2021

Regulatory Competition and State Capacity

Martin W. Sybblis
Emory University School of Law, msybbli@emory.edu

Recommended Citation
Martin W. Sybblis, *Regulatory Competition and State Capacity*, 13 WM. & MARY BUS. L. REV. 189 (2021).

REGULATORY COMPETITION AND STATE CAPACITY

MARTIN W. SYBBLIS*

ABSTRACT

This Article explores an underlying tension in the regulatory competition literature regarding why some jurisdictions are more attractive to firms than others. It pays special attention to offshore financial centers (OFCs). OFCs court the business of nonresidents, offer business friendly regulatory environments, and provide for minimal, if any, taxation on their customers. On the one extreme, OFCs are theorized as merely products of legislative capture—thereby lacking any meaningful agency of their own. On the other hand, OFCs are conceptualized as well-governed jurisdictions that attract investment because of the high quality of their laws and legal institutions—indicating some ability to manage legislative capture. This Article argues that the prevailing explanatory frameworks for OFC development and success overlook deeper institutional structures within these jurisdictions. Drawing on the political

* Assistant Professor of Law, Emory University School of Law. For their time, detailed comments and invaluable insights, I would like to thank Bart Bonikowski, Dorothy Brown, Jay Butler, Miguel A. Centeno, Guy-Uriel Charles, Henry A. Coleman, Kevin E. Davis, Dhammika Dharmapala, Elaine Enriquez, Trevor G. Gardner, G. Mitu Gulati, J. Benton Heath, Timothy Holbrook, Kristin Johnson, Hon. Ian Kawaley, Vikramaditya Khanna, Matthew B. Lawrence, Kay Levine, Bartlett Morgan, Jonathan Nash, Trang (Mae) Nguyen, Jide Okechuku Nzelibe, Raphael Pardo, Angela Robinson, Bertrall Ross, Joshua S. Sellers, Joanna Shephard, Kim Lane Scheppele, Langston Sibblies, Fred Smith, Wilbert W. Sybblis and Sheea Sybblis. I also thank the participants in the spring 2021 Identity, Politics, and the Law seminar at Duke Law School and the 2020 Culp Colloquium hosted virtually by Stanford Law School. I am grateful to Trevor Fortenberry, Rayja Fowler, Michael Kolvek, and Remya Menon for excellent research assistance. I am also grateful to the editors of the *William & Mary Business Law Review*. I thank them for their flexibility, commitment, and hard work throughout the publication process. I owe a special debt to my wife, Martha T. Kim, for her feedback, terrific sense of humor, and enduring support. I take full responsibility for all errors.

sociology literature on state development, this Article offers a new theoretical framework. It suggests that some OFCs may have experienced more success than others because of how they developed "state capacity"—i.e., their ability to formulate and implement specific kinds of policy choices skillfully and effectively. This Article makes two important contributions to the regulatory competition and OFC literatures. First, it places the institutional quality of jurisdictions at the center of the discourse and analysis of OFC achievements in the business law arena. Second, it introduces the interdisciplinary concept of "state capacity" into the growing scholarly debate concerning the rise of OFCs.

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INTRODUCTION

This Article explores an underlying tension regarding how the competition for corporate charters is conceived. The regulatory competition literature seeks to explain why some jurisdictions are more attractive to corporations and other business entities compared to others.[1] The prevailing scholarship argues that successful jurisdictions engage in a race to the bottom and are fueled primarily by legislative capture.[2] In this kind of race, jurisdictions compete with each other to provide corporate charters by enacting laws that benefit managers at the expense of shareholders.[3] Jurisdictions are able to do so because legislators are beholden to special interests.[4] Nowhere is this theoretical framework more prevalent than where it concerns the rise and competitiveness of offshore financial centers (OFCs).[5] These jurisdictions are generally defined as having: "(i) [a] primary orientation of business toward nonresidents; (ii) [a] favorable regulatory environment (low supervisory requirements and minimal information disclosure) and; (iii) low- or zero-taxation schemes."[6] Unlike the tax haven label, which is also attached to OFC jurisdictions, the "[OFC] concept avoids [the] exclusive focus on tax."[7]

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[1] *See* William Moon, *Delaware's New Competition*, 114 NW. U. L. REV. 1403, 1406 (2020) [hereinafter Moon, *Delaware's New Competition*]; Eric L. Talley, *Corporate Inversions and the Unbundling of Regulatory Competition*, 101 VA. L. REV. 1649, 1748–51 (2015).

[2] *See, e.g.*, William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 666 (1974); Moon, *Delaware's New Competition*, *supra* note 1, at 1413.

[3] Moon, *Delaware's New Competition*, *supra* note 1, at 1413.

[4] *Id.*

[5] According to William Moon:

> Legislative capture is a phenomenon especially vulnerable to the governments of small offshore jurisdictions looking to convert lawmaking authority into staple revenue streams. It is no secret that private parties work intimately with local legislatures in offshore financial havens.

William Moon, *Regulating Offshore Finance*, 72 VAND. L. REV. 1, 48–49 (2019) [hereinafter Moon, *Regulating Offshore Finance*].

[6] Ahmed Zorome, *Concept of Offshore Financial Centers: In Search of an Operational Definition* 3–4 (Int'l Monetary Fund Working Paper No. 07/87, 2007); *see also* Moon, *Regulating Offshore Finance*, *supra* note 5, at 48–49.

[7] CHRISTOPHER M. BRUNER, RE-IMAGINING OFFSHORE FINANCE: MARKET DOMINANT SMALL JURISDICTIONS IN A GLOBALIZING WORLD 23 (2016).

An important feature of OFCs is "a more general focus on cross-border services" and a significant "reliance on financial services for nonresidents."[8] According to some narratives, approximately 19 trillion dollars in wealth (personal and corporate) are said to be held in OFCs.[9] By other accounts, "about 10% of world [Gross Domestic Product (GDP)] is held in [OFCs] globally."[10] Further, some small jurisdiction OFCs "have become big players in cross-border financial services," siphoning immense capital away from powerful countries.[11]

OFCs have garnered special attention over the past two decades because of "concerns regarding money laundering and terrorism financing following the 9/11 attacks in 2001."[12] The Panama and Paradise papers debacles have also helped to draw attention to these secretive jurisdictions where the wealthy hide their money from their home tax authorities.[13] More recently, OFC jurisdictions have been identified as "corporate law havens" due to the growing number of companies using them as their place of incorporation.[14] But, despite their poor reputations, some scholars have argued that OFCs are well-governed and attribute their growth, in part, to the quality of their governance.[15] According

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[8] *Id.*

[9] *See* Jannick Damgaard et al., *Piercing the Veil*, 55 FINA. & DEV. 51, 52 (2018).

[10] Annette Alstadsaeter et al., *Who Owns the Wealth in Tax Havens? Macro Evidence and Implications for Global Inequality* 12 (Nat'l Bureau of Econ. Rsch. Working Paper No. 23805, 2017).

[11] BRUNER, *supra* note 7, at 3.

[12] *Id.*

[13] *See* Will Fitzgibbon & Michael Hudson, *Five Years Later, Panama Papers Still Having a Big Impac*t, INT'L CONSORTIUM OF INVESTIGATIVE JOURNALISTS (Apr. 3, 2021), https://www.icij.org/investigations/panama-papers/five-years-later-panama-papers-still-having-a-big-impact/ [https://perma.cc/GC2Y-9DKN].

[14] Moon, *Delaware's New Competition*, *supra* note 1, at 1409 (arguing that OFCs tend to offer more favorable regulatory environments than the natural home jurisdiction for the companies).

[15] *See* Dhammika Dharmapala & James Hines, *Which Countries Become Tax Havens?*, 93 J. PUB. ECON. 1058, 1058–59 (2009) [hereinafter Dharmapala & Hines, *Which Countries*]; ANNA MANASCO DIONNE & JONATHAN R. MACEY, *Offshore Finance and Onshore Markets: Racing to the Bottom, or Moving Toward Efficient*, *in* OFFSHORE FINANCIAL CENTERS AND REGULATORY COMPETITION 26 (Andrew P. Morriss ed., 2010); Andrew P. Morriss & Clifford C. Henson, *Regulatory Effectiveness of Offshore Financial Centers*, 53 VA. J. INT'L L. 417, 425 (2013).

to this view, it is feasible that well-governed countries choose to become OFCs because they are more likely to see greater returns—i.e., "higher foreign investment flows, and economic benefits that accompany them."[16] Consistent with the attention to "good governance" is the argument that OFCs provide a crucial service by "promoting the development of innovative regulatory regimes that offer improved asset and risk management and financial planning."[17] This good governance perspective seems to undermine the thrust of the legislative capture narrative and suggests an apparent contradiction in the literature.[18]

There appears to be two divergent perspectives. On the one hand, OFCs are merely products of legislative capture, thereby lacking any meaningful agency of their own.[19] On the other hand, OFCs are well-governed jurisdictions that attract investment because of the high quality of their laws and legal institutions, indicating some ability to manage legislative capture.[20]

This Article seeks to reconcile these two positions. This Article argues that the legislative capture and good governance explanations for OFC competitiveness overlook deeper sociohistories and institutional structures that influence how well some jurisdictions are able to compete for corporate charters.[21] This is a critical omission with immense significance for economic development in non-OFC jurisdictions. If OFCs have special institutional backgrounds, their developmental trajectories may provide an invaluable roadmap for how institutions, especially those that are legal in nature, can be utilized for economic growth purposes.[22]

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[16] Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1059 ("American evidence is consistent with this explanation, in that tax rate differences among well-governed countries are associated with much larger differences in U.S. investment levels than are tax rate differences among poorly governed countries.").

[17] DIONNE & MACEY, *supra* note 15, at 7.

[18] *Id*.

[19] Moon, *Delaware's New Competition*, *supra* note 1, at 1411 ("[L]awmakers in these jurisdictions are 'captured' by foreign corporations by being heavily reliant on annual incorporation fees for government revenue.").

[20] Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1059 ("suggest[ing] that governance quality is an important, and hitherto largely neglected, factor affecting the tax elasticity of foreign investment"); DIONNE & MACEY, *supra* note 15, at 9 ("[O]ffshore regimes guard against excessive regulatory burdens and support innovation in financial products and services and flexible regulatory regimes.").

[21] *See infra* Section I.B.3.

[22] *See infra* Section III.B.

Drawing on the political sociology literature concerning state development, this Article argues that some OFCs may be more successful than others due to how they developed "state capacity"—i.e., their ability to formulate and implement policy choices, as well as enforce legal rules skillfully and effectively in a chosen arena or economic sector.[23] Consider Delaware's legendary success in the area of corporate law.[24] Commentators agree that much of Delaware's gains in attracting firms for incorporation is a direct result of the expertise honed and embodied in the corporate law bar and the Delaware Court of Chancery, the state's specialized business court.[25]

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[23] *See* BRUNER, *supra* note 7; *infra* Parts II, III (discussing successful and failed OFCs, which Bruner refers to as Market-Dominant Small Jurisdictions ("MDSJs")); *see also* FRANCIS FUKUYAMA, STATE BUILDING: GOVERNANCE AND WORLD ORDER IN THE TWENTY-FIRST CENTURY 7 (2004) (defining state capacity as "the ability of states to plan and execute policies and to enforce laws cleanly and transparently").

Scholars have long studied the types of capabilities that make jurisdictions successful in economic development. *See* Kevin E. Davis & Michael Trebilcock, *The Relationship Between Law and Development: Optimists Versus Skeptics*, 56 AM. J. COMP. L. 895, 902–05 (2008). While economists, political scientists, and sociologists have been at the forefront of this research agenda, with the notable exception of law and development scholars, legal scholars have largely taken a backseat. *See, e.g.*, DARON ACEMOGLU & JAMES A. ROBINSON, WHY NATIONS FAIL 4 (2012); DANI RODRIK, ONE ECONOMICS, MANY RECIPES: GLOBALIZATION, INSTITUTIONS, AND ECONOMIC GROWTH 6 (2007); ATUL KOHLI, STATE DIRECTED DEVELOPMENT: POLITICAL POWER AND INDUSTRIALIZATION IN THE GLOBAL PERIPHERY 1 (2004) [hereinafter KOHLI, STATE DIRECTED DEVELOPMENT]; DIANE DAVIS, DISCIPLINE AND DEVELOPMENT: MIDDLE CLASSES AND PROSPERITY IN EAST ASIA AND LATIN AMERICA 5 (2004); *see also* Davis & Trebilcock, *supra*, at 902–05; David M. Trubek, *Law and Development: 40 Years After 'Scholars in Self Estrangement'*, 66 U. TORONTO L.J. 301, 329 (2016). Consequently, the more conspicuous examples of effective states in the area of economic development have tended to come outside of commercial and corporate law arenas with special emphasis on issues of democracy, poverty, education, healthcare, and the like. *See* Davis & Trebilcock, *supra*, at 902–05.

[24] *See, e.g.*, Roberto Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. ORG. 225, 226 (1985); Marcel Kahan, *The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection?*, 22 J.L. ECON. & ORG. 340, 344 (2006).

[25] *See* Moon, *Delaware's New Competition*, *supra* note 1, at 1437. *But see* Sarath Sanga, *The Origins of the Market for Corporate Law* 20 (March 3, 2020), http://dx.doi.org/10.2139/ssrn.3503628 [https://perma.cc/C48G-NF2Z] (suggesting

The Court of Chancery offers distinct advantages to corporations including, but not limited to, judges with expertise in corporate law and a well-developed body of judicial opinions.[26] These features are a crucial part of the "network benefits [that emanate] from [its] longstanding status as the leading incorporation jurisdiction," and its demonstrated commitment to corporate law.[27] These attributes required time and a confluence of social, economic and political experiences to develop.[28] Delaware's Court of Chancery draws on 220 plus years of rich institutional history.[29] This history suggests that *how* an institution develops could be relevant to its long-term success.[30]

OFCs that effectively compete with Delaware for corporate charters[31] may also be the products of a specific kind of institutional history.[32] While OFCs rely on input from transnational lawyers, accountants, and bankers, their capabilities may also emanate from other sources, including colonial histories that encouraged a sustained engagement with the rule of law.[33]

This Article seeks to promote a well-needed and long overdue assessment of the OFC enterprise from the ground up—i.e.,

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that "the market for corporate charters emerged as a collateral consequence of interstate commerce").

