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# **The Rise of a Rule-Based Transgressor Elite**

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CITYPERC Working Paper No. 2022-05

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# **The Rise of a Rule-Based Transgressor Elite**

Report from the CORPLINK Project<sup>1</sup>

Ronen Palan, PI, CORPLINK Project, ERC Advanced Grant

## **Introduction**

Transnationally organised, rule-based transgressor elites are the wealthiest and most powerful elites today. The core of this group comprises managers of large multinational corporations and related ‘born global’ corporations, such as Tesla, eBay and the like, large investment houses, such as Blackrock, Blackstone and Vanguard, leading international investment banks and elite legal, consultancy and accounting firms. This elite core is joined by several ancillary groups. Arguably the most significant of those are midsize corporate groups, many of which are privately held. Numbering in the hundreds of thousands, perhaps even millions, they employ tactics perfected by large corporations to arbitrage rules and ensure corporate and other forms of taxation, rules specifying personal or group liabilities or other regulations, including protection of shareholders and the like, are either partially or fully avoided. To these, Ricardo de Soares adds another group; he argues elites from development countries latch onto existing institutional and professional providers serving those other elites; once they achieve their goal of transferring capital out of their own countries, they participate actively in the process of wealth and power concentration described in this paper (Soares, 2021) .

The principal vehicle of wealth and power concentration employed by these interconnected elites is the socially sanctioned institution of the ‘artificial legal person’ or the ‘corporation’. Like Lego pieces, corporate legal persons can be combined to create cross-border corporate groups known by various names, such as ‘multinational corporation’, ‘multinational enterprise’ or ‘transnational corporation.’ The main mechanisms used by these elites to concentrate wealth are legal and accounting devices that take advantage of complexities and inconsistencies in national and cross-border rules covering incorporation, financing, corporate governance and taxation to limit exposure to what Douglass North (1990) called the constraining ‘rules of the game of society.’ These schemes are known by

their generic name, regulatory arbitrage or jurisdictional arbitrage (Fleischer, 2010; Partnoy, 2018; Riles, 2013).

The wide-spread use of techniques of ‘cost reduction’, whether in the form of direct costs, such as taxation, or indirect costs, such as reduction of risks, liabilities, cost of financing and the like, is factored into market evaluations of the corporate groups under the control of these elites. The result is a ‘virtuous’ (or perhaps ‘vicious’) cycle of wealth and debt: market capitalisation of corporate groups bolstered by arbitraging tactics is used to leverage finance; in turn, leveraged finance (debt) is used for further concentration of corporate assets and so on. In this way, an incredible wealthy transnational elite has taken shape, seemingly impervious to the systems of progressive taxation introduced by many OECD countries to avoid such wealth concentration. This elite seems to thrive in the context of mushrooming personal, corporate, municipal and national debt.

This paper reports on the findings of a project financed by the European Research Council Advanced Grant investigating the phenomenon of jurisdictional arbitrage. From the outset, the project asked two straightforward, if not necessarily simple, questions. First, why are multinational corporations, including multinational banks, so complex? Second, what is complexity in corporate organisation, and can we measure and quantify it? These questions were already ‘in the air’, so to speak, when we began to explore ways of addressing them. In diverse literature, we found references to organisational complexity, opacity and/or other factors that inevitably result in incredibly complicated organisations, from studies of the ‘economics of the firm’ to work in the fields of international business, corporate tax, economic geography, international political economy and even sociology and anthropology. Yet remarkably, as far as we could tell, no one seemed bothered to ask why multinational corporations are so complex. After all, nothing about the notion of an intensely competitive ‘self-equilibrating’ global market suggests business organisations should become very complex. On the contrary, scientific management and organisational theory are all about removing excesses, controlling time and adopting lean organisational and production systems.

The answer we came up with was somewhat unanticipated: There seems to be a connection between organisational complexity, power and inequality in the modern world. Furthermore, these three factors are combined in those tactics and strategies of regulatory and jurisdictional arbitrage that have attracted the attention of a few specialist lawyers and accountants but are ignored by the wider academic community. Interestingly, like the Kennedy and Obama administrations, the Biden administration came up with two proposals

for combatting jurisdictional arbitrage: one is to change the field of corporate taxation and the other is to impose a wealth tax. Due to space limitations, I will not address these proposals in this paper; I merely point them out to interested readers.

### **Complexity: The Paradox of Modern MNEs**

In *The Blind Watchmaker*, Richard Dawkins says physics is the study of simple things, and biology is the study of complex things:

The objects that physics study are still basically simple objects. They are clouds of gas or tiny particles, or lumps of uniform matter like crystals, with almost endlessly repeated atomic patterns. They do not have, at least by biological standards, have intricate working parts. (Dawkins, 2006, 3)

For Dawkins, the core puzzle of biology is complexity, and ‘complicated things, everywhere, deserve a very special kind of explanation’ (2006, 1). If that statement were not controversial enough (but his argument is solid and persuasive: ‘The objects and phenomena that a physics book describe are simpler than a single cell in the body of its author’ (2006, 2-3)), he also calls man-made artefacts biological things. In this sense, ‘multinational corporations’ are human artefacts. They are complex, multifaceted, internally heterogeneous, ever evolving and constantly changing.

Yet this is not the way multinationals have been treated to date. The social sciences broadly and mainstream economics and political science more specifically were strongly influenced by the development of physics. Thus, they still tend to treat social phenomena as physical objects, or rather, as the way physical objects were understood during the 19<sup>th</sup> century – simple, repetitive lumps made of elementary particles (Mirowski, 1992; Palan and Phillips forthcoming). These sciences reduce complexity to ‘constitutive parts’ in order to focus on allegedly ‘what is important’. Cut a ‘representative firm’, ‘the market’ or ‘the political system’ into two, and you will have, or so it is assumed, two sets of equally similar ‘lumps’ of material now located in separate containers. That MNEs are becoming progressively more heterogeneous over time does not fit with this agenda.

It must be recognised that we are discussing a special problem for economics. The problem is not simply one of complexity. It is a precise kind of complexity that arises ‘inside’

the organisation in so-called intra-firms transfers. Intra-firms transfer occur in a space viewed since Ronald Coase (Coase 2007) as one ‘over which the market system was suppressed’ (Jensen and Meckling, 1976, 310). On the face of it, intra-firm trade, which could amount to about 30 to 40 percent of global trade (Lanz and Miroudot, 2011), is a type of trade in which the buyer and seller are one and the same. Such ‘trade’ does not make a great deal of sense to an economist. Such ‘trade’ is registered because ostensibly, the market was brought back into the firm just about the time when Coase wrote his seminal article. Under standards mandated by the League of Nations, firms operate under the so-called ‘arm’s length’ principle, whereby all internal transactions are priced at what would be charged between independent enterprises (Langbein and Fuss, 2017). Intra-firm transfers arise, therefore, as market emulating practices where the buyer and seller are supposedly one and the same. The figures for intra-firm trade are simply the obverse side of market suppressing practices registered, as it were, in national statistics.

That MNEs are highly complex is generally known. A 2012 study commissioned by the New York Fed revealed the number of subsidiaries and affiliates owned by some of the largest US banking holding companies rose to an average of 3,400 in 2012, up from about 1,000 in 1990 (Avraham, Selvaggi, and Vickery, 2012). Around the same time, Lewellen and Robinson estimated about half of US corporations had adopted a multi-subsidiary and multi-jurisdictional (and we would add, multi-layered) organisational structure (Lewellen and Robinson, 2013). By the same token, UNCTAD World Investment Report 2016 estimated that ‘[m]ore than 40% of foreign affiliates are owned through complex vertical chains with multiple cross-border links involving on average three jurisdictions’ (UNCTAD, 2016, 124). Our own project focussed on the practices and behaviour of the 100 largest non-financial firms in the world in 2018. When we started the project in 2018, they averaged about 700 subsidiaries per group. The number of their subsidiaries had risen by an average 8% when we checked 18 months later (Phillips et al., 2020)!

