

Offshoring at Home? Domestic Use of Shell Companies for Corruption

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The recent “Panama Papers” leak has revealed that public figures in several countries use offshore shell companies in order to hide their real wealth behind murky foreign ownership structures. Less well known is the fact that corrupt policy makers also use shell companies in their own home countries that function as intermediaries to divert public resources for private benefit. Based on a qualitative empirical analysis, this paper describes how corporate vehicles are used by corrupt government officials in contemporary Hungary. One can distinguish “live” shell and “empty” shell companies. Live shells are used by governing elites to build clientele networks or to provide monopolistic market positions for oligarchs. Empty shells are technical vehicles used by local government actors to create valuable assets that can be sold for extra profit. Onshore shell entities are shown to be essential organizational structures supporting governmental corruption.

Keywords: brokerage, central and eastern Europe, corrupt public policy, Panama Papers, shell company

Using corporate entities for illicit purposes is a widespread and growing phenomenon (Konieczny, 2012; OECD, 2001, pp. 11.). One dominant form involves anonymous shell companies, legal entities that cannot be traced back to their real owners (Findley, Nielson, & Sharman, 2014, pp. 3.). The Panama Papers shocked the world when the leak of more than 10 million tax documents revealed how politicians and government elites, including several world leaders, used shell companies registered in Panama to hide assets acquired by shady means or to avoid taxes (ICIJ, 2016). However, shell companies have another, hardly mentioned aspect: they are also used by public actors at home for domestic corruption.

Although shell companies may be lawful, and can be used for mergers or complicated business transactions (“The Incorporation Business,” 2012), the lack of accurate information about their ownership structures allows their real owners to misuse them for tax evasion, money laundering, mortgage and bankruptcy fraud, terrorist financing, and even for the movement of prohibited nuclear technology (Aydogdu, Shekhar, & Torbey, 2007; He, 2010; Liddick, 2000; Ruehsen & Spector, 2015; Sharman, 2010). As this article will show, shell companies can also be used for carrying out domestic corrupt transactions. Yet the academic literature on corrupt shell companies is practically nonexistent: Matthew C. Stephenson’s (2016) substantial 348-page bibliography on corruption and anti-corruption includes only two items focusing on the shell company issue.

The present article addresses this lacuna and provides an understanding of how domestic corporate vehicles are misused for government corruption in contemporary Hungary. The organizations analyzed in the article were used to mediate transactions between corrupt actors. These exchanges typically have a multiplayer structure, involving three or more corrupt actors, both visible and secret owners, and other outsiders, who cooperate within an organizational context in order to facilitate a corrupt transaction. The most important function that a shell company can offer for its shadow owner is providing anonymity while simultaneously guaranteeing control over the shell company and its resources. This suggests a dual structure of mediation. The main action in the legal realm is implemented by the formal organization, yet the visible but fake owner (or CEO) acts as a broker, following the informal orders of the real but secret owner. This is a type of mediation where a “representative broker” is delegated by another actor, whether a single individual or a group, to represent its interests and deal with the outside world (Gould & Fernandez, 1989; Jancsics, 2015).

Due to their secretive nature, it is almost impossible to quantify the extent to which shell companies are used for illicit purposes. This article instead attempts to study the qualitative aspects of this phenomenon and, based on the analysis of 104 newspaper articles, provides an understanding of the organizational, social, and political contexts of shell companies in contemporary Hungary. The research questions are: What are the main reasons for using domestic shell companies in corrupt transactions? In what economic sectors are these organizations most frequently used? Who are the main actors who interact through a shell company, and what is the relationship between them? How should the social and political context of shell companies be characterized?

This article uses a broad concept of corruption as a deviation from the ethically universalistic form of public-resource allocation as defined in law, rules, and the modern principles of administrative impersonality, impartiality, and equality (Mungiu-Pippidi, 2016). From this perspective, corruption involves the misallocation of public resources for the benefit of particular interest groups or individuals. This concept includes nominally legal forms of corruption, particularly state capture when powerful corrupt actors manipulate government policy or actions and even shape the emerging rules of the game to favor their own interests (Hellman & Kaufmann, 2001; Kaufmann & Vicente, 2011).

METHODOLOGY

It is hard to obtain analyzable data on shell company operation because the participants try to keep their activities secret. The seminal study published by Beth Mintz and Michael Schwartz (1985) on interlocking directorates among large U.S. corporations has proven that newspaper articles and popular reports can be suitable sources for academic analysis. Since then several qualitative and quantitative studies have used newspaper articles as primary units of analysis (e.g., Ammann, Frey, & Verhofen, 2014; Burnett, Johnston, Corlett, & Kearney, 2014; Lim, Snyder, & Strömberg, 2015). The main methodological assumption is that reporters and investigative journalists are skilled at uncovering social relationships hidden behind a visible (but misleading) formal arrangement. The enormous coordinated work of 400 journalists in the case of the Panama Papers has definitely confirmed this. With some caveats, this article argues that newspaper articles provide a useful empirical database for a systematic analysis of anonymous shell organizations.