[26] Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 708–15 (2002) (discussing the impact of the Court of Chancery on Delaware's attractiveness to corporations).

[27] Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1910 (1998).

[28] *See, e.g.*, Kahan & Kamar, *supra* note 26, at 708.

[29] *See* William T. Quillen & Michael Hanrahan, *A Short History of the Delaware Court of Chancery—1792–1992*, 18 DEL. J. CORP. L. 819, 819–20 (1993).

[30] *See* David Nelken, *Towards a Sociology of Legal Adaptation*, *in* ADAPTING LEGAL CULTURES 21 (David Nelken & Johannes Feest eds., 2001).

[31] *See, e.g.*, Moon, *Delaware's New Competition*, *supra* note 1, at 1437; Lucian Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?* 2 (Nat'l Bureau of Econ. Rsch. Working Paper No. 9380, 2002).

[32] *See, e.g.*, Yon-Shik Lee, *General Theory of Law and Development*, 50 CORNELL INT'L L.J. 415, 436–46 (2019) (discussing the importance of regulatory design to law and development theory).

[33] *See infra* Parts III, IV; *see also* ORLANDO PATTERSON, THE CONFOUNDING ISLAND: JAMAICA AND THE POSTCOLONIAL PREDICAMENT 94–96 (2019); Ronald J. Daniels et al., *The Legacy of Empire: The Common Law Inheritance and Commitments to Legality in Former British Colonies*, 59 AM. J. COMP. L. 111, 127 (2011).

from the perspective of OFCs, as opposed to non-OFC (onshore) jurisdictions. It specifically contemplates *institution building* for purposes of economic growth from a law and sociology perspective.[34] Sociologists understand institutions to be more than the "rules of the game." This is the definition often used by some economists and legal scholars.[35] Instead, sociologists conceive of institutions as far more complex.[36] For example, according to historical sociologist Orlando Patterson:

> Institutions are durable structures of knowledge that define the rules and expectations of recurrent behavior. They range from weakly sanctioned, intermittent interactions (such as ritualized greetings) to formally sanctioned, continuous networks of rules, roles, and activities designed to achieve specific goals, such as organizations. Nearly all institutions involve formal and informal norms and are efficient to the degree that the two are smoothly coupled. An important aspect of institutions is institutional strength. Formal institutional rules may or may not be enforced and, instead of stably taking root, are often contested, violated, and changed.[37]

While scholars of development have long celebrated state leadership and high-quality institutions—including legal institutions—as crucial for late economic growth, few legal scholars have attempted to analyze the social conditions that led to the effectiveness of those states that became successful.[38] For the first time, this Article brings in the political sociology literature on bureaucratic quality to help make sense of the legal scholarship on the regulatory competitiveness of OFCs.[39] To date, these literatures have developed independently and persist in intellectual

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[34] *See infra* Part IV.

[35] DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 4 (1990); *see* Chantal Thomas, *Law and Neoclassical Economic Development: Toward an Institutionalist Critique of Institutionalism*, 96 CORNELL L. REV. 967, 1018–23 (2011) [hereinafter Thomas, *Institutions*]. Similarly, legal scholars have long considered law relevant for national development but have paid insufficient attention to the embeddedness of law in society and how this impacts development outcomes. *See* Davis & Trebilcock, *supra* note 23, at 905.

[36] *See* PATTERSON, *supra* note 33, at 23–24.

[37] *See id.*

[38] *See* Thomas, *Institutions*, *supra* note 35, at 1018–23.

[39] *See infra* Part IV.

silos.[40] By connecting the theoretical insights from both, this Article sheds light on how scholars and policymakers may be able to learn from the experience of a group of what may be considered developmental jurisdictions: those capable of strategically intervening in the economy to promote economic growth.[41]

This Article suggests that a jurisdiction's well-honed capabilities in a particular domain[42]—i.e., "state capacity"—provides a

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[40] *See, e.g.*, KENNETH W. DAM, THE LAW-GROWTH NEXUS: THE RULE OF LAW AND ECONOMIC DEVELOPMENT 3–6 (2006); Davis & Trebilcock, *supra* note 23, at 905. In legal scholarship, more emphasis has been placed on institutional quality, with distinctions made between formal and informal norms, as well as between the enforcement and under-enforcement of rules. *See, e.g.*, DAM, *supra*, at 17–23. With respect to the norms literature, scholars have suggested that social norms may replace formal law in some circumstances and be just, if not more, effective. *See, e.g.*, ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES i (1991); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J.L. STUD. 115, 115 (1992); Cass R. Sunstein, *Social Norms and Social Roles*, 96 COLUM. L. REV. 903, 907 (1996); *see also* Bryan H. Druzin, *Social Norms as a Substitute for Law*, 79 ALBANY L. REV. 67, 67 (2016). Regarding the matter of enforcement, scholars suggest that the efficacy of law is directly tied to how well it is enforced. DAM, *supra*, at 93. For example, Kenneth Dam argues that "no degree of improvement in substantive law—even world 'best practice' substantive law—will bring the rule of law to a country that does not have effective enforcement." *Id*. The prevailing assumption appears to be that the right type of rules (formal or informal and accounting for social context) combined with adequate enforcement will achieve the desired policy goals. *See, e.g.*, Kevin E. Davis, *Legal Universalism: Persistent Objections*, 60 U. TORONTO L.J. 537, 552 (2010).

[41] *See infra* Section III.B; David M. Trubek, *The Political Economy of the Rule of Law: The Challenge of the New Developmental State*, 1 HAGUE J. RULE L. 28, 31 (2009).

[42] As discussed in Part II, jurisdictions may have strengths in particular economic sectors or domains. For example, in the public health arena consider the various responses to the COVID-19 pandemic across developed and developing countries. *See* Ryan Heath & Beatrice Jin, *Ranking the Global Impact of the Coronavirus Pandemic, Country by Country*, POLITICO (May 21, 2020), https://www.politico.com/interactives/2020/ranking-countries-coronavirus-impact/ [https://perma.cc/M6AS-XHRE]; Ian Bremmer, *The Best Global Response to Covid-19 Pandemic*, TIME (June 12, 2020), https://time.com/5851633/best-global-responses-covid-19/ [https://perma.cc/C9CY-FZGP]; Roosa Tikkanen et al., *The 2020 International Profiles of Health Care Systems: A Useful Resource for Interpreting Country Responses to the COVID-19 Pandemic*, THE COMMONWEALTH FUND, https://www.commonwealthfund.org/blog/2020/2020-international-profiles-useful-resource-interpreting-responses-covid-19 [https://perma.cc/MT54-NNFV].

framework for conceptualizing regulatory competitiveness.[43] OFCs have primarily been framed and analyzed in the context of international tax and corporate law.[44] This Article takes a different track by engaging in an institutional analysis of OFCs. This raises the stakes in the OFC debate by focusing on the quality of institutional learning in a jurisdiction as one key variable for predicting its competitiveness for corporate charters, as well as

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While it is still too early to determine the long-term effectiveness of state responses to COVID-19, commentators made some early observations. *See* Heath & Jin, *supra*. According to The Atlantic magazine, Bhutan—one of the least developed countries with a per capita GDP of $3,412—has been "the unlikeliest pandemic success story." Madeline Drexler, *The Unlikeliest Pandemic Success Story: How Did a Tiny, Poor Nation Manage to Suffer Only One Death from the Coronavirus*, THE ATLANTIC (Feb. 10, 2021), https://www.theatlantic.com/international/archive/2021/02/coronavirus-pandemic-bhutan/617976/ [https://perma.cc/NPM7-HA8C]. As of January 2021—a little over a year after COVID-19 ravaged complex health systems and devastated wealthy economies—Bhutan had only one COVID-19 related death compared to almost 400,000 in the United States in about the same time frame. *Id*.; Ralph Ellis et al., *US Approaches 400,000 Coronavirus Deaths*, CNN (Jan. 19, 2021), https://www.cnn.com/2021/01/18/health/us-coronavirus-monday/index.html [https://perma.cc/2QG9-DRBG].

Perhaps what is most remarkable about this nation of 760,000 people is that it has approximately 337 doctors, "less than half the World Health Organization's recommended ratio of doctors to people—and only one of these physicians had advanced training in critical care." Drexler, *supra*. To many, every indication was that countries like Bhutan with an inadequate health infrastructure could not feasibly manage a pandemic. *Id*. Yet the government began preparing for the virus's onslaught in early January 2020, and by March had implemented effective screening, contact tracing, regular health updates, and the containment of public gatherings. *Id*. The country's leaders also "launched a relief fund that has so far handed out $19 million in assistance to more than 34,000 Bhutanese whose livelihoods have been hurt by the pandemic." *Id*.

Commentators note that Bhutan's response to COVID-19 was a product of leaders leaning on the country's other strengths, including "mutual trust," engaged leadership and good preparation in light of weaknesses, and the skillful coordination of existing resources. *Id*. In this regard, the small developing nation has important lessons for bigger and wealthier countries, namely how states can plan and execute policies to achieve complex goals that countries with more wealth and resources struggle to accomplish. *See, e.g.*, PETER BLAIR HENRY, TURNAROUND: THIRD WORLD LESSONS FOR FIRST WORLD GROWTH 135–50 (2013).

[43] *See, e.g.*, Miguel Centeno et al., *Unpacking States in the Developing World: Capacity, Performance, and Politics*, *in* STATES IN THE DEVELOPING WORLD 1–34 (Miguel Centeno et al. eds., 2017).

[44] *See* Moon, *Regulating Offshore Finance*, *supra* note 5, at 3.

economic growth more broadly. This approach provides invaluable insights into a broad range of national and subnational levels of government interested in coordinating business laws and various actors for purposes of enhancing economic activity.[45]

This Article makes two important contributions to the regulatory competition and OFC literatures. First, it places the institutional quality of states at the center of the discourse and analysis of jurisdictional achievements in the business law arena.[46] Second, it introduces the interdisciplinary concept of state capacity into the longstanding scholarly debate concerning the growing prominence of OFCs.[47]

The remainder of this Article is organized into four parts. Part I discusses the prevailing viewpoints in the regulatory competition literature.[48] Specifically, it suggests that prominent theories incorrectly relegate OFCs to passive jurisdictions that are rule-takers, as opposed to rule-makers. This view undervalues the agency of these jurisdictions and undertheorizes the role of well-honed capabilities in their economic development efforts.[49]

Part II draws attention to the developing literature on state capacity from political sociology.[50] This Part further suggests a need for legal scholars to keenly contemplate a role for the relationship between policy choices and bureaucratic competence in the regulatory competition arena.[51] Part III demonstrates the connection between policy choices and bureaucratic competence by way of an overview of the development of a set OFCs with similar colonial backgrounds and development trajectories.[52] This Part focuses on colonies with ties to Britain, given the strong

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[45] *See* PATTERSON, *supra* note 33, at 24; *see also* BRUNER, *supra* note 7, at 3–4; Kevin E. Davis, *Data and Decentralization: Measuring Performance of Legal Institutions in Multilevel Systems of Governance*, 102 MINN. L. REV. 1619, 1621 (2018) (discussing the need to measure "the performance of legal institutions—namely, institutions involved in promulgating and administering norms—within multilevel systems of governance").

[46] *See infra* Part I.

[47] *See infra* Part II.

[48] *See infra* Part I.

[49] *See infra* Part I.

[50] *See infra* Part II.

[51] *See infra* Part II.

[52] *See infra* Part III.

historical connection between the United Kingdom and several prominent OFCs.[53]

Part IV analyzes the cases of Barbados, The Cayman Islands (Cayman) and Jamaica—British colonies and territories in the Caribbean—through the state capacity-institutional learning framework.[54] These islands represent a prominent OFC, a reasonably well-developed OFC, and a non-OFC, respectively.[55] This Part suggests that differences in institutional learning during the colonial period may explain why some OFCs have become more successful than others, and why a subset of OFCs are capable of competing with Delaware when it comes to corporate law.[56]

I. THE COMPETITION FOR CORPORATE CHARTERS

This Part suggests that the prevailing discourse about the race for corporate charters (e.g., race to the top, race to the middle, and race to the bottom) rest on at least four interrelated theories: network externalities, public choice, institutional isomorphism, and governance. Section A highlights the scholarly discourse about how OFCs have become competitors of Delaware in the race for corporate charters.[57] Section B then unpacks the theoretical frameworks that currently explain OFC competition with Delaware and highlight their respective weaknesses.[58]

A. Competing with Delaware

The State of Delaware is often the central actor in the regulatory competition literature regarding corporate charters.[59] This literature theorizes how states attract firms to use their jurisdiction for incorporation.[60] Scholars generally agree that

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[53] *See, e.g.*, RONEN PALAN ET AL., TAX HAVENS: HOW GLOBALIZATION REALLY WORKS 124–49 (2010).

[54] *See infra* Part IV.

[55] *See infra* Part IV.

[56] *See infra* Part IV.

[57] *See infra* Section I.A.

[58] *See infra* Section I.B.

[59] *See* Kahan & Kamar, *supra* note 26, at 724.

[60] *See* Romano, *supra* note 24, at 226; Moon, *Delaware's New Competition*, *supra* note 1; Robert Anderson IV & Jeffrey Manns, *The Delaware Delusion*, 93 N.C. L. REV. 1049, 1104 (2015); William Magnuson, *The Race to the Middle*, 95 NOTRE DAME L. REV. 1183, 1183 (2020). It bears noting that scholars also

"Delaware's dominance of corporate law is indisputable, although the reasons for its appeal are strongly contested."[61] Some commentators have argued that the competition for corporate charters has produced a race to the top, whereby competition among states lead to rules that protect shareholders.[62] But the longstanding view by many commentators is that Delaware's perch in the area of corporate law is due to the production of predominantly manager-friendly rules.[63] This has been referred to as a race to the bottom and is generally considered harmful to shareholders.[64] In essence, the attempt to attract corporations to their states leads policy-makers to adopt lax regulation that insufficiently protects investors.[65] More recently, a new narrative proffers that states aim to

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discuss regulatory competition in other areas. *Id.* For example, there is a literature that addresses regulatory competition and environmental law. *See, e.g.*, Peter R. Swire, *The Race to Laxity and the Race to Undesirability: Explaining Failures in Competition Among Jurisdictions in Environmental Law*, 14 YALE L. & POL'Y REV. 67, 68 (1996); *see also* DAVID VOGEL, TRADING UP: CONSUMER AND ENVIRONMENTAL REGULATION IN A GLOBAL ECONOMY 259 (1995).