Academics are well aware, therefore, that the modern MNEs are increasingly organised into multi-subsidiary, multi-jurisdictional, layered structures. Whereas the different tasks performed by subsidiaries are studied in detail, however, the layered form of corporate organisation, ‘the way subsidiaries are arranged within ownership structures’ is not (Lewellen and Robinson, 2013).<sup>2</sup> Some economists have puzzled over these developments or at least alluded to them. With a keen eye for detail, Edith Penrose opined that when firms achieve a certain (unspecified) level of growth, they metamorphose into something else, often beginning to behave like investment funds (Penrose, 2009). Existing microeconomic tools are

not particularly helpful for studying such firms.<sup>3</sup> The economist (presumably, I have not come across one who addresses this question directly) would probably attribute the increasingly complicated nature of modern multinational corporation to exogenous forces, regulatory ‘friction.’ To an extent, I agree with that hypothetical economist. ‘Friction’, or at least regulatory friction, may explain why multinational corporations depart from the singular, homogenous notion of the lean, efficient ‘firm’ of economic theory, but the concept tells us next to nothing about the economics of friction, the way regulatory friction is producing an entirely different sort of economics.

To the economist, intra-firm transfers are at best market distorting practices (Hauser, 2021). Otherwise, the idea that the buyer and seller can be the same ‘person,’ and furthermore, in doing so, can generate ‘additional value’ sounds absurd (Karayan et al., 2002).<sup>4</sup> To the political scientist, the politics of intra-firm transfers does not sound like politics at all. The complex way in which MNEs are set up has attracted, therefore, little interest. The legal literature on regulatory arbitrage ‘is surprisingly thin’ (Riles, 2013, 68), and the literature on corporate complexity, and in particular, corporate layering, in cognate disciplines of economics, business or political science is even thinner, to the point of being non-existent.

It is difficult to explain why a phenomenon of such magnitude is ignored. But faced with a proliferation of subsidiaries and organisational complexity, the literature has adopted a variant of Freud’s kettle argument (I returned the kettle long ago...I never borrowed a kettle from you.... Anyway, it was full of holes....), with three ‘default’ positions.

The first default position is the approach taken by probably 99% of the literature on foreign direct investment (FDI) and multinational firms. Such work simply assumes corporate layering and subsidiary proliferation are ‘white noise’ best ignored. The tacit assumption seems to be that investment in a foreign country is concentrated in one subsidiary, and the subsidiary is controlled directly by the parent. It is not clear whether researchers genuinely believe this to be the case – it is generally not – or whether the approach is predicated on the idea that ignoring complexity is a necessary analytical step and, as such, allows the researcher to concentrate on the way the ‘firm’ ‘meets the relevant marginal conditions with respect to inputs and outputs, thereby maximising profits, or more accurately, present value’ (Jensen and Meckling, 1976, 306-7).

The second default position is described by Katrina Lewellen and Leslie Robinson as the ‘pure historical accident scenario’ (Lewellen and Robinson, 2013). In this articulation, firms are organised in complex chains of multiple cross-border links, but organisational

complexity is a random product of the historical evolution of corporate groups. They set up a separate subsidiary in each country in which they operate, and over time, subsidiaries are added to (or eliminated from) the structure. Lewellen and Robinson identify this position as exemplary of the Modigliani-Miller ‘invariance assumption’, thus alluding to a superficial, and in our view, misleading, reading of what Miller described later as the ‘arbitrage proof’ proposition (Miller, 1988). The Modigliani-Miller theorem showed (or supposedly showed) that what firms value (that is, market capitalisation) is impervious to their capital structure and financial arbitrage.<sup>5</sup> The reference is clearly only to financial arbitrage, which, as we argued below, is conceptually and analytically different from regulatory and jurisdictional arbitrage.<sup>6</sup>

These two default positions are inconsistent with a third position. The third position recognises some strange developments in the internal organisation of firms but attributes these developments to taxation. According to this position, a certain portion of corporate FDIs are sham operations, ‘artificial’ constructions with little to do with the firm’s core activities. Sham operations tend to involve subsidiaries in jurisdictions lacking market size, talent pool or other ingredients that justify the level of investment they obtain (e.g., ‘offshore’). The IMF estimates that perhaps a third of all FDIs are ‘phantom investments’ (Damgaard et al., 2019). These sham operations are branded ‘artificial,’ presumably to indicate they are not contributing to (what economists think is) the economics of the enterprise.

Whilst corporate organisational complexity is ignored through such analytical means in economics and business studies, in political science or IPE, organisational complexity does not get a mention at all. In politics, ranging from studies of lobbying to work on varieties of capitalism, the firm is a single entity devoid of internal diversification. Many years ago now, Robert Nye identified three channels through which ‘firms’ influence policy: first, they can have a direct influence on policy, or what is often called relational power; second, they can influence policy through agenda setting; third, they can exert influence as an instrument of the state ( Nye, 1974; for a discussion, see Kim and Milner, 2020). But whether these ‘firms’ exist as such in the real world – and economists like Penrose are dubious – does not receive a hearing in political science. Although arbitraging refers to regulatory friction, and hence presumably touches on the way states interact with markets, sadly, as the editors of one of the leading journals in the field explained to me, these matters are simply of no interest to a ‘wider audience’ in the field.



## Equity Mapping

Given the overall lack of interest, in our project, we had to start at a very basic level. To advance our understanding of the drivers of corporate complexity and layering, we needed first to have a sense of the size of the phenomenon and an inkling of how corporate groups are internally organised. To do so, we developed a comparative forensic technique to map out corporate organisation drawing on the Orbis database. We called the resulting maps ‘equity maps’ or EMs in short. Simply stated, EMs are diagrams depicting the way subsidiaries are held by corporate groups.

The Orbis database provides ownership data on entities in a group under two distinct reporting categories: direct ownership levels and total ownership levels. We used a standard social network (SNA) approach combined with a gravity-model display algorithm to convert the ownership data on multinational and subsidiary organisations into our visualised maps using a standard social network (SNA) approach.<sup>7</sup> We drew EMs for about 250 global firms, including the 100 largest nonfinancial firms in the world. We then interviewed corporate lawyers and accountants to learn about the possible use of the structures visible in these maps.

Figure 1 is an EM of WPP, a large British advertising firm with revenues more than £13 billion in 2019. The parent of the company, registered in Jersey, is represented by the red dot. Each additional dot represents a separate legal person controlled by the parent. Some subsidiaries control other subsidiaries, creating a chain of subsidiaries. The algorithm we used illustrates this controlling arrangement by ‘pulling’ the controlled entity away. Those who are not controlling other subsidiaries in the group remain visually huddled close to their parent, creating this image of a cluster. Figure 2 is an EM of Volkswagen and Figure 3 of Wells Fargo. In the last map we highlight corporate entities held internally through a split ownership arrangement (we call this phenomenon ‘splitter’, and we discuss this in (Palan et al., 2021)). Our EMs invariably reveal that MNEs depart from the image of a singular organisation rationally divided into functional or regional divisions. In fact, most are highly complex, *layered* organisations.