The present article follows a loosely structured, inductively grounded research design where the main concepts tend to emerge during the course of the study (Miles, Huberman, & Saldana, 2014, p. 19). The raw materials for this analysis are online or printed newspaper articles collected by K-Monitor, a Hungarian watchdog organization (<http://k-monitor.hu/other/about-us>). K-Monitor gathers, stores, and classifies articles concerning corruption, public financing, and the transparency of public life in Hungary. Using text analysis methods, the research considered multiple individual cases published in newspaper articles, combined with accumulated evidence about shell companies from different sources, and sought to find repeated fact patterns.

Hungarians nowadays use the term *stróman* (“straw man”) for the visible individual owner of a shell company and sometimes for the organization itself. The word was adopted from the German *Strohmann*, for an individual acting on the behalf of somebody else. The use of the term *stróman* can be tracked back to the 1930s, when the “Jewish Laws” in Hungary significantly restricted the number of Jews in the liberal professions, public administration, and commercial and industrial businesses. Jewish owners were forced to pass their enterprises to new Catholic owners on paper, but many of them continued to control the company from behind the scenes (Kadar & Vagi, 2004, pp. 63.). Hungarians started to use the word *stróman* to refer to these visible but fake Catholic business owners.

The K-Monitor database includes about 27,000 newspaper articles covering the period between 1997 and 2014, and there is comprehensive coverage between January 2006 and December 2014. K-Monitor had already coded 199 articles that were related to modern *stróman* activities. The author also searched for articles by using the keywords *fantomcég* and *fantom vállalat* (“phantom firm” and “phantom company”), which are also used as terms for shell companies in the Hungarian language. This search resulted in 26 additional articles. Finally, the author collected 225 articles published between 2007 and 2014 containing cases related to shell companies. Analysis revealed that many articles simply republished the content of preexisting articles; these were omitted for later analysis. Editorials and other commentaries that expressed personal opinions were also excluded. Using MAXQDA qualitative data analysis software, the author systematically coded the remaining 104 articles.

Finally, 48 main codes were used, with 20 having additional subcode structures. For example, under the main code “sector,” 16 subcodes for different economic sectors emerged. During the coding process, the author was interested in the main explanations for the use of shell companies, the economic sectors in which the transactions took place, who the main actors were, and the relationship between them.

The data analysis was based on iterative interplay with the data whereby the author constantly checked and revised the emerging codes, categories, and indicators. This involved three main coding phases (Pandit, 1996). However, since large segments of the coding system were restructured several times during the process, these phases somewhat overlapped. In the initial coding phase, the data were broken down by asking simple questions such as what, where, how, who, how many times, and so forth. At the second stage of the analysis, the author started to make connections between the codes to develop categories and higher-level, more abstract elements of the analysis than the original codes. Here similar incidents were grouped together under the same category. Finally, based on co-occurrences between the existing categories, core categories were created with different contexts, mechanisms, actions, and causal conditions related to them. These core categories implied eight indicators, the main elements of the construct measures of corrupt shell company types in Hungary. Table 1 shows some examples of the coding process.

TABLE 1
Examples of the Coding Process

<i>Text segment</i>	<i>Open code</i>	<i>Category</i>	<i>Indicator</i>	<i>Source</i>
Wife of former chief of staff of National Media and Infocommunications Authority wins four tobacco concessions in two towns. Local residents do not know her; she has never before worked in the retail tobacco sector.	Actors	Actors socially close to principal: kin, friends, etc.	Brokers	atlatszo.hu. Az NMHH kabinetfőnökének felesége is trafikokat nyithat. 2013.05.09. (http://atlatszo.blog.hu/2013/05/09/kabinetfonomok_felesege_is_trafikot_nyithat)
Employees of shadow principal established private limited companies months before results of tobacco tender were published. Later these companies became owners of limited partnerships in which partners were tender-winning individuals.	Actors	Trustworthy actors who can manage the shell company for a longer-term: employee, business partner. Often patron-client relation between principal and broker		origo.hu. Ők a trafikbuli legnagyobb nyertesei. 2013. 06. 18. (http://www.origo.hu/itthon/20130617-nagy-ceghalok-fogjak-ossze-a-trafiknyerteseket.html)
Foreign companies are prohibited from buying agricultural land in Hungary. A certain city government used a lawyer as intermediary on its behalf; he bought agricultural land for himself and then the government changed its status to commercial. XY Ltd., with a corporate owner in Luxembourg, was now able to buy the land and its value increased about tenfold. A big international	Actors	Trustworthy actors who can fulfill function of technical owner for a short-term: lawyers, local government, friends		HVG. Titokzatos győri földügylek: befogták az eladók száját. 2012. 10. 31. (http://hvg.hu/itthon/20120831_Fideszes_foldmulyi_Gyorben_orokre_elhallig)

