POLICY MEMO

Countering Chinese Communist Party Threats with Corporate Transparency

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Introduction: Reducing US Vulnerability to CCP Corruption

The United States is now engaged in long-overdue efforts to counter economic threats from China fueled by Chinese Communist Party (CCP) misrule. But as policymakers reach for tariffs, sanctions, and other weapons of economic statecraft, some of America’s basic financial defenses continue to be overlooked. The most urgent problem is that the US government still has no idea who really controls shell companies being used to move billions of dollars through and within its borders.

The CCP, like other adversarial regimes, routinely hides behind shell companies to exploit the global financial system in pursuit of geopolitical objectives. But it also presides over the world’s second-largest economy. Much of the cronyism, crime, and corruption that afflicts China is the result of prolonged communist misgovernment — and is facilitated by opaque corporate networks that now reach far beyond its borders.

Ending anonymous ownership of shell companies is a critical first step to protect the US financial system from the criminal by-product of CCP misrule in China. It will also set a global standard that can be enforced as a new tool of coercive economic statecraft, renewing American leadership in the fight against illicit finance and undermining the CCP’s global assault on the rule of law.

Anonymous Shell Companies: America’s Achilles Heel

No other country prosecutes foreign crime and corruption with the same aggressiveness, resources, and global reach as the United States. But the strength of the US economy and the US dollar’s ubiquity as the global reserve currency also make the United States highly attractive for money launderers looking to convert rubles, riyals, or renminbi. One vulnerability in particular makes it irresistible: the ability to create and control shell companies with complete anonymity.

A recent study found that all fifty US states require more personal information from someone trying to obtain a library card than they do from anyone setting up a company.¹ Researchers posing as terrorists and kleptocrats for another academic project found that the United States was the easiest place in the world to set up shell companies. The professional services providers they used simply had no reason to ask basic questions about their clients’ identity.² It is therefore unsurprising that, according to the World Bank, US shell companies have been used more often than those of any other country in major transnational corruption cases.³ Indeed the failure to collect corporate beneficial ownership information is the primary reason experts now rank the United States as the world’s second-worst financial secrecy haven, between Switzerland and the Cayman Islands.⁴

Anonymous shell companies continue to provide a backdoor into the US financial system and broader economy. As the administration and Congress work to counteract serious...
threats arising from CCP misrule, these companies are a vulnerability the United States can no longer afford.

China’s IP Theft and Shell Companies
Trade secret theft, software piracy, and counterfeit goods are estimated to cost the United States between $225 billion and $600 billion annually. China is “the world’s principal IP infringer,” according to the US IP Theft Commission, “deeply committed to industrial policies that include maximizing the acquisition of foreign technology and information.” Beyond commercial losses, CCP misappropriation of technology with security applications poses an obvious threat to national security.

The IP Theft Commission further notes that Chinese entities rely on shell companies both to obscure their involvement in IP theft and to shield themselves from potential US sanctions. As the China Economic and Security Review Commission has warned, even a strengthened Committee on Foreign Investment in the United States will be unable to detect and properly scrutinize Chinese investments in US technology firms if their ownership is masked by shell companies. Chinese entities have also acquired valuable American IP and technology by using shell companies to conceal their participation in US bankruptcy proceedings.

A Government Accountability Office (GAO) study of 1,406 high-security US federal leases could not identify the owners in about one-third of cases because many of them were shell companies. In cases where the GAO did identify the owners, nine out of fourteen government agencies working on sensitive national security issues were unaware that the buildings in which they were housed were ultimately owned by companies in China and elsewhere.

A recent NBC investigation found that thousands of Chinese nationals have used US-registered shell companies as phony employers to remain in the United States illegally after their student visas expire. Many go on to work for US firms dealing with sensitive information, and at least one is now being prosecuted for espionage.

Nearly 90 percent of counterfeit products entering the United States originate in China. This poses a unique challenge for defense procurement, where substandard equipment jeopardizes the safety of military personnel and compromised technology provides a window for espionage.

Another recent GAO study found that shell companies are routinely used to facilitate fraud and circumvent restrictions barring foreign contractors, including one whose faulty parts caused the grounding of forty-seven US combat aircraft. GAO also noted that “contractors fraudulently misrepresenting themselves to [the Department of Defense] could actually be operated by... adversarial foreign governments [to conduct] sabotage or surveillance.”

Shell company secrecy also incentivizes American importers of counterfeit goods. A New York company currently faces charges of illegally importing Chinese surveillance technology and selling it to US government agencies before laundering the proceeds through shell companies.

Sanctions Evasion through Shell Companies
For obvious reasons, the ability to hide financial transactions behind shell companies severely undermines the effectiveness and integrity of US sanctions programs.