Figure 1. Equity Map of WPP, a British Advertising Conglomerate

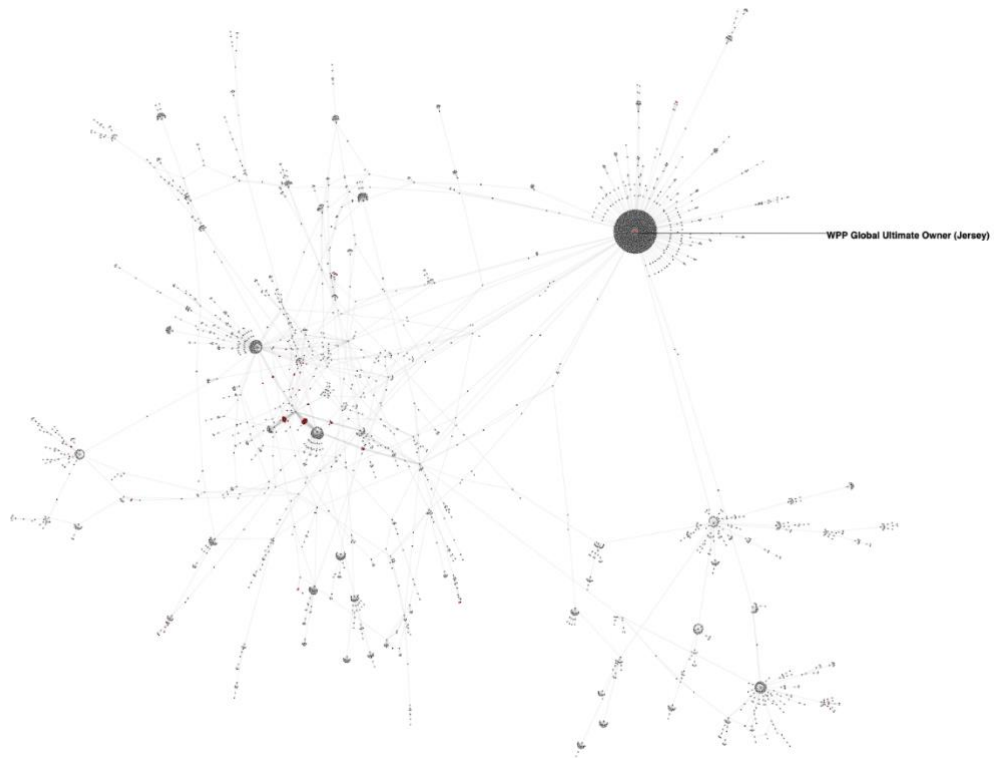


Figure 2. Equity Map of Volkswagen

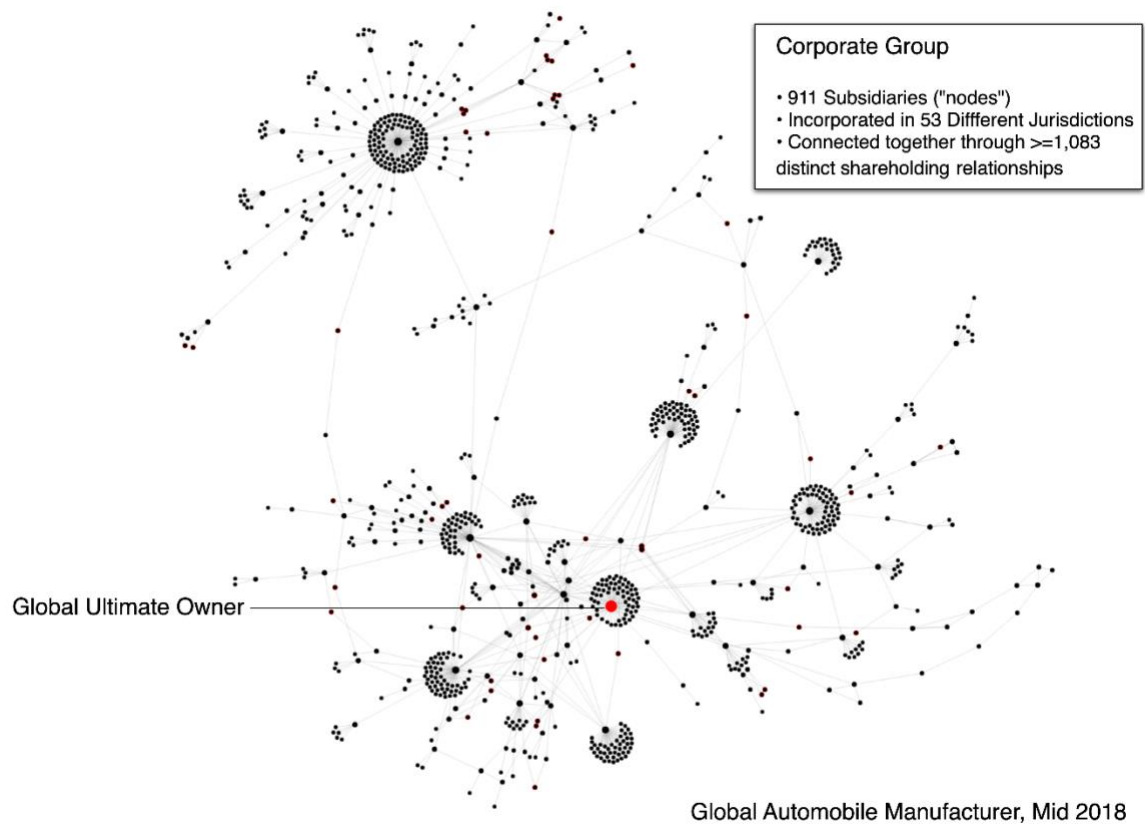
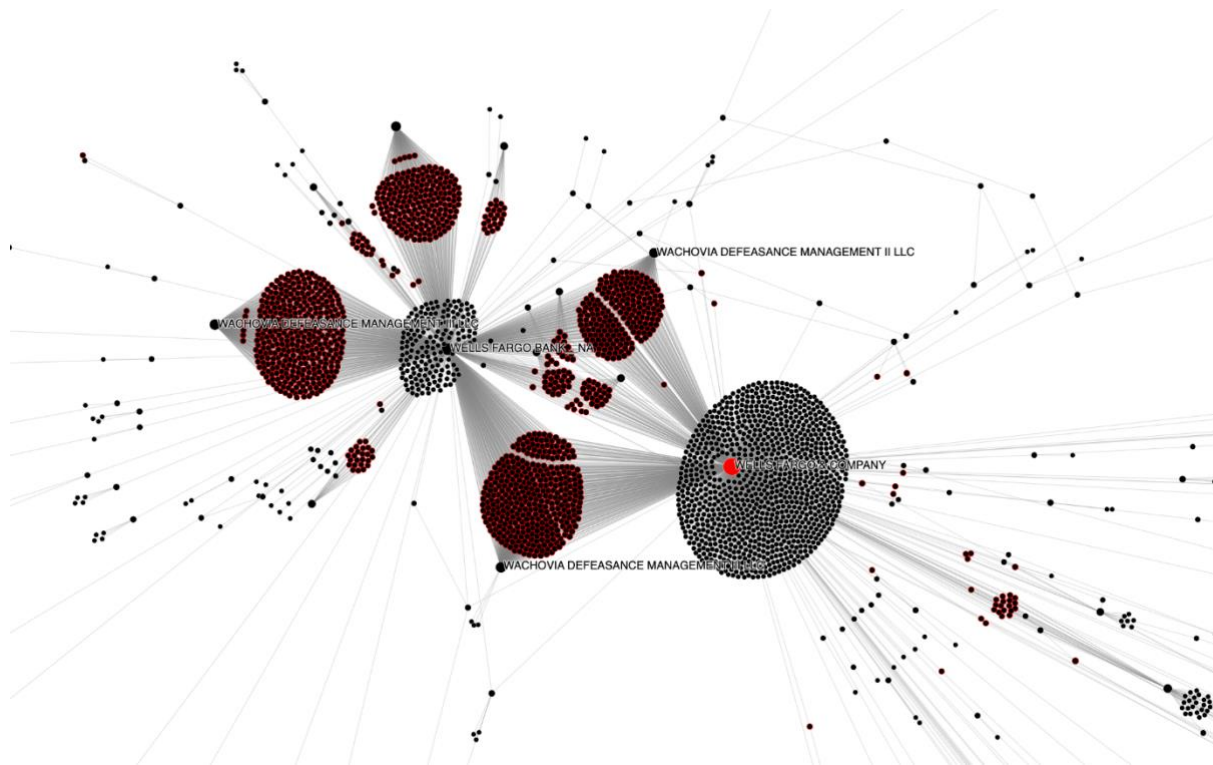


Figure 3. Equity Map of Wells Fargo, circa 2021



As our EMs show, modern MNEs are incredibly complex. The maps visually demonstrate two related dimensions to the proliferation of corporate entities. The first is the proliferation of corporate subsidiaries in groups. The second is the specific way in which those proliferating subsidiaries are then organised. The first has been studied extensively, whilst keeping an eye on simplicity. A rich literature demonstrates that the proliferation of subsidiaries and affiliates is driven, at least partially, by the requirements of operational flexibility (Desai, 2009). I leave this literature aside for now. In what follow, I focus instead on the second dimension of complexity, the layering of organisations of authority and control within an organisation.

Why do modern MNEs adopt a layered organisational structure of this nature? The simple answer is that we do not know. The more intriguing possibility alluded to above is that the rich and varied literature on MNEs and FDI does not seem to want to know. Throughout our research, therefore, we had to address a triple puzzle. First, why, despite considerable evidence to the contrary, the literature seems determined to treat corporate organisations as simple or as an afterthought (pure accident). Second, why would anyone think the armies of lawyers and accountants employed by MNEs to ensure compliance with rules and reduce the

regulatory risks and uncertainties associated with operating across borders would not take advantage of the same techniques to arbitrage national rules and regulations? And third, why would anyone believe that when those armies of lawyers and accountants take advantage of opportunities to arbitrage national rules, their focus would remain exclusively on taxation?