(Continued)

TABLE 1
Continued

<i>Text segment</i>	<i>Open code</i>	<i>Category</i>	<i>Indicator</i>	<i>Source</i>
carmaker will buy the land for an industrial park.				
A mayor and his family will have significant influence on the town's tobacco business: his wife and daughter have won four 20-year retail tobacco concessions.	Activity	Continuous economic activity	Shell Company Activity	HVG. Trafikmútyi: idegenek, képviselők és haverok sora. 2013. 04. 25. (http://hvg.hu/gazdasag/20130425_Trafikmútyi_idegenek_kepviselok_polgarmes)
The number in the company's name indicates that it was established for only one project (e.g., Király 27 Kft., Dembi 26 Kft).	Activity	One-time transaction		Magyar Narancs. Az erzsébetvárosi ingatlanpanama háttere. 2008. 04.12. (http://magyararancs.hu/belpol/az_erszebetvarosi_ingatlanpanama_hattere_-_kiment_a_haz_az_ablakon-70312)
So far 30 tobacco shops have been won by a well-known politician's kin, friends, activists, and acquaintances in Jászszág.	Activity	Allocate small units of resources to relatively large number of principals	Resource Allocation	Népszabadság. 'Micsoda szenzáció' Jászszágban! 2013. 11. 05. (http://nol.hu/belfold/20130511-micsoda_szenzacio-1385815)
In Borsod County, of the allocated 2,800 hectares of land, about 1,600 hectares were obtained by four winners.	Activity	Allocate large units of resources to a few principals		HVG. Kikértük a jegyzőkönyveket a botrányos földügylekről. 2012. 05. 16. (http://hvg.hu/itthon/20120516_angyan_fold_tamogatas)
Documents prove that <i>stróman</i> buyers, soon after the purchase, sold the properties to foreign investors at 600 million forints more than they originally paid.	Activity	Allocate resource to a shell company, then multiply its value		http://www.magyarhirnap.hu/belfold/elkeszult_az_uj_ingatlanertekbecsles.html

Systematic analysis of news streams provides access to deep structural features of manifest content that would be otherwise unnoticeable, yet there are potential drawbacks to this methodology. News may be biased and selective for several reasons (Jauch, Osborn, & Glueck, 1980). Media often interpret and package reality rather than objectively report it (Franzosi, 1987). Moreover, these kinds of media articles are created for purposes other than academic research, and thus they often provide insufficient details about each examined case (Bowen, 2009). News may also contain factual errors and selection bias. For example, the sample of cases analyzed in this study may be biased because of the newspapers' political views or journalists' particular interests. Furthermore, since the size, boundaries and other characteristics of the secret corrupt population are unknown, the subjects of the analysis cannot be selected by random sampling (Atkinson & Flint, 2001; Heckathorn, 1997). Therefore, the results of this qualitative study are probably not generalizable in the traditional quantitative sense. Yet they may form a strong foundation for understanding and explaining social phenomena similar to those investigated here, namely, the use of shell companies in government corruption (Falk & Guenther, 2007; Popay, Rogers, & Williams, 1998). In this case, so-called analytic generalization occurs when the developed concept is useful in explaining similar situations (Yin, 2013).

In order to strengthen the analytic generalizability, the author sought to identify the possible political bias of the examined newspapers. Two Hungarian academics and two media experts were asked to categorize all the newspapers in the sample based on the political tendency of the media source. The responses were surprisingly consistent. A minor discrepancy happened only in three cases (*Élet és Irodalom*, *HVG*, *Magyar Narancs*) when one expert classified them as politically independent, and the others thought they were liberal. Table 2 shows the list of Hungarian newspapers, magazines, and websites and their political tendencies; Table 3 provides the proportions of articles based on the political tendency of the media in which they were published.