China’s state-controlled corporations routinely employ shell companies to circumvent US sanctions and distance

CHINESE ENTITIES RELY ON SHELL COMPANIES TO OBSCURE IP THEFT AND SHIELD THEMSELVES FROM US SANCTIONS.
themselves from malign behavior. Huawei is accused of deceiving US banks by using a shell company registered in Mauritius to disguise business activities in Iran. The US government likewise targeted ZTE for using shell companies to buy and sell goods that Washington has banned for export to Iran and other countries.

An integral part of the illicit financial networks on which North Korea depends are shell companies registered not only in Chinese financial centers but around the world. As US Treasury officials routinely complain to Beijing, Pyongyang uses them to help procure everything from nuclear weapons components to luxury cars for Kim Jong-Un.

A US court recently held three of China’s biggest banks in contempt for failing to supply documents relating to allegations that they laundered $100 million through a Hong Kong shell company for a sanctioned North Korean bank.

While the majority of shell companies used to evade sanctions are registered overseas, a quick search of Office of Foreign Assets Control designations shows that, as of December 2019, around sixty such entities are located within the United States.

The Belt and Road Initiative’s Use of Shell Companies
China’s Belt and Road Initiative (BRI) has supercharged kleptocracy throughout the developing world, with bribes and unprecedented opportunities for embezzlement offered to local elites in exchange for infrastructure contracts and other investments. China’s “debt diplomacy” inevitably comes at the expense of US influence, as political leaders who are both publicly and personally beholden to the CCP can never be reliable security partners for the United States.

Local politicians rely on shell companies to funnel bribes or stolen funds, while Chinese contractors can hide behind them to avoid accountability when they fail to deliver on overambitious projects. From Ecuador’s crumbling Coca Codo Sinclair dam to Kenya’s unaffordable new railway and Sri Lanka’s infamous Hambantota port, the ability to conceal corruption underpins BRI expansion worldwide.

Malaysia’s 1MDB heist offers a particularly egregious example. According to reports CCP officials, in return for infrastructure deals, promised to bankroll the siphoning of $4.5 billion from the country’s development fund into shell companies and opaque investments, tried to dissuade US law enforcement from investigating, and then spied on the American and British reporters exposing the scheme.

Communist Corruption and Shell Company Concealment
After decades of Communist Party misrule, China is not only the world’s second-largest economy but a “predatory, pervasive, and entrenched” kleptocracy. Illicit financial outflows are conservatively estimated to have exceeded $1 trillion between 2002 and 2011 alone. Opaque corporate networks sit at the heart of the corrupt system that sustains and empowers the CCP’s ruling elite.

It is illegal for Chinese citizens to personally transfer more than $50,000 per year out of China. How, then, can senior CCP

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officials on modest salaries — including Xi Jinping, who earns approximately $20,000 annually — transfer the funds to finance the education and lavish lifestyles of relatives in the West?\textsuperscript{26}

In 2016, the Panama Papers leaks exposed how China’s most prominent political families — including relatives of Xi Jinping and other senior Politburo members — use shell companies to conceal their vast international holdings. China was the offshore law firm Mossack Fonseca’s predominant source of business, with clients linked to around 40,000 shell and other companies.\textsuperscript{27}

China’s state media complained in 2014 that the United States had become the top destination for corrupt CCP officials, with more than 150 hiding their wealth here.\textsuperscript{28}

Fueling the Fentanyl Crisis
Anonymous shell companies play a critical role in facilitating both the Chinese production and US distribution of opioids that killed more than 47,000 Americans in 2017 — a figure that has increased almost six-fold since 1999.\textsuperscript{29} According to the \textit{National Money Laundering Risk Assessment} of 2018, fentanyl is “generally produced in China, can be purchased online, and shipped directly to individual buyers in the United States or shipped to criminal organizations in Mexico, Canada, and the Caribbean for distribution in the United States … Law enforcement notes the increasing prevalence of Chinese money laundering networks working with Mexican drug traffickers.”\textsuperscript{30}

Anonymous shell companies facilitate every stage of fentanyl production and distribution. Chinese producers tend to conceal their operations using opaque corporate structures registered in Hong Kong and other Chinese financial centers.\textsuperscript{31} US-registered shell companies, meanwhile, are used not only to launder profits but to conceal connections with Latin American cartels and hide ownership of freight forwarding firms, P.O. boxes, and other properties used as fronts to receive fentanyl shipments directly from China.\textsuperscript{32}

Human Trafficking and Forced Labor via Shell Companies
The CCP has one of the world’s worst records on using forced labor and failing to prevent human trafficking. Shell companies provide a corporate veil behind which criminals can prey on the world’s most vulnerable people with impunity.

A report on 9,000 illicit massage businesses across the United States found that the majority of victims were women from China and South Korea.\textsuperscript{33} While 3,000 of these businesses had no corporate records at all, only 28 percent of the remaining 6,000 listed a real person as their owner — the rest were untraceable shell companies.