### **What is Jurisdictional Arbitrage?**

Systems of taxations are often highly complex and consist of a plethora of divergent rules of taxation, deductions, amortization and the like. Faced with inconsistent sets of rules and regulations, ‘sophisticated taxpayers’ (Schizer, 1999) rearrange their affairs to minimise taxation, maximise deductions or otherwise exploit gaps in accounting rules. For instance, if tax on personal income can reach 45% in the United Kingdom, whereas capital gain tax is 18% (on certain type of transactions), sophisticated taxpayers will seek to structure their income in such a way that larger proportion of their income will qualify as capital gains. If interest rates on loans are recognised as tax deductible expenses, these taxpayers may prefer to borrow money rather than use their own resources to set up a business organisation. Taxpayers exploit, in other words, *complexity, plurality and inconsistencies in tax rules* to minimise their tax bills. Such tactics are described by tax lawyers as ‘tax arbitrage.’ These tactics are entirely legal. No taxpayer is expected to voluntarily pay above what the law of a country demands.

In the United States, tax arbitrating was preceded by a different set of arbitrating tactics driven initially by competition between New Jersey and Delaware over incorporation law and corporate government rules, supplemented over time by others, such as Nevada or South Carolina (Arsht, 1976; Dyreng et al., 2013). In what is often described as a ‘race to the bottom’, Delaware stole a march over New Jersey early in the 20<sup>th</sup> century by allowing the separation of holding companies from headquarters, raising issues of ‘control,’ as discussed at length by Adolf Berle (Berle, 1950, 1947). Competition over incorporation law spilled over into other aspects of corporate law, including financing and reporting rules (O’Hara and Ribstein, 2009.) Today, Delaware corporate statutes grant business planners and investors broad latitude to privately order the rules of the internal firm but also crucially allow firms to limit or even eliminate the fiduciary duties of managers (Manesh, 2011).

The ‘race to the bottom’ in the U.S. is centered, therefore, on rules of corporate governance. Any rule, from corporate governance to reporting quality and labor or

environmental laws, can potentially be arbitrated. Indeed, tax arbitrating techniques are considered a subset of a broader set of tactics and strategies known as ‘regulatory arbitrage’ (Partnoy, 2018). These tactics take advantage of ‘gaps between the economics of a deal and its regulatory treatment, restructuring the deal to reduce or avoid regulatory costs without unduly altering the underlying economics of the deal’ (Fleischer, 2010, 227; see also Partnoy, 2018, 1024).

The international system and the global markets have assembled, perhaps unwittingly, all the necessary ingredients to encourage cross-border regulatory arbitrage: complexity, plurality and inconsistencies. The economic rationale for operating across borders is well established. Multinationals operate transnationally to access markets, expand the talent pool, achieve economies of scale and the like (Dunning and Lundan, 2008). But operating across borders inevitably produces risks and complications for firms. There are more than 200 nations in the world, each with its own set of rules of governance, laws of agency, taxation and so on. There are also divergences in laws, regulations and the like among the many dependent jurisdictions, such as the Cayman Islands or Jersey, and among the different states within a country, as in the U.S. In such cases, opportunities for arbitrating are greater. This arbitrating is dubbed ‘jurisdictional arbitrage.’

On the one hand, failing to comply with myriad local rules and regulations can be costly, as without planning, a corporate group may end up paying tax twice or even three times (Eicke, 2009). Careful legal and accounting planning of investment is as important as operational planning. Multinational enterprises require the help of experts, not only those who understand the laws and regulations of each country in which they are invested, but also those with expertise in international private law and the bilateral and multilateral agreements among the jurisdictions involved directly and/or indirectly in such schemes.

On the other hand, each regulatory authority has a higher set of rules, the basic ordering of the world according to the system of sovereignty and sovereign equality, to regulate and control activities registered in its territory. The system creates the proverbial ‘elephant in the room’, as each regulatory authority gets to ‘see’ only the portion of the MNE that happens to reside in its ‘territory’. The jurisdictions in which these organisations operate, including the parent jurisdiction, may be aware that the fragments in their jurisdictions licensed as independent legal persons are part of a larger group and serve a strategic or financial interest of management and stakeholders in a larger enterprise. Regulators may have access to a consolidated account produced by the group or perhaps to brochures and

newspaper reports about the MNE, but they can oversee directly only those fragments located in their territory. That makes the task of arbitrating national rules easier in many ways.

Three additional elements to arbitrating generally, and to jurisdictional arbitrage specifically, should be highlighted. First, the concept of regulatory arbitrage shares many common attributes with its namesake, ‘financial arbitrage’. Both require imagination and a degree of audacity. In arbitrage, writes Annelise Riles, ‘traders seek out hidden functional similarities across what look on the surface like differences’ (Riles, 2013, 72). The economic genius of arbitrage, she notes, ‘is that the similarity and the difference can be of virtually any kind. Indeed, the more unthinkable the connection, the more likely that arbitrage opportunities can be found and exploited’ (Riles, 2013, 72). Riles identifies a core dynamic of regulatory arbitrage, the impetus for expanding the range of rules or regulations that are arbitrated. Lack of imagination seems to be the only barrier to the expansion of arbitrage.

Although they are conceptually and operationally related, the two types of arbitrage have completely different impacts on pricing. Financial arbitrage is a ‘key mechanism in the adjustment process that leads to identical goods having identical prices (Partnoy, 2018, 1018).<sup>8</sup> It tends to eliminate price differences between jurisdictions by re-allocating supply and demand for financial products from one jurisdiction to another. Regulatory arbitrage, Partnoy argues, does exactly the opposite. It entrenches price diversity for similar goods, services or any other ‘factor of productions’ (such as labour, raw material), and, in fact, instead of leading to price convergence globally, regulatory arbitrage in its jurisdictional form tends to pit jurisdictions against each other, leading to the previously mentioned ‘race to the bottom’. In short, regulatory and financial arbitrage should not be confused.<sup>9</sup>

Riles’ reference to the ‘economic genius’ of arbitrage can be confusing as well. Economic instruments are highly abstract, referring to the ways economic actors adjust to prices, organise demand and supply and more generally operate in markets. Financial instruments, in contrast, are very concrete and draw on what Sebastian Orts refers to as a core ‘social technology’ – laws of contract, property and entity (Orts, 2013). Financial instruments connect present and future, specify financial quantities, identify risks and assign and protect property rights. Like all contracts, they specify the location of the contract and often the location of dispute arbitration. As such, they involve a field of law called ‘conflict of laws’, rules designed to determine which laws should apply when parties, transactions, acts or events span more than one jurisdiction (O’Hara and Ribstein, 2009). With faster communication and transportation and freer trade, O’Hara and Ribstein argue, the ability to

choose law has been expanded as well, further encouraging an expansion of arbitrating tactics used by multinationals.

The legal dimension of arbitrating shapes the way arbitrating schemes tend to evolve into ever-more esoteric forms (Freedman, 2008). In conventional public law accounts, jurisdictions (states, regions, municipalities) are seen as providers of ‘bundles of laws and regulations’, and ‘consumers’ chose their preferred bundle by either voicing their approval or exiting (Mearsheimer, 1994). In public choice theory, the implication of this ability to choose is called the Tiebout model. Writing about competition among municipalities in the Los Angeles area, Charles Tiebout posited that householders are attracted to municipalities that achieve a successful balance between tax income and provision of public services, thus incentivising municipalities to provide optimal levels of public goods (Tiebout, 1956). Some academics argue that an international competition in taxation, and presumably in other rules as well, will yield optimal offering of bundles of regulatory environment (Rose and Spiegel, 2007). This is certainly plausible. Yet public choice theory seems to neglect the option whereby ‘consumers’, in our case, multinational corporations, find ways of choosing not only among ‘whole’ bundles of rules and regulations but pick and choose elements from different bundles (O’Hara and Ribstein, 2009), doing so without the pain (or costs) of moving.