TABLE 2
Source of Articles

<i>News medium</i>	<i>Political leaning</i>	<i>Number of articles</i>	<i>%</i>
<i>atlatzo.hu</i>	Independent	2	1.9
<i>Blikk</i>	Independent	8	7.7
<i>Élet és Irodalom</i>	Liberal, Independent	1	1.0
<i>Figyelő</i>	Independent	1	1.0
<i>Hetiválasz</i>	Right	4	3.8
<i>hirszerzo.hu</i>	Independent	7	6.7
<i>HVG</i>	Liberal, Independent	8	7.7
<i>index.hu</i>	Independent	9	8.7
<i>Magyar Hírlap</i>	Right	8	7.7
<i>Magyar Narancs</i>	Liberal, Independent	1	1.0
<i>Magyar Nemzet</i>	Right	11	10.6
<i>MTI</i>	Right	4	3.8
<i>Népszabadság</i>	Left	20	19.2
<i>Népszava</i>	Left	1	1.0
<i>origo.hu</i>	Independent	15	14.4
<i>stop.hu</i>	Left	2	1.9
<i>vallalkozoi.negyed.hu</i>	Independent	2	1.9
Total		104	100

TABLE 3
Political Leaning of Articles

<i>Political leaning</i>	%
Independent	42.3
Liberal, Independent	9.6
Right	26.0
Left	22.1
Total	100

FINDINGS

All the cases selected for this analysis have a common feature—they report corrupt public policy decisions. The way the public resource distribution was planned and organized, and how the recipients were selected, had already been biased by particularistic interests. This suggests a distinct type of illicit activity: corruption on the input side of public policy, in the form of laws and rules (Graycar & Prenzler, 2013, pp. 28.). In this mode of state capture, loopholes were intentionally written into laws. The subsequent implementation of such flawed regulations was brokered using two different types of shell organizations: one “live” and the other “empty.” This is not the widespread rent-seeking activity when public policymakers enrich private owners of capital and companies. Rather, in the examples studied in this research, corporate entities are used by public officials to enrich themselves, or their political clients, through the hidden ownership of private-sector organizations.

Several scholars view shell companies as paper firms without real employees, offices, operations, and assets (FATF, 2014; Findley et al., 2014). This is true for most offshore shell companies. However, the findings of the present study suggest that in a domestic context this is not always the case. The category of “empty shells”—echoing the mainstream approach of shell companies—includes firms that serve only as technical vehicles in a corrupt transaction, firms that do not have real operations. The fact that they do not pursue any legitimate business activity does not mean that such firms do not need fake owners, managers, and contracts in order to simulate real economic transactions. They list their executives, staff, or board of directors in official documents and sometimes on websites. In contrast to the empty shell, the author classified other companies as “live shells” that had real operations and genuine commercial activities but were subverted for corrupt purposes. Live shells are functioning entities controlled by shadow owners. Within the live-shell category, two additional patterns of corruption were found. Table 4 shows the main characteristics of corrupt shell companies in Hungary.

Two types of organizations were used as shell companies: limited partnerships and private limited companies. In the case of a limited partnership, shadow owners held the general partner position in the organization. In a few instances, the principals (the hidden but real owners) also appeared as limited partners in the legal arrangement. However, since such partners are subject to registration, this was a risky and rather uncommon way to control a shadow organization. Private limited companies were more popular among the corrupt actors. Here, under the law, owners can only lose the full amount of their investment, but their personal assets are not reachable by creditors and other claimants. This company form is often misused for illicit purposes in other countries as well, mainly because of its lower minimum-share capital requirements and

TABLE 4
Corrupt Shell Companies in Hungary

<i>Indicator</i>	<i>Live shell</i>		<i>Empty shell</i>
	<i>Clientele building</i>	<i>Market capture</i>	
Real operation & infrastructure Function	Yes Principal not allowed to run business	Yes Principal not allowed to run business	No Switcher function: change value of resources
Company activity Resource allocation	Continuous economic activity Allocate small units of resources to relatively large number of principals	Continuous economic activity Allocate large units of resources to few principals	One-time transaction Allocate resource to shell company, then multiply its value
Relationship between actors	All actors belong to same network of privileged group. Beneficiaries are lower-level actors National government	All actors belong to same network of privileged group. Beneficiaries are elite economic actors National government	Brokers represent corrupt public servants. Final private buyer is independent of public side Local or regional government
Level of captured institution Brokers	Actors socially close to principal: kin, friends, etc.	Trustworthy actors who can manage shell company for longer term: employee, business partner. Often patron-client relation between principal and broker	Trustworthy actors who can fulfill function of technical owner for short-term: lawyers, local government, friends
Principals	Lower-level members of national governing party: local mayors, ministry employees, etc.	Oligarchs, businesspersons, top politicians	Local political elite members: mayors, notary, etc.

because the shareholders' identities are not strictly monitored (Benton & Beekarry, 2009). Moreover, private limited companies face a less strict regulatory and supervisory control. This article discusses relatively simple company forms. However, more complex ownership and control structures may exist, with many layers of shares registered in the names of different legal persons (FATF, 2014). The latter structures are more professionally designed and managed corrupt arrangements, and therefore it is even harder to identify their illicit nature.