Within China itself, Uyghurs detained in Xinjiang Province are routinely forced to produce textiles and other goods.\textsuperscript{34} Shell companies are one of the “unique difficulties” in Chinese supply chains that help make the origins of such products untraceable for US importers.\textsuperscript{35}

**Empowering US Law Enforcement**

Anonymously owned shell companies fuel CCP misrule and facilitate a broad range of threats to US security, prosperity, and values. But the pushback begins with a surprisingly modest administrative measure. Many US allies and partners, including
all European Union member states, are establishing corporate beneficial ownership registries that require anyone setting up a company to disclose its true owner(s). Contrast this situation with the United States, where the only requirement is to disclose legal owners who may be no more than a disinterested lawyer, incorporation agent, or even just another shell company.

The immediate benefit of introducing a US corporate beneficial ownership register would be to provide law enforcement officials with a powerful new investigative tool. The United Kingdom is now producing valuable evidence on how this works in practice, having created its own register in 2016. Not only did initial fears over potential compliance burdens on small businesses prove unfounded, but all British law enforcement agencies have made use of the register and most now access it at least weekly in the course of ongoing investigations.

A New Tool of US Economic Statecraft

Of course, a US corporate beneficial ownership register would do nothing to address the non-US shell companies used in many of the examples above, but the adoption of such a measure by the world’s most powerful country would set an important new global standard to be enforced against corrupt authoritarian regimes and other problematic jurisdictions.

At meetings of the Financial Action Task Force and other international fora, the failure of the United States to tackle shell company abuse leaves it open to accusations of hypocrisy in the fight against transnational crime. It is a source of increasing tension between US officials and their European counterparts — an unnecessary technocratic difference compared to sanctions and other substantive policy disagreements.

Introducing a beneficial ownership register would turn this situation on its head, empowering US officials to assume leadership of a nascent coalition of democracies already promoting measures to improve basic corporate transparency. The Treasury Department would be able to pile further pressure on less scrupulous jurisdictions that negligently (or purposefully) maintain weak anti-money laundering regimes and lax enforcement. By forcefully shining a light into these darker corners of the global economy, Washington can gradually eradicate corporate conduits for malign conduct and dirty money worldwide.

The United States already maintains a powerful economic arsenal to do so, including not only sanctions but actions under Section 311 of the USA PATRIOT Act, which can effectively cut troublesome foreign financial institutions off from the US dollar. Wielded properly, corporate transparency will not only strengthen the potency of existing measures but can become a tool of economic statecraft in its own right.

This is not a far-fetched proposal. Indeed, US officials stand ready to promote corporate transparency as aggressively as they have promulgated sanctions and other measures targeting the illicit financial networks empowering America’s adversaries. But they need a congressional mandate to do so.

Current Legislative Proposals to End Shell Company Abuse

There is now growing bipartisan support for action to tackle shell company abuse. In October 2019, the US House of
Representatives passed the Corporate Transparency Act, mandating the creation of a beneficial ownership register administered by the Financial Crimes Enforcement Network at the Treasury Department.\(^\text{37}\)

For the first time, establishing a beneficial ownership register is also a US government priority. According to a Statement of Administration Policy issued by the White House, it would “help prevent malign actors from leveraging anonymity to exploit these entities for criminal gain … [representing] important progress in strengthening national security, supporting law enforcement, and clarifying regulatory requirements.”\(^\text{38}\)

In the Senate, the Corporate Transparency Act\(^\text{39}\) and True Incorporation Transparency for Law Enforcement (TITLE) Act\(^\text{40}\) would also create corporate beneficial ownership registries. There is significant bipartisan momentum behind a third bill, the Improving Laundering Laws and Increasing Comprehensive Information Tracking of Criminal Activity in Shell Holdings (ILLICIT CASH) Act.\(^\text{41}\) This would not only create a beneficial ownership register but introduce important updates to the broader US anti-money laundering regime; require a new government strategy to stop authoritarian regimes abusing the US financial system; and commission an official report on the scale and nature of Chinese money laundering activities within the United States.

## Conclusion

Terrorists, kleptocrats, drug cartels, and other transnational criminals have used shell companies to facilitate dangerous activity for decades. But CCP control of the world’s second-largest economy presents an unprecedented threat to the integrity of the US financial system.

A beneficial ownership register would be a modest first step to empower law enforcement and strengthen the outdated US anti-money laundering system. American leadership to promote corporate transparency could set a new global standard that severely restricts conduits for CCP crime and corruption — while expanding the US economic arsenal for the emerging struggle between democratic capitalism and authoritarian kleptocracy.

CORPORATE TRANSPARENCY WILL NOT ONLY STRENGTHEN THE POTENCY OF EXISTING MEASURES, IT CAN BECOME A TOOL OF ECONOMIC STATECRAFT IN ITS OWN RIGHT.

AMERICAN LEADERSHIP TO PROMOTE CORPORATE TRANSPARENCY COULD SET A NEW GLOBAL STANDARD THAT SEVERELY Restricts CONDUITS FOR CCP CRIME AND CORRUPTION.
Endnotes


6 Ibid.


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