These tactics of choosing elements of bundles of regulation invalidate, in my view, a Tiebout argument about competitive regulation. It give an additional and unexpected twist to Ronald Coase’s theory. Coase argued that historically, economic systems were hierarchically structured, but ‘the capitalist system of production turned this structure on its head. The macro system became unconsciously structured, while the micro system became hierarchically structured’ (Coase, 1998, 131). Coase never anticipated that those ‘internal hierarchies’ would themselves evolve into control of subsidiaries. For instance, it is generally agreed that anti-avoidance regulations have eroded the ability of a single corporate entity located in an offshore financial centre to be used as a vehicle of tax planning. But the single entity is typically replaced by a corporate ‘structure’ consisting of several linked subsidiaries with highly choreographed transactional inter-relationships and often involving dispersal of property titles among the different arms of the same group (HM Treasury, 2014; Hodaszy, 2017; Lambooy et al., 2013; Stewart, 2008). Each subsidiary of such a structure, when seen in isolation, that is, through its annual filings and accounts, would give little inkling of its function in an arbitrating scheme.

On the surface, a subsidiary set up as part of an arbitrating structure may appear to the jurisdiction in which it is located as an innocent bystander in the corporate organisation,

as a ‘sham’ operation or ‘conduit’ or simply as one of a score of companies that seem to be doing very little. But those subsidiaries have a purpose: each ‘picks up’ a certain aspect of the laws of regulation of one country, and in combination with the other subsidiaries in the structure, it helps carve out a path of least regulatory resistance. Such complex structures are used in what Judith Freedman calls ‘exotic tax planning devices’, such as ‘double-non-taxation’, ‘dual resident entities’, ‘hybrid entities’, ‘hybrid financial instruments’ and ‘single-dip-no-pick-up’, all of which, she says, are replacing simple transfer techniques (Freedman, 2008, 16). Conceptually, such structures tend to involve a complex set of processes of spatial disentangling of otherwise entangled transactions. Some schemes involve a group of subsidiaries embedded in corporate chains, whilst others involve entire ‘branches’ of the corporate groups, and still others involve the organisation of the entire group (Phillips et al., 2021).

### **The Economics of Replication in Markets Dissected across Regulatory Authorities**

To this point, I have discussed the ways subsidiaries and internal transfers are used to arbitrage rules. But some basic questions remain unanswered: Why do firms need subsidiaries in the first place? And why do states allow those firms to arbitrage their rules? In other words, what environmental conditions brought about the economics of intra-firm transfers? Setting up a business enterprise involves the establishment of a specialised legal entity, an artificial legal person. An artificial legal person ‘is an incorporate body that is able to act as if they were real persons for legal purposes (Quentin, 2020).<sup>10</sup> By the late 19<sup>th</sup> century, the artificial legal person, the ‘corporation’, was given protection under the U.S. Constitution and was entitled to many of the rights assigned to ‘real’ persons (Stern, 2017, 34; for a discussion, see Robé, 2020).<sup>11</sup>

A new type of corporate organisation in the late 19<sup>th</sup> century began to spill across borders. This posed a unique set of challenges – how to recognise these organisations’ property titles and transactions and the legal person who could operate in foreign lands (Elbaum and Wilkinson, 1979). The fledgling multinationals of the late 19<sup>th</sup> century experimented with several organisational solutions to the problem of the legal recognition of an artificial legal person in foreign countries (Berk, 2004). During the first phase of internationalisation, several companies developed systems of foreign agents or foreign branches.<sup>12</sup> Such solutions were suboptimal at best.



As if on cue, an important set of innovations in the evolution of the concept of the artificial legal person emerged towards the end of the 19<sup>th</sup> century in the U.S. and proved particularly salient in the development of the modern MNEs. It was triggered by an amendments to the laws of incorporation between 1888 and 1892 by the ‘mother of trusts,’ the State of New Jersey. Soon emulated elsewhere in the U.S. and then beyond (Arsht, 1976; Cheffins, 2015; Yablon, 2006), the amendment permitted corporations to own stocks in other corporations (Grandy, 1989). The effects of this innovation to the U.S. economy were far-reaching. Alfred Berle argued these amendments gave rise to a new model of organisation that was ‘far from the original conception of a corporation’; rather, in this new conceptualisation, ‘a single large-scale business [was] conducted, not by a single corporation, but by a constellation of corporations controlled by a central holding company, the various sector being separately incorporated’ (Berle, 1947, 343-4). Corporate personality, he observed, ‘did not correspond to the actual enterprise, but merely to a fragment of the enterprise (Berle, 1947, 348). Investors took advantage, he argued, of the vacuum in the laws and regulations governing the fragments versus the whole by establishing aggregative assets and liabilities the law had difficulty regulating.

As with many crucial social innovations, these amendments seemed to come at the right time. Importantly, the parent-subsidary model that evolved in the U.S. following amendments to states’ incorporation laws offered a better alternative to international business. Businesses could set up a subsidiary or an affiliate abroad controlled by a parent through equity holding. The subsidiary was considered for all intents and purposes an independent legal person. As such, the subsidiary could raise funds in local markets, whilst simultaneously restricting the liability of the parent company against claims (Blumberg, 1993; Ferran, 1999). It was already evident in the early years of the 20<sup>th</sup> century that because of these and other advantages, MNEs were replacing their system of foreign branches with the parent-subsidary model.

In the majority of cases today, a multinational establishes corporate entities in host countries; these are chosen from a menu of acceptable corporate formats in those countries. The entities in host countries are subject to a great many rules and restrictions, including liability and fiduciary restrictions, compliance, reporting and taxation rules. Accordingly, not all firms have adopted this decentred legal model (Lewellen and Robinson, 2013). In fact, large firms, whether multinational or not, have tended to adopt this model. This results in a disjunction between the economic enterprise and its legal statutes witnessed already in the

U.S., a disjunction with far-reaching implications both in practice and in theories of the ‘firm’.

The disjunction is important for a number of reasons. A corporation is a legal entity licensed by a government authority. A corporation cannot be, by definition, be a multinational, and a ‘multinational corporation’ cannot transact in markets, pay tax or pay off politicians (Robé, 2020). ‘The typical MNE’, writes Itzhak Hadari in words reminiscent of Berle, is ‘a cluster of separate legal entities in several jurisdictions, which exist only if the laws of each jurisdiction recognise them as legal entities. The MNE is a business and economic creature, and the usage of that term is presently found only in those fields (Hadari, 1973, 754). Contrary to common perception, then, terms such as ‘multinational corporation’ or ‘multinational enterprise’ or ‘transnational corporation’ or any other fashionable term are misnomers.

The activities attributed to the ‘multinational corporation’ are performed by subsidiaries and affiliates, and subsidiaries and affiliates, in turn, are subject to the rules and regulations of their country of registration. U.S Courts have found ways, up to a point, of putting together these fragmented enterprises and treating them as a whole (Berle, 1950, 1947, 1958). But the prospect of the UK or Germany or Cayman Islands, for that matter, ceding sovereign authority over subsidiaries licensed to operate in their jurisdictions to another regulatory authority is proving far more difficult. This has created the phenomenon of the elephant in the room described above: regulators are able to regulate only the portion of the group that is under their control, and broadly speaking, no other regulatory authority is able to intervene in the regulation of that portion. Myopic regulation is therefore built into the way enterprises are run today.

Myopic regulation is a structural feature with important implications for the notion of market and market exchange. Although often presented as a meeting point of buyers and sellers, markets for goods and services, aka ‘economic’ markets, are facilitating platforms for countless acts of exchange of property titles (Picciotto, 1992). Exchanges of goods or services are replicated, in other words, in the legal realm as the exchange of property titles (Commons, 1990). As long as economies remained largely national (if not regional), and firms were single legal persons, it was not unreasonable to assume the process of *replication* of market exchanges of goods and services as exchanges of property would be automatic, instantaneous and perhaps unproblematic. Property rights were exchanged in markets, and they were the same rights as those exchanged under systems of contractual relationships. The

market auctioneer had no discretion in such matters, so economists could ignore the process of replication in the legal sphere.