Live Shells

The main reason for the existence of live shells is that their real owners cannot openly exercise ownership in an operating firm and therefore need a seemingly independent broker who can do it for them. In the case of live shells, the state distributes valuable resources, licenses, concessions, or other monopolistic market positions to this shell company that virtually guarantee profit making. This is not a one-time illegal extraction of public resources, but rather the provision of an extra-profit opportunity to a functioning economic entity. Here the main organizers of corruption are able to considerably restructure whole market sectors or segments of a sector. The way the resource distribution is planned and organized and the recipients selected is already biased to benefit particular individuals. Although the distribution of licenses and opportunities has been corruptly tailored to benefit certain people, the actors involved attempt to create a legally defensible structure that appears to make the recipient side seemingly independent from the policy creators and distributors. Since in live-shell cases the state allocates only the right to make a profit, and does not provide straight cash, the recipients need an organizational structure capable of obtaining the right, and then operating and making money. In most cases, live shells do not have only an owner or CEO but require other, real employees as well.

Two dominant economic sectors were repeatedly mentioned in the articles in which live-shell companies were extensively used: tobacco retail and agriculture. These cases are related to two large-scale concession projects in which the Hungarian state redistributed substantial amounts of public resources. In both projects, journalists identified many suspicious cases.

Tobacco is a 500 billion forint annual business in Hungary (about US\$2 billion). In 2013, the Hungarian government turned the previously liberalized tobacco retail business into a state monopoly and then announced a tender for a 20-year concession of tobacco sales. This administratively reduced the number of business units from 42,000 small businesses selling tobacco to about 6,000 newly created tobacco shops with an exclusive legal right to sell cigarettes and cigars. The contract also guaranteed lavish compensation for the concession owners if a future government were to cancel the contract before the end of the 20-year concession period. After a nontransparent selection process of those would be licensed to sell tobacco, investigative journalists gradually identified more and more interpersonal connections between the new concessionaires and members of the ruling government coalition. Many previous shop owners who also applied for the tender and licenses lost their right to sell tobacco. There are different estimates of the proportion of concessions that were allocated in a particularistic way. Based on cases revealed by journalists, between 25% and 35% of the concessions were obtained by shell companies owned by members of social networks closely linked to the national government.

The agriculture cases are related to a large-scale subsidized land-lease program initiated by the state in 2012. The official goal of the project was to provide 65,000 hectares of cheap land to

lease for local communities in Hungarian rural regions, especially for young people, in order to help them to take off or enlarge their family farms. However, it turned out that, on average, only 15–20% of the land was given to local farmers. The remaining part was concentrated in the hands nonlocal actors closely linked to the governing party. The secretary of agriculture went public and resigned in protest after he realized that, in fact, interest groups and party loyalists had been the winners, rather than local farmers. After the secretary's whistleblowing, journalists started to dig deeper into the lists of tender winners and found many interpersonal connections between the new leaseholders and party oligarchs as well as members of the governing party coalition.

During the analysis of the articles, two main subcategories were crystalized in the live shell stories, representing two distinct forms of biased particularistic distribution of state resources. Both can be found in the tobacco concession and land-leasing examples. In the case of "client building," the main reason for using shell companies was to reward client networks surrounding the governing political party. This was a reallocation of small units of resources to a relatively large number of winners. The second category was "market capture." Here shell companies were used to help powerful economic actors and oligarchs obtain a dominant market position while hiding their ownership of the business. In market capture, large units of resources were allocated among just a few principals.

In both categories, the journalists revealed close social relationships between the distributors, the principals, and the recipients. The actors knew each other, sometimes very well. In client-building examples, the form of relationship between the broker and the principal was mainly kinship, friendship, or at least membership of the "political family." By contrast, in the case of market capture, the broker was often a current or former employee or a business partner of the principal. This indicates friendship or an unequal patron-client relationship.

Client Building

Clientelism is a targeted distribution of resources to supporters in exchange for their loyalty (Grzymala-Busse, 2008). Party patronage and client networks are especially widespread in the post-communist democracies of Central and Eastern Europe (Kopecký & Mair, 2012; Nakrošis & Gudžinskas, 2012). The present article provides insights into the mechanisms of how shell companies are used in a systematically organized client-building procedure in Hungary. Here the shadow principals are public servants, national politicians, or mayors who are legally banned from having a formal position in business firms. In the most typical pattern, family members, spouses, siblings, parents and parent-in laws, friends, or even neighbors of people linked to the governing party won several concessions.

In one case, a secretly recorded conversation was leaked in which the mayor of a city openly discussed the possible winners and losers of the tender with other assembly members. The mayor claimed that tender winners should be "committed right-wing conservatives," as were the current national and most local governments. Talking about another candidate, the mayor asked his colleagues if the person had "delivered" enough votes for the party in the latest local parliamentary elections to deserve this kind of favor. This suggests a classical example of political clientele building where low-level actors affiliated with the party are rewarded with concessions for their political support and loyalty. Such targeted spending generates sufficient support to stay in power without allocating resources to all members of society (Grzymala-Busse, 2008).