[61] Anderson & Manns, *supra* note 60, at 1104.

[62] *See, e.g.*, VOGEL, *supra* note 60, at 259; *see also* Ralph K. Winter, *The 'Race for the Top' Revisited: A Comment on Eisenberg*, 89 COLUM. L. REV. 1526, 1526–29 (1989); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J.L. STUD. 251, 257 (1977); Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210, 1211–12 (1992).

[63] *See, e.g.*, Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1488 (1992).

[64] Corporate law scholar William Magnuson artfully explains:

> [S]tate legislatures desire to attract corporations to their jurisdictions in order to increase tax revenues, create jobs, and generally improve their economies. But in order to appeal to the corporations and corporate executives that make decisions about where to locate business, states must adopt regulations that are *more permissive* than the regulations in force in other states. As each state adopts progressively looser regulations in order to outdo their neighbors, the resulting degradation of standards leads to suboptimal levels of regulation, whether it be in shareholder protections, labor laws, tax levels, or environmental standards.

Magnuson, *supra* note 60, at 1185.

[65] *Id.* It bears noting that Delaware's development as a leader in corporate law has also been linked to a few notable institutional and socio-historical factors. Quillen & Hanrahan, *supra* note 29, at 825–26. For example, as it pertains Delaware's well-known specialized business courts, corporate law

avoid extremes (race to the top or race to the bottom)[66] when competing with each other in the corporate charter arena.[67] Instead, states aim to copy each other for efficiency reasons and resist too much difference—in part to avoid the attention of federal regulators.[68] It bears acknowledging that some scholars see

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experts William Quillen and Michael Hanrahan suggest Delaware's lack of an institutionalized court of Chancery, tied to the Crown, during the colonial period—which was present in other colonies—prevented the development of "long lasting prejudices against equity and chancery courts." *Id.* Further, a set of "highly qualified nineteenth century chancellors in [the] small conservative state not bothered by urban or agrarian radicalism developed principles and procedures, and practice that enabled the Court to evolve into a form nationally recognized for resolution of corporate disputes." *Id.* at 831. Additionally, social and physical context mattered in at least two ways. First, "[t]he egalitarian movement of the 1840s and 1850s never gained momentum in Delaware where there was strong conservative influence from mercantile interests." *Id.* at 832. Second, "Delaware's small size enabled equity to be efficiently administered in a single, centralized chancery court, unlike large states where it was more practical to administer equity in county courts." *Id.*

[66] This Article addresses the race to the bottom theory in sentences that follow. *See infra* notes 67–70 and accompanying text.

[67] *See* Magnuson, *supra* note 60, at 1186.

[68] *Id.* Competition between states therefore does not lead to divergence in rules as much as it leads to convergence. *Id.* According to William Magnuson: "This dynamic, which may usefully be called the '[race to the middle],' pushes states toward regulatory schemes that are similar or identical to the schemes adopted by sufficiently large numbers of other states. The [race to the middle] encourages states to focus on harmonizing, not differentiating, their regulatory structures." *Id.* But there is a well-developed argument from neo-institutional theory that convergence in this regard isn't for purposes of efficiency but helps to bolster the legitimacy of competitors. *See* Paul J. DiMaggio & Walter W. Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48 AM. SOCIO. REV. 147, 147–48 (1983).

The race to the middle theory has several component parts. First, organizations, including states, find it inefficient to reinvent the wheel. *See* Magnuson, *supra* note 60, at 1186–87. If a rule in another state works well, states are inclined to follow that model. *Id.* Second, network effects are important. *See infra* Section II.B. If the pre-existing rule has a strong following among firms, lawyers, and other actors; it is worthwhile to adopt that rule to lower learning and other costs. Magnuson, *supra* note 60, at 1186. Third, an interest in similarity allows for harmonization of rules among states, which can facilitate cross-border transactions. *Id.* Finally, as indicated earlier, states are encouraged to pursue similar rules to avoid standing out to federal policymakers. *Id.* Difference could prove problematic if it signals to the federal government that some rule or practice may need to be tamped down or curbed in some significant way. *Id.*; *see also* Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 591, 597 (2003).

no significant race for corporate charters because Delaware already has such a commanding[69] lead on would-be state competitors.[70]

The shared assumption among theories that articulate a race for corporate charters has largely been that the competitors are predominantly within the United States—whether states or the federal government.[71] For example, legal scholar William Moon has noted that "[t]here is virtually no literature on whether and to what extent foreign nations compete with American states to supply corporate law."[72] But interest has grown in this area. A small group of scholars and commentators, including Moon, have begun to discuss the prospect of OFCs as active competitors for corporate charters.[73] Importantly, the contemporary

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[69] One could equate Delaware's lead over competitors to that of world class sprinter Usain Bolt over rivals. *See* Doug Mills, *100? 200? Doesn't Matter. They Still Can't Catch Usain Bolt*, N.Y. TIMES (Aug. 18, 2016), https://www.nytimes.com/2016/08/19/sports/olympics/usain-bolt-200-meters-results.html [https://perma.cc/A6JF-Y7DY].

[70] *See, e.g.*, Kahan & Kamar, *supra* note 26, at 684–85. In this vein, it cannot be discounted that variables such as state politics and professional talent—among lawyers and accountants in particular—have contributed to Delaware's enduring preeminence. *Id.* at 694. With the aid of empirical data, Robert Anderson IV and Jeffrey Manns have argued that Delaware's continued prominence is tied to the risk aversion of lawyers and Delaware's past reputation. Anderson & Manns, *supra* note 60, at 1090.

[71] *See* Robert Anderson IV, *The Delaware Trap: An Empirical Analysis of Incorporation Decisions*, 91 S. CAL. L. REV. 657, 659 (2018). This is unsurprising because the scholarship on jurisdictional competition has predominantly focused on the competition between American states. *Id.* Perhaps this domestic focus led to an assumption about a minimum quality of institutions throughout the country. *See* James E. Alt & David D. Lassen, *Political and Judicial Checks on Corruption: Evidence from American State Governments*, 20 ECON. & POL. 33, 56 (2008) (finding that "divided government in American states is associated with lower corruption"). Consequently, discussing the capabilities of states where it concerns the passage and implementation of legislation impacting corporate charters may be seen as unnecessary. *See* Roe, *supra* note 68, at 591–92; Romano, *supra* note 24, at 225; Kahan & Kamar, *supra* note 26, at 681; Kahan, *supra* note 24, at 340; Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1909–11 (1998).

[72] Moon, *Delaware's New Competition*, *supra* note 1, at 1407.

[73] *See* BRUNER, *supra* note 7, at 3; Moon, *Delaware's New Competition*, *supra* note 1, at 1406; DIONNE & MACEY, *supra* note 15, at 14. On the heels of the Panama Papers debacle, which revealed the financial holdings of prominent world figures in OFC jurisdictions, Christopher Bruner expertly "re-imagine[d] offshore finance" and showed how these jurisdictions "have become big players in cross-border financial services." BRUNER, *supra* note 7, at 3; *see also* Ian

arguments for the relative success of OFCs seem to fold neatly into those previously made about Delaware's potential race to the bottom approach,[74] including various related theories that underpin this perspective.[75]

Bremmer, *These 5 Facts Explain the Massive Political Fallout from the Panama Papers*, TIME (Apr. 6, 2016, 11:36 AM), https://time.com/4283587/these-5-facts-explain-the-massive-political-fallout-from-the-panama-papers/ [https://perma.cc/L2QU-SPVP]. According to Bruner, OFCs are not only attractive to financiers because of the tax benefits they offer to foreign corporations but OFCs are also viable alternatives to Delaware due to the regulatory environments they provide. BRUNER, *supra* note 7, at 10, 47. Anna Manasco Dionne and Jonathan R. Macey have long proffered that "the modern OFC tends to offer not only low taxation rates and company registry services, but also regulatory advantages and financial products competition." DIONNE & MACEY, *supra* note 15, at 14. Taking this argument further in a series of insightful articles, William Moon argues that OFCs are producers of corporate law and are growing rivals to Delaware. Moon, *Regulating Offshore Finance*, *supra* note 5, at 3–4; *see also* Moon, *Delaware's New Competition*, *supra* note 1, at 1406. Moon draws attention to OFCs as part of "an emerging international market for corporate law." Moon, *Delaware's New Competition*, *supra* note 1, at 1403. To support this argument, Moon notes that, of the growing number of American firms incorporated overseas, approximately a quarter are located in "the Cayman Islands ['Cayman'], Bermuda, and the British Virgin Islands ['BVI']." *Id.* at 1426. Consistent with Moon's assessment, political economy scholars posit that "[i]n some of their earliest forms, tax havens emerged as a reaction more to regulation than to taxation as such." Ronen Palan et al., *Tax Havens: How Globalization Really Works*, CORNELL STUDIES IN MONEY 109 (Eric Helleiner & Jonathan Kirshner eds., 2010).

[74] While scholars and commentators highlight the impact of influential professionals—primarily powerful lawyers and accountants—and the role of legislative capture by foreign firms as key explanations for how OFCs compete with each other, let alone Delaware or other "onshore" jurisdictions, a deeper analysis is required. *See, e.g.*, Moon, *Delaware's New Competition*, *supra* note 1, at 1426; NICHOLAS SHAXSON, TREASURE ISLANDS: UNCOVERING THE DAMAGE OF OFFSHORE BANKING AND TAX HAVENS 105–06 (2011); PALAN ET AL., *supra* note 53, at 140. These variables undoubtedly have a role to play in understanding the operations of OFCs, as they pertain to who has power in the OFC world and how that power is used. *See, e.g.*, STEVEN LUKES, POWER: A RADICAL VIEW 1 (2d ed. 2005) (discussing the dimensions of power). But they do not alone offer a comprehensive theory for why OFCs have become prominent in the competition for corporate charters. *See* Centeno et al., *supra* note 43, at 1. To this end, an OFC's capabilities—its "state capacity"—is sorely undertheorized in legal scholarship. *See id.* at 1, 7 (noting that Max Weber suggests "the state, and particularly the rule of law, is a façade covering the reality of relations of power").

[75] *See* BRUNER, *supra* note 7, at 10–11 (reflecting on the debate that MDSJs reflect a "race to the bottom"); *see also* Cary, *supra* note 2, at 666.

B. Theorizing Regulatory Competition for Corporate Charters

Subsumed in the legislative capture and good governance perspectives on regulatory competition are four interrelated theories that help to explain the corporate charter competition and, ultimately, the rise of OFCs. They are (1) network effects,[76] (2) public choice,[77] (3) institutional isomorphism,[78] and (4) governance.[79] While these theories provide important insights into the jurisdictional competition for firms, they are limited in their explanatory power.

1. Network Effects

Network effects are considered a main driver in industry development.[80] They allow some places to thrive more than others from specific types of economic activities.[81] According to this theory, "[c]ertain products become more valuable as their use, or the use of compatible products, becomes more widespread."[82] The legal scholarship that incorporates this approach examines the relationship between a critical mass of industry actors (e.g., professionals, experts, companies, etc.), the viability of an economic activity, and the choice of legal rules in a jurisdiction.[83] For example, scholars

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[76] *See* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 763, 763–64 (1995); Michael L. Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 AM. ECON. REV. 424, 424 (1985).

[77] William W. Bratton, *Delaware Law as Applied Public Choice Theory: Bill Cary and the Basic Course After Twenty-Five Years*, 34 GA. L. REV. 447, 452–53 (2000); *see* Moon, *Regulating Offshore Finance*, *supra* note 5, at 45–46; *see also* Moon, *Delaware's New Competition*, *supra* note 1, at 1434.

[78] DiMaggio & Powell, *supra* note 68, at 149–50.

[79] *See, e.g.*, Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1058–59; *see also* BRUNER, *supra* note 7, at 3–4; DIONNE & MACEY, *supra* note 15, at 10–11.

[80] Klausner, *supra* note 76, at 763.

[81] *Id.*; Katz & Shapiro, *supra* note 76, at 424.

[82] Klausner, *supra* note 76, at 772.

[83] *See, e.g.*, Anupam Chander, *How Law Made Silicon Valley*, 63 EMORY L.J. 639, 642 (2014); AnnaLee Saxenian, *Inside-Out: Regional Networks and Industrial Adaptation in Silicon Valley and Route 128*, 2 CITYSCAPE, 41, 41 (1996); *see also* Karen Bradshaw, *Stakeholder Dynamics in Development Projects*, 50 J. LEGAL STUD. (accepted following peer review; forthcoming 2021).

have suggested that popular legal provisions in documents—or legal rules more generally—can grow in importance, in part, because they have achieved a certain threshold of prior use.[84]

In the case of Delaware, Michael Klausner proposes that the importance of Delaware's corporate law:

> depends in part on interpretive network externalities and legal services externalities—the present value of future judicial decisions interpreting Delaware law and the net present value of legal services applying Delaware law. Consequently, as the number of firms incorporated in a state increases, the value of its charter increases.[85]

Given that Delaware has long established a sophisticated and well-known network of actors (e.g., laws, lawyers, courts, etc.)[86] to service the legal needs of firms, other states may find it difficult to overcome its first-mover advantage.[87] According to William

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[84] Michael Klausner uses contract language as a prime example:

> When the use of a contract term becomes widespread, its value may rise because of several phenomena. More judicial precedents can be expected, on average, to enhance the clarity of the term. Common business practices implementing the term may become established, further reducing uncertainty. Legal advice, opinion letters and related documentation will be more readily available, more timely, less costly, and more certain. Finally, firms may find it easier to market their securities.