Things changed, however, towards the end of the 19<sup>th</sup> century. On the one hand, the concept of property rights underwent an important transformation, first in the U.S. and then globally, with the recognition of the notion of intangible property and ‘goodwill’ (Commons, 1990, 1924; Palan, 2015). Different sets of property rights regimes operated in different countries, and international businesses had to contend with divergent laws and different discourses on the nature of a business enterprise, not to speak of different rules and notions of contractual engagement and rules of property. Countries had different systems of accounting and diverse interpretations of what accounting meant in the first place. Instead of encountering one set of rules, or the auctioneer ‘market’ found in economic textbooks, wherein a single platform operates under similar ‘constraining’ rules, businesses discovered markets were dissected across national territories. The same transaction, the same exchange of goods or services, the same contract for labour, land or machinery, replicated, as it were, in different markets could take a different form and be priced differently.

If they were aware of the bundles of rules and regulations, it seems likely that businesses would opt to invest in a country (or not) based on its bundles. With this in mind, the World Bank sought to encourage development by making states more responsive to business concerns. As Susan Strange noted, countries began to offer ‘business-friendly’ regimes, creating what is known as the ‘competition state’ (Strange, 1994). Scholars of varieties of capitalism argue that different regulatory environments shaped different sorts of multinationals (Hall, 2015). Yet this idea is based on the assumption that MNEs are singular organisations and can only opt for one set of bundles over another. In fact, there was nothing to prevent MNEs from adapting to regulatory conditions at the subsidiary level instead of the group level. Furthermore, the ease of setting up subsidiaries, combined with improvements in communication and transportation, offered MNEs the opportunity to not only consider the location of exchange but also plan for the regulatory environment in which exchange was replicated.

Consequently, for MNEs, replication became both an issue and an opportunity. They had to factor in not only operational costs in a foreign country (labour, currency, infrastructure, political stability etc.) but also divergent laws on governance, financing, taxation and the like. Replication was equally an opportunity, however, as the MNE could now consider spreading its fragments in such a way as to reduce or avoid certain regulatory costs, including taxation. Enterprising companies learned to dissociate the location of market

exchange from the location of the replicated transaction of market exchange, taking advantage of arbitraging rules.

In this way, a series of events after the emergence of modern economics, including internationalisation, the regulatory state, the rise in taxation and the decentred legal organisation as technique of coping with sovereign equality, combined to make replication an important aspect of corporate planning.

### **The Rise of the ‘Business Planner’**

We have now the basic outline of a very special explanation of corporate complexity. At issue is not simply ‘regulatory friction,’ but an economy that evolved because internationalisation and the nature of global markets created opportunities for a new set of economic activities centred on the processes of transaction replication. This economy thrives in the shadows of an imagined market economy posited by mainstream economics. It is an economy, a space for action, shielded from view because of three erroneous assumptions: first, the notion of the ‘firm’ is confused with the corporation; second, the market is misconceived as ‘public exchange, mart or auction rooms, where the traders agree to meet and transact business’ (Marshall, 2009, 270); third, the notion of exchange is one-dimensional. Put differently, if firms inhabited the textbook market economy, then the job of acquiring ‘resources from their environment for the production and sale of goods and services at a profit’ (Penrose, 2009, 31) would most likely result in lean, mean machines containing the smallest number of corporate subsidiaries organised in the most simplified way possible. But MNEs operate in a different market, one that is dissected among regulatory authorities; therefore, their organisations have adapted to avoid the perils associated with such markets and have seized the opportunities created by lack of rule harmonisation.

There is value to be made, in other words, in controlling the location of replicated transactions. MNEs have begun to employ professionals, dubbed ‘business planners’ (Manesh, 2011), tasked with the job of creating a business concern with the aid of the social tools of law and accounting. The business planners are dedicated groups of professionals, either a specialised unit within an organisation or an external group, typically set up among the leading investment banks, legal firms or leading accounting firms (Bankman, 2004). These groups are frequently profit-generating units. In addition to lawyers and accountants, they often include experts in financial instruments, such as futures and derivatives, legal

instruments that evolved as techniques for manipulating time and space (CFA, 1998; Donohoe, 2015; Schizer, 1999).

These teams, whether internal to the group or external consultants, are charged with a specific set of tasks described by John Karayan, Charles Swenson and Joseph Neff under the SAVANT acronym: Strategy, Anticipation, Value Added, Negotiations and Transformation. In their words:

To add maximum value to each transaction, decision makers need to stay focused on the firm's *strategic* plan, *anticipating* tax impacts across time for all parties affected by the transaction. Managers *add value* by considering these impacts when *negotiating* the most advantageous arrangement, thereby *transforming* the tax treatment of items to the most favourable status. (Karayan et al., 2002, xvi)

Similar considerations are applied to other spheres of regulation, and specialised teams handle the regulatory costs in these spheres. Business planners are given two complementary set of tasks. They tasked with constructing a functioning 'business concern' out of the available legal and accounting tools. They are also tasked with optimising the regulatory environment to extract value. These planning units are explicitly tasked, therefore, with avoiding financial, legal, compliance and political risks and complications associated with operating across borders and also with finding ways to minimise or avoid regulatory costs. They can, and often do, take advantage of the elephant in the room scenario to support their client's goals.

It can be argued, therefore, that just as companies are adopting the principles of lean production, eliminating waste defined as anything that does not add value for the customer (Chen and Meng, 2010; Shah and Ward, 2007), so too this group of professionals is tasked with removing regulatory 'waste' from the organisation. The systems used to remove those regulatory 'excesses' are, by their nature, as we saw, spatial (as they are concerned with the issue of replication), contributing to the incredible spatial complexity of modern organisations (to play on the notion of 19<sup>th</sup> century physics).

The business planner's role is to optimise the organisation of the multinational firm and ensure they control, to the fullest extent possible, their environment, including the rules and regulations of transactions, and are not controlled by a regulatory environment created by states in a somewhat haphazard manner (as far the MNE is concerned). The business planner sets up organisations that, in effect, carve their own 'regulatory paths' through the cacophony

of rules, regulations and taxations produced by a market dissected among regulatory authorities. Like a tunnel-boring machine, the organisation constructs 'paths' through the different jurisdictions in which it operates, whilst at the same time, it draws 'lines' across those paths to shield itself from regulatory hazards along the way.

It seems to me that if we follow a business planner's we obtain a different perspective on MNEs. An MNE is, for the business planner, a machine, a *machine designed to make machines*. An EM is a diagram of these *machines designed to make machines*. These truncated state machine diagrams depict a system, that is, an input and output machine, without giving direct information about the purpose or ultimate strategy animating the machine.

### **CORPLINK's Empirical Research Agenda**

The CORPLINK project produced a theoretical argument on corporate complexity, the process of replication and the rise of the rule-based transgressor elite. By following the actions of the 'business planners', we developed a rich empirical research agenda centred on EM exercises. Instead of selecting some version of economic theory and applying it to the data, our approach has tended to follow the logic of the business planner with the aim of following inductively with generalizations about the impacts of such practices.

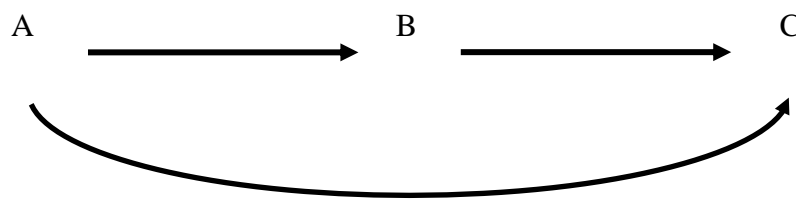
What are the business planner's tools of the trade? When devising an investment strategy, the business planner should first ask her/himself whether the investment should take the form of a branch. Alternatively, should the business set up a separate legal entity in a host country? If the latter model is chosen, and this tends to be the norm, then the next set of questions relates to the legal form the entity or entities should take in the host country. There is a menu of options, ranging from a limited liability incorporated subsidiary to a partnership, trust or any other form acceptable to the host country. Each legal form has important implications for a range of rules governing the investment.

The next step in planning involves lines of investment control. The parent can decide to control the chosen entity (or entities) in the host country through majority shareholding (>50.01% share). In that case, the entity is described as a 'subsidiary.' Or the parent may opt for either minority holding or co-ownership with, say, a domestic distributor; the first arrangement is typically called an 'affiliate.' Finally, the parent may prefer to set up a joint-venture with another or other groups. Each arrangement will be subject to different regulatory

requirements for both parent and subsidiary. For instance, affiliates' profits or expenses may not be included in consolidated accounts and may not appear on the group's accounts for other regulatory purposes.