Market Capture

The second category of live shells includes cases where individuals were only permitted to obtain a limited number of licenses or concessions, and as a result, as shadow principals, they arranged for brokers to win and run additional tenders on their behalf. In these examples, the resource allocation helped the shadow owners, oligarchs, and other businesspersons to develop invisible but dominant market positions in a sector or a region by controlling a large number of organizations through brokers. In market capture, the visible representatives of the shell company were mainly employees or business partners of the shadow principal, but in a few cases family members or friends were the fake company owners.

Journalists repeatedly revealed a close social relationship between the authorities who allocated the concessions and the winners. In order to manage and supervise the whole tobacco concession project, the Hungarian state established the National Commercial Tobacco Company. Documents showed that in the late 2000s, the current CEO of this company was a board member and top manager in companies owned by a certain businessperson whose shell companies received several tobacco concessions in the tobacco project.

Investigating the tobacco contracts, reporters exposed a huge cluster of concession holders who in fact comprised a retail tobacco “empire.” Shell companies of current and former employees or partners of a complex company holding won 500 concessions all around the country. It turned out that the owner of the holding and main shadow principal was the very person who had designed and “tailored” the tobacco concession law. It was leaked and verified that an earlier version of the law had been prepared on his personal laptop. Since in this case it was hard to fill 500 shell companies merely with employees, the organizers of this cluster used almost anybody available to be a broker or straw man, from elderly parents to young siblings and even a pensioner house cleaner. Some other powerful actors were also able to cover huge parts of cities or even counties with tender-winning shell companies. Moreover, tobacco shops in the best locations, including busy gas, bus, and train stations, the airport, and crowded shopping malls, were typically obtained by powerful businesspersons. Such positions guarantee long-term extra-profit.

In the agriculture case, market capture patterns were also identified. Obtaining large tracts of land as low-cost, long-term leases can be profitable even without any productive activity. The European Union’s subsidy is 300 euros per hectare for farms. Given the low-cost of the lease per hectare, a farmer who is able to get 100 hectares is ensured a yearly income from the EU subsidies alone of 7.5 million forints (about US\$30,000) even if the land is left uncultivated. In Borsod County, about 60% of the leased land is in the hands of shell companies related to four people. In Fejér County, only eight people shared 80% of the land that was sold. The prime minister’s close soccer buddy, the mayor of his hometown, is also among the biggest winners of the agriculture case. Via shell companies, the mayor obtained 1,250 hectares, which means he is eligible to receive about US\$300,000 annual through the EU subsidy. Any actual profit from the crops is an additional gain.

Empty Shells

Empty-shell companies are different from their live-shell counterparts. They do not have real operations, employees, infrastructure, or assets. The main reason for using them is that they

serve as technical vehicles that facilitate a corrupt transaction. In most cases, empty shells were used to facilitate the allocation of local-government resources into private hands. During an interim period, the official owners of the shell companies were lawyers, friends, and, in some cases, the local government itself. Finally, most of the real private-sector owners who bought the shell companies became oligarchs or Hungarian subsidiaries of multinational corporations. To sum up, empty shells provide their benefits to shadow principals through subsequent sales, not ongoing operations.

Like the live-shell model, empty-shell cases can be classified as corruption on the input side of public policy, since here, too, local regulations are manipulated in order to misallocate public resources. Yet this pattern is also a bit different from live-shell cases. Before the implementation of laws and rules that will serve certain persons, the public resources are transferred to the shell organization. Due to the newly created regulatory framework, the value of the resources owned by the shell company will be multiplied and then the whole enterprise will be sold to a third party for extra-profit. This suggests that empty shells in corrupt transactions have an important “switcher” function. They help to smoothly transform the character of resources from public to private property, and at the same time they facilitate an increase in the value of the same public resource after the introduction of a new public policy.

One major way to use administrative tools to make a plot of land much more valuable is to switch its status from agricultural to one where houses and shops can be legally built. In Hungary, local governments have the discretionary power to make this change. Several media examples showed this pattern. A shell company would purchase agricultural land; the local government then changed the status of the land, giving the shell company all the permissions necessary for a real estate project; and finally, a multinational corporation seeking to build a factory, shopping mall, or residential buildings bought the shell company. At the time of the research, foreign citizens or firms were legally prohibited from buying agricultural land in Hungary, but they could purchase land classified as a building area. The shell companies were the vehicles that turned cheap agricultural areas into legally purchasable assets to be sold at a profit to a foreign corporation or investor.