Klausner, *supra* note 76, at 761.

[85] *Id.* at 843–44. Klausner suggests that:

> A state's charter is a large package of contract terms, which includes the state's substantive and procedural laws, the right to use the state's judiciary to resolve disputes, and access to its bar for legal advice and representation. Just as the value of a single corporate contract term may include network externalities, so too may the value of a particular state's charter. These network externalities parallel those associated with individual corporate contract terms.

Id. at 843.

[86] *See* Ron Levi & Mariana Valverde, *Studying Law by Association: Bruno Latour Goes to the Conseil d'État*, 33 L. & SOC. INQUIRY 805, 809 (2008) (discussing how various actors (humans and objects) are connected in the production of law).

[87] *See* Kahan & Kamar, *supra* note 26, at 725–26. But how do networks develop to the extent that they create positive externalities? The theory of agglomeration economies explains role for geography in the development of industries. *See, e.g.*, Paul Krugman, *Increasing Returns and Economic Geography*, 99 J. POL. ECON. 483, 483 (1991).

Bratton, "it is not Delaware's code but its personnel and their reliable customer service incentives that keep it ahead and deter market entry by a competing state. A potential competitor would have to create courts of experts as knowledgeable as Delaware's existing bench."[88] According to one view, "Delaware's appeal is driven by lawyers' default decision making based on Delaware's past preeminence and reflects lawyers' failure to assess the value added by Delaware compared to other states."[89]

Network effects are also present in OFCs.[90] Moon has identified the interaction between lawyers (e.g., the "offshore magic circle"[91] law firms), corporations, "specialized business courts," and "corporate governance rules" as one reason for the rise of an "international market for corporate law"—with OFCs being important service providers.[92] Arguably, much like Delaware,[93] the institutional environment created by the various actors involved in the OFC may serve to make some OFCs more attractive destinations for finance.[94] Investors may choose Jurisdiction A over

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[88] *See* Bratton, *supra* note 77, at 469–70; Klausner, *supra* note 76, at 845.

[89] Anderson & Manns, *supra* note 60, at 1052. The scholars note that "[l]awyers appear generally to follow a 'herd mentality' in which Delaware serves as both the clear default (that lawyers and/or clients assume adds value) and the 'safe choice,' which constitutes the path of least resistance and effort." *Id.* at 1088. In a subsequent article, Anderson further suggests there is "a clear relationship between the sophistication of a company's legal representation and the jurisdictional choice decision." Anderson, *supra* note 71, at 694 (noting that "more sophisticated lawyers choose Delaware incorporation for their clients[,] and less sophisticated lawyers choose local (home state) incorporation for their clients"). On the one hand, sophisticated firms are more inclined to encourage their clients to incorporate in Delaware. *Id.* at 710. On the other hand, less sophisticated firms (which are smaller in terms of geographic scope of their practice) are more likely to steer clients toward home state incorporation. *Id.* That said, some scholars suggest that the federal government may be Delaware's top competitor because the federal government also regulates corporations. *See* Roe, *supra* note 68, at 600.

[90] Moon, *Regulating Offshore Finance*, *supra* note 5, at 48.

[91] Moon, *Delaware's New Competition*, *supra* note 1, at 1434.

[92] *Id.* at 1403.

[93] Klausner, *supra* note 76, at 843–44.

[94] Brett McDonnell artfully explains:

> States which derive strong benefits from having many businesses incorporated there may become committed to keeping the law favorable to corporate decision makers. More corporate cases may lead to a more experienced and expert judiciary.

Jurisdiction B because of the network that exists in Jurisdiction A and prior familiarity with this network, not exclusively because of the quality of Jurisdiction A's laws.[95]

But while network effects can play a pivotal role in jurisdictions' attractiveness to firms, their explanatory power is limited without an in-depth, comparative historical explanation for why key networks developed in a particular location and not in others.[96] This type of explanation is particularly important in the case of small OFCs.[97] In these cases, one can find multiple island nations—similarly situated in geography and economic size—actively vying to be tax and corporate law havens.[98] How and why networks develop more robustly in some over others bears careful economic, social, and historical explanations.[99]

2. Public Choice Theory

Public choice theory provides another potential explanation—at least with respect to the race to the bottom perspective—for Delaware's success, as well as the success of some OFCs.[100] While admittedly broad and multifaceted,[101] the public choice literature neatly connects the role of legislative capture to industry growth.[102] Going a step further from network effects, scholars suggest that some special interests can effectively organize to

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> Corporate lawyers and service companies know more about the leading states than other states. All of these gains from having many corporations incorporated in a state, in turn, make that state more favorable to future new incorporations or reincorporations.

Brett H. McDonnell, *Getting Stuck Between Bottom and Top: State Competition for Corporate Charters in the Presence of Network Effects*, 31 HOFSTRA L. REV. 681, 685 (2003).

[95] *See* Anderson & Manns, *supra* note 60, at 1051–54.

[96] BRUNER, *supra* note 7, at 200–01.

[97] *Id.* at 192.

[98] *See id.* at 191–220.

[99] *See infra* Part II.

[100] *See* Bratton, *supra* note 77, at 461.

[101] *See* Daniel Farber, *Public Choice Theory and Legal Institutions*, *in* THE OXFORD HANDBOOK OF LAW AND ECONOMICS: VOLUME I: METHODOLOGY AND CONCEPTS 181, 447–48 (Francesco Parisi ed., 2017).

[102] *See* Moon, *Delaware's New Competition*, *supra* note 1, at 1431–32.

promote their cause with policymakers.[103] This is because of the smallness of their group, their political or economic influence, or a combination of these. [104]

If one takes a public choice perspective, it may seem unsurprising that Delaware's legislation may appear friendly to managers.[105] In 1974, William L. Cary argued that Delaware had become subservient to the needs of corporate interest.[106] More recently, Bratton noted that for a jurisdiction like Delaware to be competitive, it has to limit the likelihood of exit by business "by making a credible commitment to remain constant to its customer firms' interests."[107] But Cary worried that the revenue benefits derived from incorporations may cause the legislative and judicial branches of government "to lack the neutrality and detachment" necessary to address the needs of shareholders.[108] This further caused Cary to ponder the wisdom of allowing Delaware "to grant management unilateral control untrammeled by other interest."[109]

According to one perspective in the political economy literature, a strong state (or jurisdiction) acts in the larger public interest without succumbing to the pressures from interest

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[103] Lina Eriksson explains that "a central problem for public choice theorists is the *capture* of the political and bureaucratic process by self-interested politicians, bureaucrats and special interest groups, that is the biasing of policy outcomes in favor of some interests over those of the general public." Lina Eriksson, *Public Choice Theory*, *in* HANDBOOK ON THEORIES OF GOVERNANCE 322 (Christopher Ansell & Jacob Torfing eds., 2016).

Consider the case of corporate criminal legislation. Vikramaditya Khanna has argued that, in times of prominent corporate malfeasance, corporate interests may actively lobby for specific kinds of corporate crime legislation that levy low costs on actors—thereby allowing for their continued prosperity. Vikramaditya S. Khanna, *Corporate Crime Legislation: A Political Economy Analysis*, 82 WASH. U. L. Q. 95, 98 (2004). The main aim of these actors is to "[avoid] legislative and judicial responses that are more harmful to their interests and sometimes deflect ... criminal liability away from managers and executives and onto corporations." *Id.*

[104] *See id.* at 1433.

[105] Thomas, *Institutions*, *supra* note 35, at 981. Chantal Thomas juxtaposed the idea of a benign welfare state with public choice theory. *Id.* The latter views "decisions by political institutions as merely the aggregate of individual self-interested choices ... subject to a variety of flaws." *Id.*

[106] Cary, *supra* note 2, at 663.

[107] Bratton, *supra* note 77, at 448.

[108] *Id.* at 663.

[109] *Id.*

groups.[110] OFCs are hardly referred to as strong jurisdictions in this regard in the literature.[111] Indeed, two interrelated features of OFC operations have been used to explain their rise: sophisticated transnational corporate lawyers and legislative capture by corporations (and their lawyers).[112]

First, with respect to legal professionals, some scholars point to the "emergence of 'offshore magic circle'[113] law firms that purport to provide full-service law practice ranging from offshore mergers and acquisitions to offshore fund formations."[114] One theory is that the norms about how offshore investments operate have traveled with these actors from one jurisdiction to another—perhaps leading to efficiencies and best practices along the way.[115]

Second, it has been argued that well-organized and influential groups of lawyers who represent corporate interests have also managed to capture the legislatures in OFCs.[116] These legislatures in turn make laws that are beneficial to their corporate

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[110] It bears noting that "the idea of the 'weak' state buffeted by pressures from interest groups, which is a staple of public choice theory and the literature on 'rent seeking' by lobbying groups, has family resemblance to the older Marxist theory of the state on the end of the political spectrum." Pranab Bardhan, *State and Development: The Need for a Reappraisal of the Current Literature*, 54 J. ECON. LIT. 862, 868 (2016). The strong state, on the contrary, "acts neither at the behest of, nor on behalf of, the dominant classes." *Id.* at 869. This type of state is capable of deciding when it is in the country's best interest to conform to select interest group pressures—such as when it has long term economic growth benefits for the population—and when it is useful to chart an entirely new course. *Id.* at 867.

[111] *See, e.g.*, Moon, *Delaware's New Competition*, *supra* note 1, at 1406; SHAXSON, *supra* note 74, at 87, 88, 92.

[112] Moon, *Regulating Offshore Finance*, *supra* note 5, at 3.

[113] This is "a colloquial term given to law firms that have established physical offices in strategic offshore jurisdictions like Jersey, Bermuda, the British Virgin Islands, Hong Kong and the Seychelles." Moon, *Delaware's New Competition*, *supra* note 1, at 1434.

[114] Moon, *Regulating Offshore Finance*, *supra* note 5, at 3.

[115] *See, e.g.*, YVES DEZALAY & BRYANT GARTH, THE INTERNATIONALIZATION OF PALACE WARS: LAWYERS, ECONOMISTS, AND THE CONTEST TO TRANSFORM LATIN AMERICAN STATES 5 (2002) (discussing how "law ... reproduce[s] the field of power" in several Latin American countries); *see also* DiMaggio & Powell, *supra* note 68, at 152–54 (discussing how social pressures from professionals can influence organizational change—not the pursuit of efficiencies).

[116] Moon, *Delaware's New Competition*, *supra* note 1, at 1429–37.

"customers."[117] As a consequence, American corporations are glad to evade domestic regulations by incorporating in an OFC and using the jurisdiction's corporate governance laws to regulate their internal affairs.[118] In short, "offshore financial havens are often straightforward cases of legislative capture, whereby laws can literally be written by interested private actors."[119]

Pursuant to this thesis, OFCs offer a permissive regulatory regime merely clothed in the appearance of legal formalities.[120] But a focus on the legislative capture of OFCs as the key explanatory variable for their success overlooks the possibility that the activities of special interest in OFCs—including local constituents—may offset those of special interests in "onshore jurisdictions," such as the United States.[121] For example, corporate law experts Anna Manasco Dionne and Jonathan Macey suggest that "[o]ffshore competition is particularly threatening for entrenched local interests because of the inability of onshore interest groups to influence offshore regulators. Indeed, the relative isolation of offshore regulators from onshore interest groups is likely one of the primary reasons for their success."[122]

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[117] *Id.*

[118] Moon, *Regulating Offshore Finance*, *supra* note 5, at 7–10.

[119] *Id.* at 6–7.

[120] Moon focuses on Cayman, Bermuda and the British Virgin Islands ("BVI") in his article. Moon, *Delaware's New Competition*, *supra* note 1, at 1406. In addition to Bermuda, Bruner highlights the performance of Dubai, Singapore, Hong Kong, and Switzerland. BRUNER, *supra* note 7, at 11.

[121] *See generally* Moon, *Delaware's New Competition*, *supra* note 1 (examining how offshore jurisdictions compete with U.S. jurisdictions, specifically Delaware).

[122] *Id.* at 1432–37. According to Moon, OFCs are faced with immense pressures from special interests to legislate for their benefit. *See id.* (explaining how lawyers and other private-sector actors influence corporate law in OFCs). In this regard, the "motives of offshore corporate law havens (OFCs) are not too different from those of Delaware." *Id.* at 1431–32. There is a form of quid pro quo—i.e., favorable legislation in return for revenue. *See id.* at 1432. Moon notes that OFCs "rely on the profits from recurring franchise and incorporation fees received from locally registered business entities." *Id.* Even more directly, Moon argues:

> To focus exclusively on government coffers to explain the behavior of legislators would neglect another pivotal aspect of [the] corporate lawmaking process—the various interest groups, including lawyers, accountants, and other stakeholders who stand to benefit from attracting foreign corporations, that also

But, while the legislative capture thesis is compelling, there is reason to suspect that not all of these jurisdictions are equally subject to the influence of special interests.[123] If these jurisdictions were all subject to capture by the same or similar set of external actors, we would likely see more uniformity in legal structures and less specialization among OFCs than currently exist.[124] Consequently, a well-developed theory of capture across OFCs is required. This theory would explain variation in the degree of capture among these jurisdictions, which would include a role for interest groups from within OFCs (i.e., domestic actors) on the sector's institutional development and trajectory.[125]

3. Institutional Isomorphism

If legislative capture alone does not explain legal change in OFCs, perhaps lessons about how states behave can be learned from scholars of organizations. States must decide whether to resist conformity and stand out in their policy choices or follow the lead of other states and move toward the standardization or harmonization of rules as suggested by the race to the middle theory.[126] In this regard, Magnuson accepts that "the race to the

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> drive the corporate lawmaking process in offshore corporate law havens, just as they do in the domestic context.

Id. at 1432.

[123] *See* BRUNER, *supra* note 7, at 8 (identifying legislative autonomy—albeit, without a discussion of interest groups—as a feature of "market-dominant small jurisdictions").