Next, planners consider the spatial organisation of the investment. They may opt for a direct holding scenario (Figure 4), in which subsidiary C is controlled by parent A. They may opt for an indirect holding scenario, where parent A controls intermediary B, which controls, in turn, subsidiary C and so on.

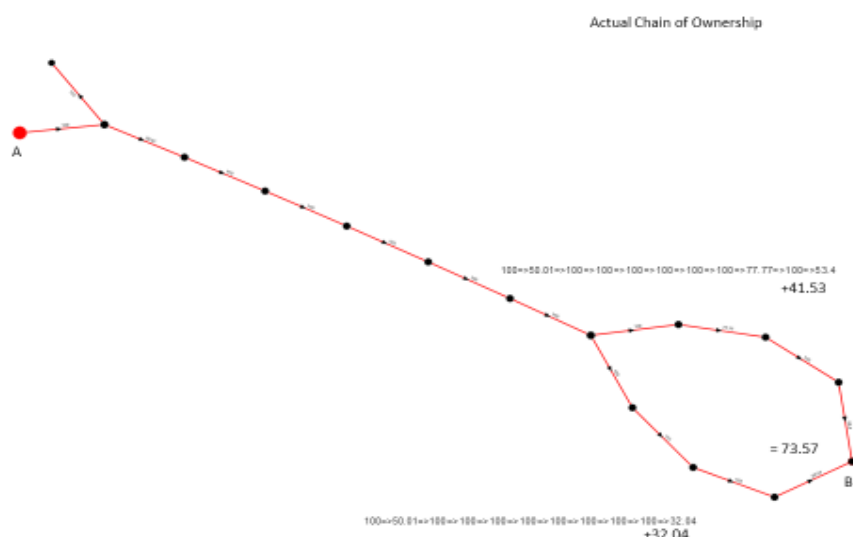
*Figure 4. Direct and Indirect Ownership Pattern*



Now, the use of an indirect holding may be down to what Lewellen and Robinson call the pure historical accident scenario. A company sets up an investment in country B; the investment is successful, and subsidiary B then invests in subsidiary C. Whatever the reason for such a structure, indirect control through an intermediary will have profound implications for the set of rules applied to the investment. Whereas in a direct holding scenario, the investment is subject to the rules of home and host country and bilateral and multilateral rules between the two countries, in an indirect holding scenario, the investment is subject to two sets of these triple rules: between countries A and B and between countries B and C. On the one hand, the establishment of an intermediary in a third country adds complications and creates issues of compliance for the parent (and hence adds to the cost of the investment). This would lead us to expect limited use of such intermediating holding companies. On the other hand, the intermediary located in a carefully selected country may introduce a new pathway through the maze of rules, regulations and taxation and may end up less onerous or otherwise produce some other preferred regulatory conditions for the parent. For instance, Omri Marian of the famous LuxLeaks demonstrated how the introduction of a Luxembourgish intermediate subsidiary was used to change rules of profit repatriation in ways that reduced tax to the bare minimum (Marian, 2013).

Considerable evidence suggests the strategy of using intermediary subsidiaries is far more common than direct holding (Phillips, et al., 2020). Management can opt to set up a series of intermediary companies, creating a ‘chain’ of intermediate holding companies (Figure 5). The parent may also opt to split ownership of investment by creating two or more separate chains, as in Figure 5; each side of a chain may hold less than 50.01% of the investment (and could be mistaken for an affiliate subject to a different set of rules of disclosure and accounting). We call these ‘splitters.’ Such splitters may be a pure historical accident scenario, as two branches of the same group may opt, for instance, to cost-share in certain technology. A splitter can be used, in turn, to arbitrage countries’ rules of ownership (some countries do not allow majority held foreign investment) in what we call a ‘fused’ liability structure.

*Figure 5. Schematic Representation of a Splitter Ownership Structure*



As we continued to follow the logic of a business planner in our project, a common typology of corporate organisations began to emerge. MNEs tend to be held by a controlling entity, a global ultimate owner (GUO). Through shareholders, the GUO controls intermediary corporate entities; in turn, these entities controlled by the parent control other entities in the group. Alternatively, the GUO controls a chain of intermediaries, some of whom may be organised as splitters. Finally, some entities control no other entities in the group; these are ‘end of chain’ entities or ‘standalones.’ A considerable amount of circumstantial evidence



suggests end of chain entities are ‘operational’ subsidiaries, whereas intermediaries, whether in simple, chain or splitter form inevitably have an element of arbitrage (Palan et al., 2021; Phillips, et al., 2020). They are the main drivers of organisational complexity as witnessed in corporate EMs.

The focus of our empirical research was and still is on the intermediaries, an area of corporate organisation that has hitherto attracted little attention. Broadly stated, our assumption (and conclusion so far) is that a high proportion of intermediaries in a group or a high proportion of revenues located under the control of intermediaries is indicative of the intensity of arbitrage. This is obviously a large research agenda, and five years into the project, we have barely scratched the surface.

### **Arbitrage, Complexity and Power**

In *The Law Market*, Ribstein and O’Hara talk about the way corporations can ‘organize under the law of any state regardless of where they are physically located (O’Hara and Ribstein, 2009, 107). Now, anyone who can achieve a degree of control over the environment in which s/he operates, either by evading or avoiding some or all of the constraining ‘rules of the game in a society’ (North, 1994) or by selecting the kind of institutional environment and the rules that apply to him/her is in possession of a very powerful weapon. For controlling one’s environment and/or achieving a degree of autonomy from the will of others is the definition of power. In that sense, arbitrage techniques are exercises of power, arbitrage power – a power tool that is materially visible in the branch organisation of the corporate structure, pervasive and yet poorly understood. It is poorly understood because it operates in a no-man’s land avoided by economics and politics alike.

We should be clear that multinationals can, and often do, use different sources of power to reduce regulatory burdens or improve their competitiveness. Arbitrage power, however, does not work through any of the recognised channels in political science. Arbitrage power is not relational power; there is no A that makes B do what B would not do otherwise. How multinationals use their financial or technical knowledge to control political and societal agendas is well documented; they can ‘advise’ governments on a course of action, including regulations, and by so doing, control the regulatory agenda, at least to a degree. Sometimes multinationals use their financial power to control an entire governmental apparatus. Arbitrage power, however, is not a form of power associated with either setting up

or controlling the agenda of discussion, nor is it incompatible with the use of such techniques of power. Arbitrage power is not even structural power, for instance, as this notion was articulated by Susan Strange. It is not a power 'gained' through location within a network.

The question, then, is whether arbitrage is power at all. Arbitraging has many of the outward trappings we associate with the concept of social power. It is power because, as we came to realise, for the modern, sophisticated multinational such as Apple or Amazon, the payment of corporate taxation or other taxations, such as stamp duty or capital gains tax, has become a discretionary act. This is not to say multinationals are not paying tax at all, or that all or most of them opt for arbitrage to obtain zero taxation. There are good reasons for MNEs not to reduce taxation to an absolute minimum (Eicke, 2009). The point is that arbitraging allows them the option of not paying tax. Some MNEs are more concerned with liability issues, seeking to ensure misdeeds or failed investments either will not affect the financial health of the group or will protect management from assuming the burden of personal liability for misdeeds. Arbitrage has all the trappings of power because it is optional and discretionary; it provides organisations with the tools to mould the environment in which they operate to better suit their wishes.

Last but not least, arbitrage is not only discretionary; it is also a selective form of power that is not available to all. In fact, most individuals and small businesses do not have the resources needed to arbitrage national rules and regulations. Only the biggest, most sophisticated organisations do. Nor do all employees of such organisations enjoy the fruits of arbitraging; this is limited to a select few.

### **Who Enjoys the Fruits of Arbitrage Power? The Rise of a Rule-Based Transgressor Elite**

So who benefits from the work of the 'business planner'? The answer is the controllers of those organisations, the higher echelon of management and principal shareholders. The common denominator among the wealthiest people in the world is not that they are 'capitalists' in the way Marxists understand the term, i.e., 'owners of means of production.' The privileged group does not necessarily contain the type of businesspersons about whom Veblen was speaking – experts in the art of buying and selling. These people are not necessarily the brightest; they have not distinguished themselves as the best technical or organisational brains of their generation. This group is not a modern version of Josephson's

‘robber barons’ (Josephson, 1962), cheating their way to wealth. There is certainly an ancillary powerful elite who make their money that way, often in ‘transition economies’. But the wealthiest economic elite is not composed, as a general rule, of tax evaders and money launderers. On the contrary, many members of this elite are vocal in their opposition to what they consider to be tax abuse, illicit money and the like.