In one highly publicized case, a corrupt clique that included the mayor sold 26 multistory buildings in a historical district in Budapest that were owned by the local government and were on the UNESCO World Heritage List. The National Office of Cultural Heritage assisted the corrupt actors by issuing expert reports that released the buildings from monuments protection and supported their demolition. After this “switch,” the buildings were sold to shell companies that were finally acquired by international investors who were free to demolish the old houses and start new real estate development projects in the area. In other cases, shadow principals, mostly local mayors, acquired insider information about planned highway, railroad, or subway routes. These infrastructure projects would considerably increase the value of properties close to the road or railroad line. Mayors used shell companies to buy the land before the official announcement of the future infrastructure project.

In contrast to client building and market capture patterns in which the national government misallocated resources, corrupt actors at the local government level usually cannot build an entire quasi-market for their shell companies. Their legislative power is “only” enough to increase the value of the resources owned by the shell company. They can create highly valuable assets that can be sold for extra-profit, but they cannot guarantee a long-term operation

and profit-making to the shadow principals. Therefore, corrupt empty shells always end up making market-type transfers, in which the public resource turns into private property when a third party buys it. This does not mean that there is no collusion between the public and private parties. However, after the final transaction, the shadow principal no longer controls the shell company. Empty shells are established for a one-time corrupt transaction.

HOW TO CURB CORRUPT SHELL COMPANIES

Partnerships between government and the private sector can be found worldwide. In some cases, they take the form of contracting out previously government-provided services to the private sector. In other cases, government provides citizens with vouchers to purchase services from private businesses (Savas, 2000, p. 4.). Although the mainstream literature on public and private partnerships is rather enthusiastic, arguing that they are sources of better administrative performance and service, some scholars are very critical of these collaborations, claiming that there are systemic vulnerabilities embedded in such partnership structures because they provide “relatively unrestricted arena of high, oligarchic opportunism against the public toward commercial self-interest” (Kouzmin, Johnston, & Thorne, 2011, pp. 225–232). In fact, these arrangements enable oligarchic elites to invisibly or visibly move between the public and private spheres in a self-interested manner (Thorne & Johnston, 2012). It has long been known that government officials are able to structure concessions by including a high-level of monopoly profit for the rent-seeking private actors who obtain the concession (Rose-Ackerman, 1997, p. 39). However, the shell company phenomenon analyzed in this article brings into sharper focus the evolution of perverse forms of public-private collaboration as potential vehicles for corruption. Corrupt cliques on the government side use private entities to siphon off huge amounts of resources from the government system for themselves and their political allies. These corrupt actors pay special attention to making their operations seem lawful and extract money through legal contracts that require a large amount of “clean” shell companies (Jancsics, 2016). Even in the case of market capture when oligarchs are the beneficiaries of the corrupt deal, public actors design and control the whole process.

The live-shell type is especially worrying because it suggests that corrupt networks are deeply embedded in the entire government. The findings indicate that systemic integrity issues at the national and local governmental levels affect the lives of large numbers of citizens. This is in a sharp contrast to the conventional notion that corrupt transactions are “win-win” deals and do not have clear losers. In the analyzed cases, social groups negatively impacted by the corrupt deals were accurately identified. Losers of live-shell transactions are spread through the country. Thousands of entrepreneurs—small shop owners and small farmers—were driven out of business. In the tobacco concession case, the increasing proportion of smuggled cigarettes from unidentified sources raises significant health issues among the smoker population. In addition, dealing with smugglers criminalizes ordinary citizens. The guaranteed 20-year concession period makes it very expensive for future governments, and thus for the taxpayers, to cancel the corrupt contracts. As for the agricultural land-lease project, the concentration of oligarchic land in the countryside may further increase social inequalities in rural Hungary. Moreover, the empty-shell cases suggest that corrupt actors transfer the most valuable property of a local community to private ownership for a cheap price.

There are three reasons why conventional anti-corruption policies may fail against the corrupt shell phenomenon in this Central European case. First, the informal nature of the principal-broker relationship makes it hard to identify the real owners. Second, social cohesion, the basic foundation of the representative brokerage structure, suggests that the actors do not rationally evaluate the possible outcomes of their behavior. Thus a stricter criminal code or more effective law enforcement may be ineffective. Third, in many cases, shell companies are just one element of a broader corruption scheme that starts at the stage of public policy decision-making. Focusing only on the shell organizational structures as the main problem, without addressing the whole political and power context, may significantly limit the impact of any anti-corruption policy.

Much of the policy literature emphasizes the importance of supervisory and legal regimes in the fight against illicit shell companies. The Panama Papers have led to demands that offshore companies make their ownership structures public (“Who Is Next,” 2016). These reports call for stricter regulations and better company registries to ensure that authorities can acquire adequate, accurate, and timely information on the beneficial ownership of shell companies (OECD, 2000). These claims are based on the assumption that anonymity is enhanced by the use of formal mechanisms, such as bearer shares, nominee shareholders, and nominee directors. In these cases, the rights of the real owner are usually guaranteed by a private contract called a declaration of trust. However, examples from the present article suggest that domestic shell companies are often controlled by trusted individuals and there is no formal relationship or contract between the fake and real owners. Even the most accurate and updated company registry will fail to reveal such connections. Data-mining techniques, for example, looking for same-family membership based on matching the mother’s maiden name, may expose some informal links in the ownership structure. However, a large number of cases will still go unrecognized when close social bonds cannot be proved from the official data.