[124] *See id.* (focusing argument on the differences between offshore jurisdictions). For example, Bermuda is known for its reinsurance market and Cayman has garnered a reputation as being "the largest holder of US Securities in the world. Hedge funds are the main factor for this strong Cayman-US link." Jan Fichtner, *The Anatomy of the Cayman Islands Offshore Financial Center: Anglo-America, Japan, and the Role of Hedge Funds*, 23 REV. INT'L POL. ECON. 1034, 1034 (2016); *see also* Moon, *Regulating Offshore Finance*, *supra* note 5, at 13–16; BRUNER, *supra* note 7, at 59–67.

[125] *But see* Tony Freyer & Andrew P. Morriss, *Creating Cayman as an Offshore Financial Center: Structure & Strategy Since 1960*, 45 ARIZ. ST. L.J. 1297, 1299–300 (2013) (describing the actors and institutions that made Cayman a successful OFC). If there is significant divergence among OFCs in the type of interest groups that seek to exert influence on their development, this could explain differences in their success and viability. *See id.*

[126] *See* Magnuson, *supra* note 60, at 1186 (describing "race to the middle" theory).

middle may allow suboptimal, but widely adopted, regulatory schemes to crowd out more efficient, but sparsely adopted, ones."[127] Implicit in this perspective is the long-accepted organizational theory of institutional isomorphism.[128] According to scholars Paul DiMaggio and Walter Powell, while there is an efficiency argument for adopting pre-existing and well-developed rules, conformity—or institutional isomorphism—is often motivated by other reasons.[129] Institutional isomorphism explains how institutions, including legal institutions, can become more homogenous due to social processes and forces that make them "more similar without necessarily making them more efficient."[130]

Pursuant to the institutional isomorphism theory, three social forces tend to impact decisions around institutional choice.[131] First, there is the human and group desire to be seen as legitimate as compared to peers, which is referred to as mimetic isomorphism.[132] This may be the case of poorer jurisdictions modeling the institutions of wealthier nations or ex-colonies modeling the governance strategies of former empires.[133]

Second, the influence of professionals (e.g., lawyers or accountants), who have specific training and ideals regarding how a type of business activity should be undertaken, can be imparted across different environments.[134] This has been conceptualized as normative isomorphism.[135] For example, American business lawyers may take their legal training and American approach to transactional lawyering to a number of foreign countries and present these features of law practice as the normatively better approach.[136] In addition, these professionals often move from one organization or jurisdiction to another, thereby sharing their

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[127] *Id*. at 1186.

[128] *See* DiMaggio & Powell, *supra* note 68, at 149–50 (describing three "mechanisms" of institutional isomorphism in detail).

[129] *See id.* at 153.

[130] *Id.* at 147.

[131] *Id.* at 151.

[132] *Id.* at 151–52.

[133] *See, e.g.*, Holger Spamann, *Contemporary Legal Transplants: Legal Families and the Diffusion of (Corporate) Law*, 2009 BYU L. REV. 1813, 1816.

[134] DiMaggio & Powell, *supra* note 68, at 152.

[135] *Id.*

[136] Carol V. Rose, *The "New" Law and Development Movement in Post–Cold War Era: A Vietnam Case Study*, 32 L. & SOC. REV. 93, 121–22 (1999).

knowledge and promoting some degree of uniformity or harmonization in policies and legislation.[137]

Third, in some instances, there is a power dimension to institutional isomorphism.[138] This has been termed coercive isomorphism.[139] Here, "formal and informal pressures" are brought to bear on organizations from external actors upon which they depend, as well as "by cultural expectations in the society within which [the] organizations function."[140] For example, international organizations and wealthy nations may seek to influence the policy choices and legal reform strategies of developing countries by threatening to withhold foreign aid.[141]

The institutional isomorphism thesis explains why OFCs may have strong institutional similarities, including their tax and corporate legal structures.[142] But it does not explain how differences occur.[143] Given the social pressures to conform, it does not articulate an explanation for why some OFCs stake out their own areas of specialization and prominence.[144] For example, Cayman is known as the destination for hedge funds and Bermuda is well known for insurance captives.[145]

4. Governance

One of the more compelling theories for why some countries are better able than others to achieve economic growth relates to the quality of their governance.[146] International tax scholars have suggested that the quality of governance in a country also directly impacts whether that country will become a tax haven (or

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[137] DiMaggio & Powell, *supra* note 68, at 152–53.

[138] *Id.* at 150–51.

[139] *Id.*

[140] *Id.* at 150.

[141] *See* John W. Meyer et al., *World Society and the Nation-State*, 103 AM. J. SOC. 144, 167–68 (1997); *see also* Kevin E. Davis & Michael B. Kruse, *Taking the Measure of Law: The Case of the Doing Business Project*, 32 LAW & SOC. INQUIRY 1095, 1114 (2007) (discussing how legal indicators, such as the World Bank's Doing Business indicators, can be used as benchmarks for foreign aid).

[142] DiMaggio & Powell, *supra* note 68, at 147.

[143] *See id.*

[144] *See id.*

[145] *See* Fichtner, *supra* note 124, at 1051; Moon, *Regulating Offshore Finance*, *supra* note 5, at 13–16; BRUNER, *supra* note 7, at 59–67.

[146] Francis Fukuyama, *What Is Governance?*, 26 GOVERNANCE 347, 360 (2013) [hereinafter Fukuyama, *What Is Governance?*].

OFC).[147] In an analysis of over 200 countries, Dhammika Dharmapala and James Hines, Jr. show that well-governed countries are more likely than poorly governed countries to find success in the offshore finance world.[148] These scholars convincingly show that OFCs "score very well on cross-country indices of governance quality that include measures of voice and accountability, political stability, government effectiveness, *rule of law*, and the control of corruption."[149] Importantly, they argue that "causality runs from governance quality to tax haven status."[150] Dharmapala and Hines further suggest that "there are almost no poorly governed tax havens [OFCs]."[151] This makes sense if we accept that some of the key selling features of OFCs are the transparency and stability of their government,[152] as well as the high quality and sophistication of their legal regimes.[153]

Investors arguably pick some OFCs because of their confidence in the legal and political institutions they provide.[154] But, despite frequent media and academic references to tax evasion and corruption in OFCs,[155] scholars have found that these jurisdictions tend to demonstrate strong fidelity to the rule of law and regulatory effectiveness.[156] To this point, it has become largely accepted

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[147] Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1058–59.

[148] *Id.*

[149] *Id.* at 1058 (emphasis added). Dharmapala and Hines used the governance index from Daniel Kaufmann et al., *Governance Matters IV: Governance Indicators for 1996–2004*, 60 (World Bank Pol'y Rsch. Working Paper No. 3630, 2005).

[150] Dhammika Dharmapala & James R. Hines, Jr., *Which Countries Become Tax Havens?* 2 (Nat'l Bureau of Econ Rsch. Working Paper No. 12802, 2006) [hereinafter Dharmapala & Hines, *Which Countries Working Paper*].

[151] Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1058.

[152] *Id.* at 1059. Dharmapala and Hines show that "causality runs from governance quality to tax haven status." Dharmapala & Hines, *Which Countries Working Paper*, *supra* note 150, at 2. In other words, becoming a tax haven or OFC does not improve the quality of governance of a country. *Id.*

[153] *See* Moon, *Delaware's New Competition*, *supra* note 1, at 1407; Morriss & Henson, *supra* note 15, at 448.

[154] For example, in discussing the value of money, anthropologist David Graeber observes that "the value of a unit of currency is not the measure of its value of an object, but the measure of one's trust in other human beings." DAVID GRAEBER, DEBT: THE FIRST 5,000 YEARS 47 (2014).

[155] *See, e.g.*, Andrew P. Morriss, *Offshore Financial Centers in Regulatory Competition*, *in* OFFSHORE FINANCIAL CENTERS AND REGULATORY COMPETITION 102–46 (Andrew P. Morriss ed., 2010) [hereinafter Morriss, *Regulatory Competition*].

[156] *See* Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1058–59.

that, beyond the promise of low taxes, OFCs can only attract multinational corporations and wealthy individuals to their shores by promising a high quality legal environment.[157]

Of course, not all OFCs reflect the same degree of good governance or are equally successful.[158] Dharmapala and Hines distinguish between those countries that are focused on the substance of international finance versus those that, in their attempt to be tax havens, are involved in nefarious activities—and are consequently less reputable.[159] Specifically, the scholars explain:

> A view that is frequently expressed in both scholarly and popular writings is that tax havens are 'outlaw' countries that disregard international norms. The results in [the study] may appear surprising from this perspective. It should be noted that there is some degree of overlap between the set of tax haven countries and those countries alleged by the OECD to facilitate money laundering activity, and with those countries that provide 'flags of convenience' for international shipping ... 'Pure' tax havens (i.e., those tax havens that are not also alleged by the OECD to facilitate money laundering or identified as providing 'flags of convenience') are even better-governed than tax havens as a group. Consequently, restricting attention to those 'pure' havens would only strengthen the association between tax haven status and good governance.[160]

In a tribute to the importance of good governance in more successful and reputable jurisdictions, Andrew Morriss and Clifford Henderson suggest that OFCs have a strong "incentive to effectively regulate to protect the integrity of their 'brands' in the financial market by controlling money laundering and other criminal activities."[161] These scholars propose that "[w]hen the differences in financial sectors, government structures, and other

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[157] *See* BRUNER, *supra* note 7, at 21; Moon, *Delaware's New Competition*, *supra* note 1, at 1407; DIONNE & MACEY, *supra* note 15, at 12. Andrew Morriss argues that "[g]overnments can provide legal environments that facilitate economic activity by promoting contract enforcement, secure property rights, honest and efficient courts, registries for forms of property from land to security interests, and other services." Morriss, *Regulatory Competition*, *supra* note 155, at 122.

[158] *See* BRUNER, *supra* note 7, at 191–220 (discussing failed OFCs: what Bruner terms Market-Dominant Small Jurisdictions (MDSJs)).

[159] Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1061.

[160] Dharmapala & Hines, *Which Countries Working Paper*, *supra* note 150, at 12–13.

[161] Morriss & Henson, *supra* note 15, at 434.

factors are considered, mature OFCs are at least as likely to be exerting *more* regulatory effort than their onshore competitors as they are to be exerting less."[162] According to Dionne and Macey, OFC optimists may argue that "some OFCs are at least as well regulated as, if not better regulated than, prominent onshore markets such as in the United States and the United Kingdom, particularly following a recent international effort to improve transparency and combat money laundering."[163] But the desire to protect their brand and provide certainty to investors is not enough to ensure good governance since this desire may be necessary but not sufficient for effective regulation.[164]

Even the most ambitious developing country in search of growth may find it difficult to become a successful OFC if it is poorly governed.[165] Investors would be too insecure to invest their assets in this type of jurisdiction, tax benefits notwithstanding.[166] But how is good governance assessed in this context? Dharmapala and Hines assess high quality governance by using specific indicators, including cross-national measures of the rule of law.[167]

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[162] *Id.* at 454.

[163] Dionne and Macey argue that:

> OFCs provide legitimate alternative markets for law-abiding individuals and corporations and protect corporations' ability to take risks in an increasingly global economy. OFCs are also said to have more generalized benefits for onshore governments, particularly to the extent they give companies access to tax-free or low tax capital, improving the free flow of capital and contributing to onshore markets.

DIONNE & MACEY, *supra* note 15, at 12.

[164] *See, e.g.*, Miguel Centeno & Alejandro Portes, *The Informal Economy in the Shadow of the State*, *in* OUT OF THE SHADOWS: POLITICAL ACTION AND THE INFORMAL ECONOMY IN LATIN AMERICA 28 (Patricia Fernandez-Kelly & Jon Shefner eds., 2006) ("[A] weak state may assign itself a large 'load' of regulatory measures over civil society .... These states may be described as 'frustrated' because of the permanent contradiction between the voluminous paper regulations that they spawn and their inability to enforce them in practice.").

[165] *See* Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1058 (noting that tax havens tend to be well-governed).

[166] *See* DIONNE & MACEY, *supra* note 15, at 12.

[167] Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1060. The concern here is that references to governance, even when founded on indicators, remain void of actionable steps that can be taken to enhance regulatory competition. *See* Kevin E. Davis, *Legal Indicators: The Power of Quantitative Measures of Law*, 10 ANN. REV. L. & SOC. SCI. 37, 47 (2014) [hereinafter Davis, *Legal Indicators*].

Indicators—like the World Governance Indicators upon which Dharmapala and Hines rely—are innately imprecise as to the phenomena they seek to measure.[168]

As much as indicators objectively attempt to assess the quality of governance in a country, these technologies inevitably reflect standards that are influenced by their creator's method of analysis, ideology and even cultural norms.[169] Further, it is unclear what high scores on sub-indicators of governance—like the rule of law, freedom of speech, accountability, political stability, low corruption, and government effectiveness—actually mean for the day-to-day running of government.[170] Indeed, Dharmapala and Hines accept that "the evidence that [OFCs][171] are better-governed than comparable [non-havens] does not identify the mechanism through which governance [might influence] the propensity to become a [OFC]."[172]

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[168] Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1064; *see* Davis, *Legal Indicators*, *supra* note 167, at 44–45.

[169] Kevin Davis et al., *Indicators as a Technology of Global Governance*, 46 L. & SOC'Y REV. 71, 78 (2012).

[170] *See World Governance Indicators*, WORLD BANK, https://info.worldbank.org/governance/wgi/ [https://perma.cc/DRH5-J8AZ].

[171] Dharmapala and Hines use the term "tax haven." Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1064.

