investment) institutions in this process. That is critical when plutocrats can access property protections as a spillover of ”normal” business practices like minimizing their taxes or seeking safeguard for their foreign investments as our findings suggest.

Finally, the analysis points toward a need to better under the globalization of the individual (Cooley and Sharman, 2017). One of the starting points of our theory is that individual plutocrats in emerging markets are able to build nationality portfolios in a fashion that mimics MNCs. Their ability to build such portfolios are supported by a host of ”enablers” - lawyers, accountants, wealth managers, estate agents - whose economic and political incentives merit further research (Harrington et al., 2017). But incorporation is only one path in nationality diversification and thereby legal arbitrage; plutocrats can buy “golden visas” and passports in the burgeoning mobility market. The plutocratic toolkit continues to expand even as we see the growth of populist movements. In short, the findings call for more academic work on when and why economic interdependence empowers the superwealthy by fostering institutional inequalities.

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# Appendix

## A Additional Descriptives

### A.1 Offshore jurisdictions represented in the offshore leaks data

Table A.1: **Offshore jurisdictions represented in the offshore leaks data.**

| | |
|---|---|
| Anguilla | Luxembourg |
| Antigua & Barbuda | Malaysia |
| Aruba | Malta |
| Bahamas | Marshall Islands |
| Barbados | Mauritius |
| Belize | Monaco |
| Bermuda | Netherlands |
| British Virgin Islands | Netherlands Antilles |
| Brunei | New Zealand |
| Cayman Islands | Niue |
| Cook Islands | Panama |
| Costa Rica | Ras Al Khaimah |
| Cyprus | Samoa |
| Grenada | Seychelles |
| Guernsey | Singapore |
| Hong Kong SAR China | St. Kitts & Nevis |
| Ireland | St. Lucia |
| Isle of Man | Turks & Caicos Islands |
| Jersey | United Arab Emirates |
| Labuan | United Kingdom |
| Liberia | United States |
| Liechtenstein | Vanuatu |

## A.2 More detail on the ECT's sectoral coverage

Article 1(5)(b) of the Energy Charter Treaty defines the "Energy Sector" as economic activity that falls into the following seven categories:

1. "prospecting and exploration for, and extraction of, e.g., oil, gas, coal and uranium;"
2. "construction and operation of power generation facilities, including those powered by wind and other renewable energy sources;"
3. "land transportation, distribution, storage and supply of Energy Materials and Products, e.g., by way of transmission and distribution grids and pipelines or dedicated rail lines, and construction of facilities for such, including the laying of oil, gas, and coal-slurry pipelines;"
4. "removal and disposal of wastes from energy related facilities such as power stations, including radioactive wastes from nuclear power stations;"
5. "decommissioning of energy related facilities, including oil rigs, oil refineries and power generating plants;"
6. "marketing and sale of, and trade in Energy Materials and Products, e.g., retail sales of gasoline; and"
7. "research, consulting, planning, management and design activities related to the activities mentioned above, including those aimed at Improving Energy Efficiency."

We map these seven categories as closely as possible to the 4-digit NAICS industry codes provided in the Amadeus data, erring on the conservative side when the 4-digit codes are not precise enough to separate energy from non-energy related activities. We consider the following NAICS industries to be in the energy sector:

1. `21**`: Mining, Quarrying, and Oil and Gas Extraction
2. `22**`: Utilities
3. `324*`: Petroleum and Coal Products Manufacturing
4. `4235`: Metal and Mineral (except Petroleum) Merchant Wholesalers
5. `4247`: Petroleum and Petroleum Products Merchant Wholesalers
6. `447*`: Gasoline Stations
7. `486*`: Pipeline Transportation