Mainstream anti-corruption measures are based on the assumption that corrupt actors behave rationally and evaluate the costs, benefits, and risks of participating in a corrupt exchange and act according to this calculation. Therefore, the theory goes, proper incentive and punishment structures may successfully reduce the actors’ willingness to be corrupt (Bardhan, 2006; Becker & Stigler, 1974; Rose-Ackerman, 1986). However, giving ownership and decisional power to a stranger, especially when the shell organization has real assets, is risky. The fact that the organization receives resources in a corrupt way makes the arrangement even riskier. Very often the secret principal is not affiliated with the organization through any formal tie and thus does not have control over activities taking place in the official realm. Due to the extremely high risk (and thus transaction cost) of illegal deals and the lack of formal affiliation, shadow principals cannot rely on conventional market or administrative tools to control a company (Frances, Levacic, Mitchell, & Thompson, 1991). They must use informal network structures to coordinate activities (Powell, 1990). This network-type governance mechanism is often called “clan control” in the literature (Ouchi, 1980). In this situation, interpersonal trust, choosing family members or friends to become brokers, is a crucial risk-reducing factor (Jancsics, 2015). Social bonds and loyalty are generally stronger sources of stability in a relationship than simple utilitarian considerations (Bernstein, 2011). Shared social-network membership indicates relatively high social cohesion, an effective mechanism for monitoring compliance with group norms, sustaining a strong sense of shared fate, and regulating the behavior of group members (Stovel & Shaw, 2012). The particularistic norm systems of close-knit trust networks often become

dominant over society-wide formal norms, thereby making criminal law and other rules especially ineffective against illicit transactions coordinated by particularistic norms (Graycar & Jancsics, 2016; Schweitzer, 2004). The examples in this article suggest that mainstream anti-corruption measures may work only when the social bond between the broker and the principal is relatively weak, and where brokers are lawyers or less connected employees.

The tobacco and agriculture cases both show not only corruption on the policymaking side but also a form of systemic corruption when the illicit practice is part of the normal operation of the whole political-institutional system. The corrupt elite is able to turn off crucial control mechanisms (Jancsics & Jávör, 2012). Live-shell cases are large-scale corrupt transactions involving hundreds of people, organizations, ministries, national and local authorities, and a huge amount of public resources. Despite the fact that these well-publicized cases required the coordinated action of many participants, the state's control institutions, such as the police, prosecution, and other audit organizations, did not take any steps to investigate these systemic corruption schemes. Actors whose task is to monitor and punish corrupt behavior were also corrupt and did not act in the interest of the general public (Persson, Rothstein, & Teorell, 2010; Rothstein, 2011, pp. 99–104). There were no trustworthy actors with considerable decisional power in the formal institutional structure.

This article confirms what other empirical studies suggest—that the Hungarian state is captured by particularistic interests (Fazekas & Tóth, 2014; Transparency International Hungary, 2012). These government-related cliques are able to manage market capture, monopolizing significant market segments by using the regulatory power of the state. The current corrupt governmental network is much more centralized than it was under the previous Hungarian governments. There is a dense corrupt cluster very close to the core, which constitutes a small but powerful governing elite (Fazekas & Tóth, 2014; Magyar, 2016). In the case of state capture, typical anti-corruption measures are useless because legal mechanisms can be effective only after the systemic network corruption has been dismantled (Mungiu-Pippidi, 2009).

When powerful corrupt elites control almost all public institutions, there are no benevolent principals on the government side who could act in the interest of the public good (Persson et al., 2010). Thus, the only possible force to fight against this kind of corruption should come from outside the public realm. The fact that there are clearly recognizable losers in these cases has a positive side. The first step to curb systemic corruption would be to organize the losers against the corrupt governing elite (Mungiu-Pippidi, 2009). However, this strategy requires a grand coalition of all actors willing to fight against the corrupt network, and such collective action is not easy to foster. Empirical evidence from 471 anti-corruption civil society projects in Central and Eastern Europe suggests that diverse coalitions made up of journalists, the media, NGOs and other civil society actors, trade unions, and even ordinary citizens are the most effective ones (Mungiu-Pippidi, 2015, pp. 173–174). Moreover, the most successful coalitions were not top-down projects organized directly by donors, but rather were bottom-up movements partially sponsored by donors but also with many volunteer participants.

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