[172] *Id.* Arguably, Christopher Bruner's description of successful MDSJs provides an ideal type for what governance means in practice. BRUNER, *supra* note 7, at 41–43. Bruner describes an "ideal type" as providing "an empirically grounded 'terminology' permitting one to speak more coherently about a given social phenomenon." *Id.* at 42–43. Bruner highlights five features that tend to stand out among successful OFCs. *Id.* at 42. First, they tend to be "small and poorly endowed with natural resources, limiting their economic-development options." *Id.* at 43. Second, they are capable of passing legislation within their jurisdiction—a feature Bruner refers to as "legislative autonomy." *Id.* at 44–45. Third, they are geographically and culturally linked to several wealthier countries. *Id.* at 45. Fourth, they "heavily invest in human capital, professional networks, and related institutional structures." *Id.* at 46. Finally, they "consciously balance close collaboration with and robust oversight of the financial professional community, seeking at once to convey flexibility, stability, and credibility." *Id.* Reflecting on the underlying theories regarding Delaware's success—outlined in Part I—it would appear that factors such as network externalities, the ability to manage interest groups, and the approach to institutional isomorphism remain relevant. *See supra* Sections I.B.1–3. But, even if we accept that better governed small jurisdictions that feature Bruner's five factors are likely to achieve success in the OFC arena, we are still left to

References to governance outcomes do not tell us how jurisdictions ensure that the relevant actors within their borders work together harmoniously to promote successful offshore financial services.[173] According to economist Pranab Bardhan, "[b]eyond being a 'nightwatchman' of property rights and markets, the state often needs to be a guide, coordinator, stimulator, and a catalytic agent for economic activities in situations where, for various historical and structural reasons, the development process has been atrophied."[174] Consequently, when contemplating an explanation for why some countries are better positioned to become OFCs and to be successful in this arena, this Article suggests it is worth considering a role for state capacity as an important explanatory factor.[175]

II. STATE CAPACITY

This Part introduces the concept of state capacity and suggests that the corporate charter race depends on a jurisdiction's ability to strategically coordinate and engage aspects of network effects, collective action problems, and institutional isomorphism. It suggests that state capacity may be the genesis or underpinning of good governance.

A. Conceptualizing State Capacity

Scholars of development proffer that a state's capabilities or "capacity" is directly related to its developmental success.[176]

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wonder how exactly they are able to achieve this feat, and why others that are similarly situated cannot. *See infra* Section III.C.

[173] *See infra* Section II.A.

[174] Bardhan, *supra* note 110, at 864.

[175] *See infra* Section II.A.

[176] *See, e.g.*, Elaine Enriquez & Miguel Centeno, *State Capacity: Utilization, Durability, and the Role of Wealth vs. History*, 1 INT'L & MULTIDISCIPLINARY J. SOC. SCI. 130, 132 (2012) (discussing the role of states in development); PETER EVANS, EMBEDDED AUTONOMY: STATES AND INDUSTRIAL TRANSFORMATION 10, 22 (1995).

Ruchir Sharma, Chief Global Strategist at Morgan Stanley Investment Management, touched on the concept in his book "The 10 Rules of Successful Nations"—although it is referred to as "state power." RUCHIR SHARMA, THE 10 RULES OF SUCCESSFUL NATIONS 65–83 (2020). In considering the role of states in a country's economic development, the author notes that: "Successful nations don't have small governments; they have the right-sized government for

Consequently, social scientists have used a range of variables to indicate a state's capacity in their empirical analyses.[177] For example, scholars have defined state capacity as one of or a combination of the following: country wealth (i.e., economic strength), military power, the physical reach of the government throughout a territory, and the government's bureaucratic capabilities.[178] Needless to say, a number of these variables are interrelated and correlated.[179] However, the differing perspectives stem from the diverse disciplinary approaches used to study the concept.[180] For example, economists are often, though not exclusively, concerned with country wealth and how states facilitate economic growth.[181] Political scientists often contemplate how states make and implement policy choices.[182] Sociologists have taken to studying the bureaucratic strength of states.[183] Despite the divergence in strategy, each of these disciplines has revealed that a state's capacity for

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their stage of development." *Id.* at 65. In light of the ambiguity regarding the nature of this type of government, Sharma clarifies that: "The state needs to be large enough to maintain conditions essential to civilized commerce, including basic infrastructure and mechanisms to contain corruption, monopolies and crime." *Id.* at 71.

[177] *See* Enriquez & Centeno, *supra* note 176, at 134–35.

[178] *See, e.g.*, *id.* at 134–36; Hillel Soifer & Matthias vom Hau, *Unpacking the Strength of the State Infrastructural Power*, 43 STUD. COMP. INT'L DEV. 219, 220–21 (2008).

[179] *See* Enriquez & Centeno, *supra* note 176, at 142–43.

[180] *See, e.g.*, *id.* at 134 (discussing the various ways scholars understand "state capacity"); *see also* Rafael La Porta et al., *The Economic Consequences of Legal Origins*, 46 J. ECON. LIT. 285, 286 (2008) [hereinafter La Porta et al., *Economic Consequences*]; Davis & Trebilcock, *supra* note 23, at 897–99; DARON ACEMOGLU ET AL., A REVIEW OF DOING BUSINESS (2013) [hereinafter DARON ACEMOGLU ET AL., A REVIEW]; Timothy Besley, *Law, Regulation, and the Business Climate: The Nature and Influence of the World Bank Doing Business Project*, 29 J. ECON. PERSPECTIVES 99, 101 (2015).

[181] *See, e.g.*, Daron Acemoglu et al., *State Capacity and Economic Development: A Network Approach*, 105 AM. ECON. REV. 2364, 2364–66 (2015); Timothy Besley & Torsten Persson, *The Origins of State Capacity: Property Rights, Taxation, and Politics*, 99 AM. ECON. REV. 1218, 1219 (2009).

[182] *See, e.g.*, Soifer & vom Hau, *supra* note 178, at 220; Michael Mann, *The Autonomous Power of the State: Its Origins, Mechanisms and Result*, 25 EUR. J. SOC. 185, 185, 189 (1984).

[183] *See, e.g.*, Peter Evans & James Rauch, *Bureaucracy and Growth: A Cross-National Analysis of the Effects of The "Weberian" State Structures on Economic Growth*, 64 AM. SOC. REV. 748, 748 (1999).

development is contextual.[184] For example, a given state may be extremely capable of activity A but not activity B.[185]

Some political sociologists propose that state capacity enables the bureaucratic arm of government to effectively accomplish chosen policy goals.[186] In this vein, state capacity speaks to the capabilities that allow governments to pursue and implement a chosen agenda designed by a well-organized, talented, and experienced group of experts from within, rather than rely on external (i.e., non-governmental) sources for advice and guidance.[187] Arguably, this type of internal expertise helps the government withstand the pressures from special interest groups.[188] While there is an economic component to creating this type of bureaucracy, since experts must be adequately compensated, there are other aspects as well.[189] One view is that these countries may find it

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[184] *See, e.g.*, Enriquez & Centeno, *supra* note 176, at 156.

[185] *See, e.g.*, Elaine Enriquez et al., *A Cross-National Comparison of Sub-National Variation*, 61 AM. BEHAV. SCI. 908, 928 (2017) (discussing the contextual nature of "state capacity").

[186] Centeno et al., *supra* note 43, at 3–25. There is an implicit recognition that not all policy goals are achievable, particularly within a short time frame. *Id.* at 3. There is also the reality that it is infeasible to tackle too many goals simultaneously. Enriquez & Centeno, *supra* note 176, at 141–42; *see* Evans & Rauch, *supra* note 183, at 760.

[187] *See* Theda Skocpol & Kenneth Finegold, *State Capacity and Economic Intervention in the Early New Deal*, 97 POL. SCI. Q. 255, 260–61 (1982).

[188] *Id.* at 276–77. During Donald Trump's administration, the kind of bureaucratic depth and expertise often referred to by political sociologists has been referred to pejoratively as the "deep state." But, scholars, such as Jon Michaels, have argued that:

> [T]he American bureaucracy is very much a demotic institution, demographically diverse, highly accountable, and lacking financial incentives or caste proclivities to subvert popular will; that demotic bureaucratic depth of the American variety should be celebrated, not feared; and that, going forward, we need greater, not lesser, depth insofar as the American bureaucracy serves an important, salutary, and quite possibly necessary role in safeguarding our constitutional commitments and enriching our public policies.

Jon D. Michaels, *The American Deep State*, 93 NOTRE DAME L. REV. 1653, 1655 (2018).

[189] *See* Evans & Rauch, *supra* note 183, at 760.

economically beneficial to invest in high quality bureaucracies as a way to spark growth.[190]

Sociologists Peter Evans and James Rauch have empirically shown that specific characteristics of government agencies are helpful for economic growth.[191] These scholars empirically demonstrate that "variations in the form of state organization might affect economic dynamism."[192] Features like "meritocratic recruitment" and "predictable career ladders" aid in "structur[ing] the incentives of individual bureaucrats in a way that enhances the ability of the organizations they manage to effectively pursue long-term goals."[193] "Meritocratic recruitment" speaks to a form of government employment based on education and other objective measures of professional qualification.[194] A "predictable career

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[190] According to Kevin Davis and Michael Trebilcock:

> [W]ealth need not be a pre-requisite to institutional quality [because] high quality institutions may not actually be very expensive .... The principal costs associated with operating legal institutions are the costs of personnel. However, personnel costs tend to be determined principally by the supply of workers with relevant skills rather than simply by national wealth. Some countries that are poor in the sense of having low levels of national income and/or limited endowments of natural resources nevertheless have relatively low-paid but well-educated populations. In those countries, the cost of maintaining high quality legal institutions may not be prohibitive. Moreover, in some cases the quality of institutions is manifested in their ability to limit rather than expand the role of the state.

Davis & Trebilcock, *supra* note 23, at 922.

[191] Evans & Rauch, *supra* note 183, at 760. This suggests that the cost of a high-quality bureaucracy may be a small price to pay for the economic upside. *See id.* at 752; Alejandro Portes & Lori D. Smith, *Conclusion: The Comparative Analysis of the Role of Institutions in National Development*, *in* INSTITUTIONS COUNT: THEIR ROLE AND SIGNIFICANCE IN LATIN AMERICAN DEVELOPMENT 187 (Alejandro Portes & Lori D. Smith eds., 2012).

[192] Evans & Rauch, *supra* note 183, at 750. Evans and Rauch construct their thesis and research around Max Weber's theory on bureaucracies. *Id.* at 748. According to these scholars, "[t]he Weberian perspective does not negate the positive effects of strengthening market institutions, but it does postulate that bureaucratically structured public organizations, using their own distinct set of decision-making procedures, are a necessary complement to market-based institutional arrangements." *Id.* at 749.

[193] *Id.* at 752.

[194] *Id.* at 751.

ladder" refers to the provision of suitable, practical, and reliable incentives over the course of a career in government service—as a way to retain and promote skilled employees.[195]

Evans and Rauch found that states with a bureaucracy that scored high on these features tended to have better economic performance—even when accounting for initial wealth.[196] Going further, scholars have suggested that some agencies within the government bureaucracy may be more important to economic growth than others.[197] These are "mostly economic agencies."[198] But, perhaps the key benefit to having a competent bureaucracy is that it can effectively assist with "coordination problems that may be crucial in instigating new activities."[199]

This ability—to skillfully and seamlessly identify and coordinate relevant actors and regulations—may separate some aspiring OFC jurisdictions from more prominent and established ones.[200] Specifically, stronger OFCs may have the facility to build on network externalities, the autonomy to incorporate the best ideas from special interests while reducing the likelihood or the extent of being captured, and the sophistication to know when to adopt another country's rules and when to chart a new course.[201] This may amount to what Dharmapala and Hines refer to as good "governance."[202]

B. State Capacity and Policy Implementation

The combination of expertise nurtured over time, a set of well-crafted and tested ideas by seasoned professionals, and the ability to effectively coordinate a range of actors are critical aspects of a state's capacity.[203] Consequently, high quality government

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[195] *Id.*

[196] *Id.* at 748.

[197] *See* Portes & Smith, *supra* note 191, at 178.

[198] *Id.* at 176–78 (noting that institutions "whose prime mission is economic," such as the "stock exchange and the tax authority" may prove especially important to development).

[199] Evans & Rauch, *supra* note 183, at 753.

[200] *See* Peter Evans et al., *The Political Foundations of State Effectiveness*, *in* STATES IN THE DEVELOPING WORLD 387 (Miguel Centeno et al. eds., 2017).

[201] *See infra* Section III.C.

[202] Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1058.

[203] Skocpol & Finegold, *supra* note 187, at 260–61.

bureaucracies are crucial to policy implementation.[204] The cumulative years of experience and institutional knowledge of internal experts can guide policymakers away from potential implementation dead-ends, as well as leverage previously gathered data and analysis.[205] In this regard, "state strength [is conceived as] autonomy from civil society and its power holders."[206] This view of state capacity[207] may be articulated as the counterweight to the legislative capture perspective, whereby powerful interests lay hold on the state apparatus and use it for their own personal gain.[208]

An example of the role of bureaucratic quality for policy implementation comes from a form of natural experiment in American history.[209] Political scientists Theda Skocpol and Kenneth Finegold studied the relative success of two legislative acts signed into law under President Franklin D. Roosevelt during the Great Depression.[210] These were the Agricultural Adjustment Act (Adjustment

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[204] Evans et al., *supra* note 200, at 387.

[205] Skocpol & Finegold, *supra* note 187, at 260–61.

[206] Enriquez & Centeno, *supra* note 176, at 135.

[207] Skocpol and Finegold proffer "[g]overnments that have, or can quickly assemble, their own knowledgeable administrative organizations are better able to carry through interventionist policies than are government that must rely on extragovernmental experts and organizations." Skocpol & Finegold, *supra* note 187, at 260–61.

[208] *See, e.g.*, Bertrall R. Ross, *Democracy and Renewed Distrust: Equal Protection and the Evolving Judicial Conception of Politics*, 101 CALIF. L. REV. 1565, 1609 (2013). On the contrary, poor quality bureaucratic arrangements can prove constraining on a country's economy. Evans & Rauch, *supra* note 183, at 749, 751. According to political economy scholars:

> The insights of earlier work on bureaucratic coherence and capacity, which were a cornerstone of the analysis of the role of the state in promoting industrial growth, remain basic. The widespread provision of complex collective goods that have positive network externalities requires competent civil servants coherently organized on a very large scale. Meritocratic recruitment, career paths with overall rewards roughly on par with private-sector alternatives, and esprit de corps sufficient to valorize the accomplishment of shared projects are even more important when development is focused on capability expansion than they were in earlier models in which the state, while crucial, was essentially an auxiliary to private capital.