The common denominator among members of the wealthiest and most powerful elite is large shareholdings in big, sprawling, arbitrating firms. This elite is, as far as we can tell, unique in human history. In common with other elites, it benefits from the institutions of society, the rules, norms and organisations that shape our lives. But this elite has learned to take advantage of the rules to shield itself from those very rules. It employs a technique of power, arbitrage power, to ensure the rules apply to it in one way, but apply to the rest of society in another. It is a rule-based transgressor elite, expert in compliance ‘with the letter of a law while violating its very spirit’ (Fleischer, 2010).

This elite has learned to take advantage, as Jean-Philippe Robé argues, of a powerful weapon hidden in plain sight: the artificial legal person. The artificial legal person, in its later manifestations is limited liability, a joint stock company protected by law and allowed to own shares in other companies (Robé, 2020). This group employs the legal facility of the artificial legal person, the corporate personality, as a vehicle, so that networks of entities operate in the business world as a unified ‘going concern.’ It uses the network of companies, the MNEs, who are confused for singular ‘actors’ in the business world, as a vehicle for enrichment and control. The internal layering of corporate control matches an ‘external’ layering of different realities or different perceptions of realities, legal, corporate and accounting, to create a confusing array of organisational structures that benefit some but not others. The secret to wealth and power in the modern world lies in this realm of what may appear on the surface as non-market economics, the world of ‘intra-firm transfers’, a mere statistical anomaly that arise in national trade statistics. Arbitrage is the elephant in the room, seen and yet unnoticed and unremarked, diffused through different prisms of law, economics, politics and sociology.

## **Conclusion**

Modern firms are not only multinational, multi-subsidary organisations; they are also layered organisations, structurally organised parents (or GUOs), branches and chains. Considering SAVANT, the likelihood that intermediaries in third countries evolve in a pure historical

accident scenario is remote. The danger of falling afoul of compliance and other rules is considerable. The idea that some organisational structural arrangements are ‘artificial’ whilst others are not can be ruled out as well: the MNE is a human artefact. It consists of artificial legal persons organised systematically into a business concern. The emulated internal market that operates through subsidiaries, as evident in our EM diagram, is a social machine (hence artificial) designed to make machines. These machines are organised so they can navigate the regulatory maze of a world economy dissected among diverging, often competing, regulatory authorities. They are machines designed to make machines in ways that suit their controllers. This makes them arbitrating machines.

The techniques of arbitrating are used primarily to shield organisations from unwanted regulations. These are techniques of power. These techniques are hidden in plain sight. They are obvious to anyone who is working in the business world, yet hidden from view because the way economics and political science were constituted in the late 19<sup>th</sup> century makes it very difficult to make sense of an economics or a politics in which buyers and sellers are the same person. Michel Foucault once remarked, ‘Power is tolerable only on condition that it masks a substantial part of itself. Its success is proportional to an ability to hide its own mechanisms’ (Foucault, 1976, 86). Jurisdictional arbitrage is a kind of power that benefits from an epistemological shield provided by mainstream economics and political science. The self-proclaimed ‘philosophical Dadaist’, Paul Feyerabend, argues, theories can also be exercises in collective myopia that ‘transcend, devalue, and push aside complex forms of thought and experience’ (Feyerabend, 1993). Paradoxically, arbitrating operates at a space left out by current theory. And if Foucault is correct, and ‘success is proportional to ability to hide’, then not only arbitrage power is a very successful strategy, but the shielding provided by mainstream theory (I include Marxism, or Ricardian economics, in this mainstream) is playing a role in maintaining this power structure. So much so that it gave rise to, shaped and, crucially, still protects the most important economic elite today – the rule-based transgressor elite.

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## Notes

<sup>1</sup> The report summarises the work that was conducted by the team at City on the CORPLINK project. The team consists of Ronen Palan, project leader; Richard Phillips, the originator of the EM approach and developer of much of CORPLINK’s empirical and theoretical research agenda; Jean-Phillipe Robé, the inspiration for much of the conceptual and empirical development of the project, Hannah Petersen, who worked closely with Richard Phillips to develop the EM approach, Anastasia Nesvetailova and later Photis Lysandrou helping us understand financial structures and arbitrage, Yuval Millo of Warwick Business School, not formally part of the project, but helping throughout with accounting knowledge and developing the concept of the corporate information footprint. The project also benefitted from research assistance provided by Andrei Sandu and Xinyi Wei, and editorial and proof reading assistance by Elisabeth Thompson. ‘Corporate Arbitrage and CPL Maps: Hidden Structures of Controls in the Global Economy’ (CORPLINK) is an ERC Advanced Grant, 694943, funded by the European Research Council. <https://cordis.europa.eu/project/id/694943>.

<sup>2</sup> Avraham et al. have little doubt, however, that the principal drivers of organisational complexity are ‘regulation (and regulatory arbitrage), tax management, and the determination of control rights and priority of claims in bankruptcy’ (Avraham et al., 2012, 74).

<sup>3</sup> Douglas Allen argues the ‘representative firm’ of economics is a ‘theoretical construct’ (Allen, 2005, 899). Neil Kay believes Penrose is highly influential and concludes ‘there was no irony or contradiction in the idea that in the theory of the firm, the firm was not a firm’ (Kay, 2000, 14).

<sup>4</sup> Strictly speaking, the buyer and seller may not be the same person. Subsidiaries are not always held 100% by the parent. Indeed, the definition of a subsidiary is a separate legal person controlled, directly or indirectly, at over 50.01% > by the group (and affiliates at less than 50.00%). This means other parties can own part of the ‘firm’ internally.

<sup>6</sup> A secondary literature in comparative politics drawing on what is known as the Tiebout predicate maintains states shunned by the Modigliani-Miller model firms will learn their lesson and respond by offering a better ‘menu’ of regulatory options (Boadway and Tremblay, 2012; Mendoza and Tesar, 2005; Tiebout, 1956). Hence, some academics argue international competition in taxation, and presumably in other rules as well, would yield superior bundles of regulatory environment (Rose and Spiegel, 2007).

<sup>7</sup> Orbis data are arguably the best available, yet their limitations are well known (Cobham et al., 2015; Cobham and Janský, 2018; Ribeiro, et al., 2010; TAXUD, 2018). The principal problem from our perspective was that the Orbis ownership data supply an Excel-like ‘data-dump’ for all shareholder information. Certain ambiguities with the data call for ‘cleaning’, something that, to the best of our knowledge, no other ‘mapping’ exercise has attempted to do.

<sup>8</sup> A financial ‘arbitrageur seeks to profit from a discrepancy in the price of the investment in two different markets by buying or producing the product in the market of lowest regulatory cost’ (Riles, 2013, 70).

<sup>9</sup> Whereas financial arbitrage is a purely economic phenomenon and hence can be described in the language of economic theory, jurisdictional arbitrage is a quintessentially political economic phenomenon and requires a different set of analytical categories.

<sup>10</sup> Although as Dewey explains, “‘artificial’ is not fictitious, i.e., that is, artificial is real, and not imaginary,’ once a corporation is created, it is real (Dewey, 1926, 655). There is considerable debate on the origins of this innovation, but the general consensus is that the modern corporation emerged ‘from a stew of medieval and early modern European business forms’ (Wright, 2013, 20).

<sup>11</sup> Individuals can be replaced but the legal person persists – and this, of course, is why individuals are prepared to invest in the development of the legal person for future gains. It also allows flexibility, as not everything must be decided in advance.

<sup>12</sup> A business association would hire an agent located in another country, and the agent would handle the association’s businesses in that country (Wilkins, 2005). Alternatively, businesses might set up a foreign branch in a separate country (in countries allowing these branches to be set up). The branch would then be considered part of the same business; hence, if a branch office were involved in a lawsuit or litigation of any kind, the liability extended to the parent organisation (Bondzi-Simpson, 1990).