Evans et al., *supra* note 200, at 307.

[209] *See, e.g.*, NATURAL EXPERIMENTS OF HISTORY 8 (Jared Diamond & James A. Robinson eds., 2011).

[210] Skocpol & Finegold, *supra* note 187, at 255.

Act) and the National Industrial Recovery Act (NIRA) (together with the Adjustment Act, the "Acts").[211] Both Acts were adopted in early 1933 and aimed to create "authoritative new administrative organizations—the National Recovery Administration (NRA) and the Agricultural Adjustment Administration (AAA)—through which economic functions formerly shaped by market competition would be planned and regulated in the public interest."[212] Notwithstanding their similar ends, the Acts had "sharply contrasting trajectories of development."[213] The Adjustment Act found success, and the NIRA eventually collapsed.[214]

In terms of goals, NIRA sought to enable the private sector to make a "reasonable profit" while ensuring that labor receives "living wages."[215] The Adjustment Act aimed to increase the price of "agricultural commodities."[216] It sought to "promote[ ] a redistribution of income to farmers who were struggling financially from low prices and continual domestic surpluses in major agricultural commodities."[217] Skocpol and Finegold suggest that the reason for

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[211] *Id.* According to Skocpol and Finegold, "[b]oth the [NIRA] and the [AAA] were passed by Congress in the spring of 1933, during the heady 'Hundred Days' of intense legislative activity that followed [Franklin Delano Roosevelt's] inauguration amidst the depths of the depression." *Id.*

[212] *Id.* at 256.

[213] *Id.* at 257.

[214] *Id.*

[215] *Id.* at 256. Jason E. Taylor explains:

> The NIRA required firms in the manufacturing sector to join with their competitors in drawing up industry-level "codes of fair competition." Compliance with these cartel codes, the contents of which were public record, was mandatory, and violations could be punished through government fines and imprisonment, although they rarely were .... The NIRA was designed as a quid pro quo—in exchange for granting wage and hour alternations favorable to its employees, businesses were allowed to engage in collusive behavior.

Jason E. Taylor, *Cartel Code Attributes and Cartel Performance: An Industry-Level Analysis of the National Industry Recovery Act*, 50 J.L. & ECON. 597, 600 (2007).

[216] Skocpol & Finegold, *supra* note 187, at 256.

[217] Briggs Depew et al., *New Deal or No Deal in the Cotton South: The Effect of the AAA on the Agricultural Labor Structure*, 50 EXPLORATIONS IN ECON. HIST. 466, 466–67 (2013). Depew et al. suggest that "[t]he major program of the [Agricultural Adjustment Administration ('AAA')] involved paying farmers to take land out of production with a goal of reducing agricultural output and therefore placing upward pressure on output prices." *Id.* at 467.

the divergence in outcome between the two agencies is that NIRA was built on a weak bureaucratic administration, while the Adjustment Act benefitted from skilled career personnel who were effective at policy making and implementation.[218]

On the one hand, NIRA inherited the more anemic side of what was an unevenly developed American federal bureaucracy.[219] The program was essentially built on a model that relied on outside experts who were not permanently situated within the government.[220] And, while well-organized private sector special interests had tremendous influence over how the NIRA functioned, including its strategies, the eventual outcomes were not viewed as beneficial to these groups.[221] Skocpol and Finegold theorize that the failure of organized interest groups to achieve their desired goals, especially given a weak government bureaucracy, is counterintuitive.[222] Pursuant to public choice theory, we would expect that "the best organized interest groups in society, and those with access to the greatest political skills and resources, would be the ones to achieve their political goals in 'the governmental process.'"[223]

On the other hand, the Adjustment Agency inherited the U.S. Department of Agriculture (USDA)—a bureaucracy with immense capabilities.[224] The USDA had benefitted from a unique history.[225] Congress had passed the Morrill Act in 1862, "authorizing federal land grants to support the establishment in each state of a college oriented to agricultural research and education."[226] Graduates of these colleges were actively recruited to the USDA.[227] And, over time, an arguably uniform identity of professional backgrounds and expertise—not to mention an emphasis on research and policy making—emerged.[228]

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[218] Skocpol & Finegold, *supra* note 187, at 257–61.

[219] *Id.* at 261–68.

[220] *Id.* at 262.

[221] *Id.* at 259–60.

[222] *Id.* at 259.

[223] *Id.* at 259–60.

[224] *Id.* at 270.

[225] *Id.* at 271–73.

[226] *Id.* at 273; *see also* NATHAN M. SORBER, LAND GRANT COLLEGES AND POPULAR REVOLT: THE ORIGINS OF THE MORRILL ACT AND THE REFORM OF HIGHER EDUCATION 54 (2018).

[227] Skocpol & Finegold, *supra* note 187, at 273.

[228] *Id.* at 273–74.

Ultimately, the proficiency in the USDA was so formidable that civil servants "were willing to make policy *for*, rather than just *with*, the farmers and their organizations."[229] Arguably, "their training and career experiences had given them a concrete sense of what could (and could not) be done with available governmental means."[230] Moreover, these civil servants were able to skillfully balance the interests of the state, the larger public, and agriculture special interests to achieve "a programmatically coherent course" of policies, strategies, and outcomes.[231] It is this seemingly intangible quality that appears to separate high capacity states from others.[232] Economists Pranab Bardhan suggests that "a more general characteristic of a strong and effective state is the capacity to make credible commitments in the face of pressures from diverse interest groups."[233]

In short, state capacity requires competent bureaucracies and strong leadership that can utilize the levers of government toward a chosen agenda.[234] But, admittedly, even if a state has the capacity to fend off the pressures of special interests, the political will to do so may not always be present. Scholars argue that "constraints on executive power are considered necessary to restrain pandering to narrow interests or self-aggrandizement on the part of the leadership."[235] This suggests a crucial role for law and legal institutions as both a means of constraining the executive (e.g., via a constitutional order with checks and balances) and a mechanism for policy implementation.[236] In other words, once the policy goal is identified, an effective state readily targets the laws and institutions it intends to use to achieve these ends.[237] A talented bureaucracy employs internal experts who can interpret and deploy rules in a manner suitable for the chosen economic and social policies.[238]

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[229] *Id.* at 274.

[230] *Id.*

[231] *Id.* at 275.

[232] Bardhan, *supra* note 110, at 866–67.

[233] *Id.* at 867.

[234] *Id.* at 866–67, 869.

[235] *Id.* at 863.

[236] *See* Kim Lane Scheppele, *Autocratic Legalism*, 85 U. CHI. L. REV. 545, 547–48 (2018) (noting how constitutions and law can be used to achieve illiberal goals).

[237] Bardhan, *supra* note 110, at 866–68.

[238] *Bureaucracy*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/other/bureaucracy/ [https://perma.cc/Z675-D39P].

C. State Capacity, Bureaucracy, and Development

As a general matter, legal scholars do not routinely analyze bureaucratic structure and strategy when exploring the relationship between law and economic development.[239] In this regard, the theoretical connection between bureaucratic capacity, institutions and economic development remains underexplored in the legal academic literature. But, as legal scholarship has become more interdisciplinary,[240] there is growing interest in the value that disciplines like sociology can bring to legal analysis.[241] For example, legal scholar Chantal Thomas has built on a broad range of literatures to bolster the argument for an "institutional analysis of institutionalism" as it pertains to theoretical and practical aspects of the relationship between law and economic development.[242] Thomas has specifically explored how ideas from sociology can inform our understanding of law's role in development.[243] For example, Thomas artfully explains how sociologist Max Weber's early theories on modern government made the connection between government bureaucracy and the type of "legal system that allows capitalism to thrive."[244]

In a similar manner, legal scholar Alvaro Santos has meticulously tied the role of a precise form of state capacity—"legal capacity"—to the economic success of developing countries by

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[239] *See, e.g.*, Davis & Trebilcock, *supra* note 23, at 899–902 (discussing the history of law and development studies).

[240] *See, e.g.*, Richard A. Posner, *The Future of the Student-Edited Law Review*, 47 STAN. L. REV. 1131, 1133 (1995) (discussing "the principal nondoctrinal subfields").

[241] *See, e.g.*, Chantal Thomas, *Max Weber, Talcott Parsons and The Sociology of Legal Reform: A Reassessment With Implications for Law and Development*, 15 MINN. J. INT'L L. 383, 385–86 (2006) [hereinafter Thomas, *Implications for Law and Development*]; *see also* Davis, *Legal Indicators*, supra note 167, at 38–44.

[242] *See* Thomas, *Institutions, supra* note 35, at 1018 (discussing the flaws in law and neoclassical economic development).

[243] *See* Thomas*, Implications for Law and Development, supra* note 241, at 383 (discussing "the influence of Weberian thought on a particular strain of policy discourse on law and development that emerged during the mid-twentieth century in the United States").

[244] *Id*.

focusing on international trade law.[245] Similar to the analysis employed by Skocpol and Finegold, Santos makes the case that investments in a talented cadre of civil servants—in this case, government lawyers—who can effectively coordinate legal strategy in a forum like the World Trade Organization's (WTO) "dispute settlement system"[246] with their government's economic policy objectives is one path to growth.[247] More precisely, "[c]ountries that actively pursue heterodox development policies are also more likely to invest in their local legal capacity and to rely on it to advance their national policy goals."[248]

To demonstrate the importance of the state capacity framework, Santos uses case studies of Mexico and Brazil.[249] Santos explains the difference in policy autonomy[250] via the WTO litigation forum in terms of "developmental legal capacity," which is the ability to effectively use legal expertise to further "national policy goals."[251] According to Santos, for an emerging economy to play the international trade game well, "[it] needs to carve out [local policy autonomy] deliberately, which requires a great degree of training, coordination, and institutional capability."[252]

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[245] Alvaro Santos, *Carving Out Policy Autonomy for Developing Countries in the World Trade Organization: The Experience of Brazil and Mexico*, 52 VA. J. INT'L L. 551, 554 (2012).

[246] The World Trade Organization ("WTO") has a well-developed system for resolving trade disputes among its member governments. *See* WTO, *A Unique Contribution*, https://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm [https://perma.cc/5REA-P7MN]. "The system is based on clearly-defined rules, with timetables for completing a case. First rulings are made by a panel and endorsed (or rejected) by the WTO's full membership. Appeals based on points of law are possible." *Id.*

[247] Santos, *supra* note 245, at 592. Santos introduces "the concept of 'developmental legal capacity,' which acknowledges that trade law can be both a sword to open markets and a shield for heterodox policies." *Id.* at 554.

[248] *Id.* This framework is built in part on a socio-legal analysis of the litigation process. *See* Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 L. & SOC'Y REV. 95, 95–97 (1974); *see also* Joel B. Grossman et al., *Do the "Haves" Still Come Out Ahead?*, 33 L. & SOC'Y REV. 803, 807 (1999).

[249] Santos, *supra* note 245, at 596–628.

[250] Santos describes "policy autonomy [as] the space that a country can create by mobilizing its legal capacity to use the rule and doctrinal flexibility of the WTO in the service of a developmental strategy." *Id.* at 606.

[251] *Id.* at 554.

[252] *Id.* at 555.

A part of this institutional strength is access to government lawyers who can translate economic policy into international legal rules that expand domestic policy autonomy and, ultimately, economic growth.[253] For example, Brazil's development strategy is one in which industrial policy is seen as a path to economic development.[254] Mexico's strategy for economic development "is one of free trade liberalization."[255] In order to ensure their strategies are successful within a potentially constraining international trade law context, each country has had to rely on its legal capacity to win favorable judgments in front of the WTO.[256] But Santos argues Brazil's legal capacity[257] has been more well developed and consequently more effective than Mexico's legal capacity.[258]

Santos explains that "Brazil has built an institutional legal infrastructure that includes a trade team in the Foreign Affairs Ministry, a variety of intra-ministerial trade groups, and established coordination mechanisms between the government and the private sector and civil society."[259] In addition, Brazil's "Foreign Ministry lawyers have been sent for training to Brazil's permanent mission in the WTO and to trade litigation firms in Washington, D.C., and elsewhere. As a result, Brazil has created a cadre of lawyers who are able to represent the government in the WTO dispute settlement system."[260]

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[253] *Id.* at 609, 612.

[254] *Id.* at 599 (noting that this model includes "trade promotion, industrial policy and science, technology and innovation policy, finance, and social policy").

[255] *Id.* at 607.

[256] *Id.* at 613.

[257] *Id.* at 609. Santos argues that:

> Brazil exhibits what can be described as developmental legal capacity, geared to advance the country's industrial policy agenda through the government's promotion of select, targeted sectors. An important aspect of Brazil's legal capacity is making sure that the country's legal strategies accord with the government's interests, not only for a given case but also systemically for the future. So far, Brazil has been able to defend several of its industrial policies in the WTO against challenges from countries that claimed they were violations of its WTO obligations.

Id. at 609.

[258] *Id.* at 608–10.

[259] *Id.* at 609.

[260] *Id.*

Mexico, however, has a weaker legal bureaucratic structure in the international trade unit of its Ministry of the Economy.[261] Instead of legal experts with long career tenures, "there has been considerable turnover and limited institutional continuity to take advantage of accumulated knowledge and experience."[262] Significantly, "[t]here are few incentives for people to stay and ascend the career ladder, eventually pushing them out and losing valuable human capital."[263] Notably, legal counsel from law firms—including the United States—are relied on for help with litigation strategy.[264]

Notwithstanding Santos's insightful work, scholars have yet to make a direct link between this type of indigenous legal capacity and OFC development.[265] Given the limited resources of many small jurisdictions that have become successful OFCs, it bears exploring how these places are able to cultivate and coordinate the expertise required to promote and sustain an offshore finance sector. The next Part argues that a review of the colonial history of OFCs may reveal insights into why some of the smaller OFC jurisdictions have developed the deep capabilities and, indeed, agency to forge ahead in the international finance arena.[266]

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[261] *Id.* at 609–10.

[262] *Id.*

[263] *Id.* at 610.

[264] *Id.* Santos observes that "[t]here seems to be no movement towards investing in and training a cadre of Mexican lawyers that can do the bulk of the lawyering and litigation." *Id.* The assumption here, and one supported by a range of scholars, is that the state is required to guide development, and that the private sector alone was inadequate. Bardhan, *supra* note 110, at 864. Ultimately, the strategic investment in legal professionals and networks can be core to economic growth given that laws and legal institutions are vehicles for policy formulation and deployment. Santos, *supra* note 245, at 594.

[265] *See* Santos, *supra* note 245, at 610.

[266] *See infra* Part III. It is well accepted that the colonial experience has undermined the bureaucratic capabilities of some developing countries. *See, e.g.*, KOHLI, STATE DIRECTED DEVELOPMENT, *supra* note 23, at 1–24. There is a compelling argument that the current institutional structures of many post-colonial developing economies were molded in the colonial era. *Id.*; *see also* PATTERSON, *supra* note 33, at 27–28; DARON ACEMOGLU & JAMES A. ROBINSON, WHY NATIONS FAIL: THE ORIGINS OF POWER 250–71 (2012). Political scientist Atul Kohli proffers that countries like Nigeria experienced a particularly extractive type of colonialism whereby Britain invested little in developing a well-run and centralized state with an "effective civil service." KOHLI, STATE DIRECTED DEVELOPMENT, *supra* note 23, at 18. This left independent Nigeria with the immense task of "overcom[ing] the original deficiencies of state construction."

III. COLONIALISM, INSTITUTIONS AND DEVELOPMENT

A. The Institutions-Development Paradigm

While OFCs have emerged in different parts of the world, including Europe, Asia, the Pacific region, and the Commonwealth Caribbean,[267] this Article focuses on islands in the latter region because they share sufficient similarities and differences for fruitful scholarly analysis. First, there is a strong historical connection between the British Empire and the development of major financial centers, including in the Commonwealth Caribbean.[268] Second, OFCs in this region are small islands that have comparable geographic and economic structures.[269] Third, given the colonial history and demographics of these islands, they tend to share similar cultural contexts.[270] Nonetheless, the islands have also experienced divergence in economic performance.[271] For example, the

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Id. But, even if an ex-colony had a colonial history that encouraged the building of high-quality institutions, political leadership is still required to skillfully marshal them toward the selected policy goals. *See, e.g.*, HENRY, *supra* note 42, at 21–44 (noting that Barbados and Jamaica inherited institutional features that some scholars would consider beneficial to economic growth—foremost, the British common law—but Barbados made better macroeconomic policy choices).

Scholars of state development have insightfully explained that: "An efficient state bureaucracy is merely a tool, and it can deliver on its potential only if is deployed in the right direction, if it is partially insulated from interference, and when it can provide mechanisms to address contradictory forces." Centeno et al., *supra* note 43, at 11. In other words, leadership matters. And, importantly, "a state's effectiveness in a given sector can be judged only in the context of a political decision to make that sector a priority." *Id.*

[267] *See* PALAN ET AL., *supra* note 53, at 149; Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1061–62; BRUNER, *supra* note 7, at 15–38.

[268] *See* PALAN ET AL., *supra* note 53, at 124–49; Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1066; BRUNER, *supra* note 7, at 28–30.

[269] *See, e.g.*, Winston H. Griffith, *CARICOM Countries and the Irrelevance of Economic Smallness*, 28 THIRD WORLD Q. 939–58 (2007) [hereinafter Griffith, *Economic Smallness*]; *see also* Winston H. Griffith, *Caribbean Countries and the Twenty-First Century*, 18 CANADIAN J. LATIN AM. & CARIBBEAN STUD. 25, 25–27 (1993) [hereinafter Griffith, *Caribbean Countries*].

[270] *See*, *e.g.*, DAVID S. BERRY, CARIBBEAN INTEGRATION LAW 17–35 (2014) (describing countries in the Caribbean region and summarizing their economies).

[271] *See, e.g.*, Winston H. Griffith, *A Tale of Four CARICOM Countries*, 36 J. ECON. ISSUES 79, 102 (discussing "the economic performances of four CARICOM

OFCs of Antigua and Barbuda, Barbados, Belize, The Bahamas, and Grenada have all had varying levels of economic success.[272]

In recent decades, commentators have attempted to explain the divergence in economic development among Caribbean islands. Attention has swiftly turned to the role of institutions and governance in economic growth.[273] Some scholars have debated whether institutions or policy choices explain economic performance among some of these countries.[274] But little attention has been paid to the OFC enterprise resident in some Caribbean jurisdictions as a way of understanding how institutions—particularly legal institutions—are related to economic progress.

Since the 1990s, New Institutional Economics (NIE) scholars and international finance institutions have been advocating for "increasingly comprehensive notions of good governance in a globally integrated economy."[275] However, interestingly, OFCs had already recognized that specific laws and legal practices were useful for growth.[276] For example, as early as the 1930s several jurisdictions, including Bermuda and the Bahamas, were actively using legislation to attract foreign businesses.[277] Bermuda began its offshore enterprise in 1935 by incorporating "what many believe

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countries from about 1970 to 1997") [hereinafter Griffith, *CARICOM Countries*]; *see also* Peter B. Henry & Conrad Miller, *Institutions vs. Policies: A Tale of Two Islands* 2–4 (Nat'l Bureau of Econ. Research, Working Paper No. 14604, 2008).

[272] *See, e.g.*, DILLON ALLEYNE ET AL., PRELIMINARY OVERVIEW OF THE ECONOMIES OF THE CARIBBEAN 2019–2020, 81 (2020); J. Rogrigo Fuentes et al., *Understanding Economic Growth in the Caribbean Region: A Conceptual and Methodological Study* 1–56 (Inter-Am. Dev. Bank Working Paper No. IDB-WP-595, 2015).

[273] *See, e.g.*, Griffin, *CARICOM Countries*, *supra* note 271, at 84–92 (discussing institutions and development where it concerns, Barbados, Guyana, Jamaica and Trinidad and Tobago).

[274] *See*, *e.g.*, Henry & Miller, *supra* note 271, at 10–11 (arguing that policy choices matter more for economic growth); PATTERSON, *supra* note 33, at 21–119.

[275] Kerry Rittich, *The Future of Law and Development: Second-Generation Reforms and the Incorporation of the Social*, 26 MICH. J. INT'L L. 199, 206 (2004).

[276] *See* PALAN ET AL., *supra* note 53, at 126, 137.

[277] *See id.* at 126–27; BRUNER, *supra* note 7, at 57; *see also* Freyer & Morriss, *supra* note 125, at 1315.

was the first exempt company in the world."[278] Cayman began its international business efforts in 1966 by passing "the Banks and Trust Companies Regulation Law, the Trusts Law, and the Exchange Control Regulations Law, and [further developed] its 1960s companies law."[279]

One could reasonably argue that NIE scholars were late to the game.[280] It was already clear to a subset of developing jurisdictions[281] that "the design and functioning" of legal institutions were relevant for economic growth.[282] But since OFCs did not emerge fully formed, we should consider their historical origins for clues as to why some jurisdictions gained more traction in the international finance market than other aspiring places.[283]

B. The End of the British Empire

As World War I came to a close, states began to explore various ways to rebuild their economies.[284] "[F]ollowing the end of [the war] through the early 1970s, a small number of states led by Switzerland began to develop tax havens as [one] international development strategy."[285] There quickly arose a significant number of OFCs of "English legal origins across those small jurisdictions active in cross-border finance."[286] The growth of these

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[278] PALAN ET AL., *supra* note 53, at 126; *see also* OFFSHORE COMMERCIAL LAW IN BERMUDA 12–13 (Ian RC Kawaley ed., 2013).

[279] PALAN ET AL., *supra* note 53, at 137.

[280] Davis & Trebilcock, *supra* note 23, at 900–02.

[281] It bears emphasizing that some OFCs are not independent nations, but are territories. PALAN ET AL., *supra* note 53, at 149. Examples include Cayman, Bermuda, and British Virgin Islands. *Id.* at 124.

[282] Davis & Trebilcock, *supra* note 23, at 902.

[283] PALAN ET AL., *supra* note 53, at 112, 130.

[284] Richard N. Cooper, *Fettered to Gold? Economic Policy in the Interwar Period*, 30 J. ECON. LITERATURE 2120, 2121–22 (1992). Switzerland is considered to be the first OFC (i.e., outside of the United States), along with Liechtenstein and Luxemburg. PALAN ET AL., *supra* note 53, at 107. According to Palan, Murphy, and Chavagneux, "Switzerland was known as a tax haven in the 1920s." *Id.*; *see also* Alstadsaeter et al., *supra* note 10, at 2.

[285] PALAN ET AL., *supra* note 53, at 108. Palan and his co-authors note that Switzerland was the first country to copy the U.S. states where it concerned innovating around laws in order to attract corporations. *Id.* at 111.

[286] *See* BRUNER, *supra* note 7, at 28; PALAN ET AL. *supra* note 53, at 149 (noting that "the largest [group of tax havens] is made up of the UK-based or British Empire–based tax havens").

jurisdictions in the international finance sector has made it difficult for scholars to ignore the apparent connection between English common law heritage and OFC development.[287] This link emanates from the British colonial history of many of these jurisdictions.[288] According to Palan et al.:

> Modern tax havens are still largely organized in three groups. First and still by far the largest is made of the UK-based or British Empire–based tax havens. Centered on the City of London and fed by the Euromarket, it consists of the Crown Dependencies, Overseas Territories, Pacific atolls, Singapore, and Hong Kong. The second consists of European havens, specializing in headquarter centers, financial affiliates, and private banking. The third consists of a disparate group of either emulators, such as Panama, Uruguay, and Dubai, or new havens from the transition economies and Africa.[289]

Given the diversity of OFCs, it is apparent that the common law alone does not explain the rise and relative success of some of these types of jurisdictions.[290] If the common law was the secret to success, as some economists have previously argued,[291] all the aforementioned territories and post-colonies of Britain should be equally prominent and successful—but this is certainly not the case.[292] In fact, scholars have recognized a small subset of these common law jurisdictions, like Bermuda, British Virgin Islands and Cayman, that have gained a global reputation for cross-border finance and as corporate law havens.[293]

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[287] DAM, *supra* note 40, at 26–28; BRUNER, *supra* note 7, at 28; PALAN ET AL., *supra* note 53, at 149; *see also* Dhammika Dharmapala, *What Problems and Opportunities Are Created by Tax Havens?*, 24 OXFORD REV. ECON. POL'Y 661, 663 (2008).

[288] PALAN ET AL., *supra* note 53, at 124–25.

[289] *Id.* at 149.

[290] *See* BRUNER, *supra* note 7, at 29–30.

[291] *See, e.g.*, La Porta et al., *Economic Consequences*, *supra* note 180, at 298.

[292] Katie Warren, *The top 15 tax havens around the world*, BUS. INSIDER (Nov. 19, 2019, 11:24 AM), https://www.businessinsider.com/tax-havens-for-millionaires-around-the-world-2019-11 [https://perma.cc/9XA2-HE2T].

[293] *See* Moon, *Delaware's New Competition*, *supra* note 1, at 1427 (highlighting the prominence of Bermuda, Cayman, and the British Virgin Islands); BRUNER, *supra* note 7, at 51–187 (highlighting the success of Bermuda,

OFCs in the British Commonwealth were cultivated over time and from afar.[294] Their beginnings can be traced to British courts circa 1876 with court rulings that "allow[ed] companies to incorporate in Britain without paying tax."[295] Due to the nature of the common law and the expanse of the British Empire at the time, this type of ruling was binding on remote colonies like "Bermuda, the Bahamas, and later the Cayman Islands and Hong Kong."[296] Commentators have described how elites in London capitalized on this allowance and orchestrated a network of offshore centers throughout the Caribbean to serve their interests.[297] But there is more to this narrative.[298]

Much of the story began after World War II when Britain lacked the financial and military capacity to hold and maintain its colonies.[299] At the same time, London had developed "a relatively powerful, and more importantly, internationally-oriented financial sector."[300] Thus Britain was "in search of quick and easy 'savings' to

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Singapore, and other jurisdictions); *see also* Freyer & Morris, *supra* note 125, at 1297–1398 (highlighting the rise of Cayman).

[294] PALAN ET AL., *supra* note 53, at 124–42.

[295] *Id.* at 112.

[296] *Id.* at 115; *see, e.g.*, Todd v. Egyptian Delta Land & Inv. Co. [1929] 1 KB 119, 150 (HL) (appeal taken from Eng.) (a key case in the United Kingdom that allowed foreign firms registered in the United Kingdom to avoid taxation because they operated elsewhere).

[297] *See* SHAXSON, *supra* note 74, at 88–91.

[298] At the fall of the British Empire, elites in Britain sought to retain their global power through a less visible means—international finance. *Id.* at 88. This was made feasible by the Bank of England, which allowed English Banks to engage in unregulated foreign transactions in foreign currency. *Id.* These types of transactions slowly and deliberately spread to Britain's offshore territories, perhaps the most well-known being Cayman. *Id.* The City of London of Corporation, as distinct from the City of London, was at the center of this development. *Id.* Indeed, the accommodating regulations of the Bank of England, which was heavily influenced by the City of London Corporation, made London an attractive place to foreign banks. But London was not enough. *Id.* Banks situated in the City of London Corporation would in turn establish branches in former colonies and current territories of Britain. *Id.* at 89.

[299] *See* JOHN DARWIN, BRITAIN AND DECOLONIZATION: THE RETREAT FROM EMPIRE IN THE POST-WAR WORLD 3–33 (1988); Ronen Palan, *International Financial Centers: The British Empire, City-States and Commercially Oriented Politics*, 11 THEORETICAL INQUIRIES L. 149, 174 (2010).

[300] PALAN ET AL., *supra* note 53, at 165.

maintain its unwieldy empire" and was consequently, "keen to embrace tax haven status for its small colonial outposts, because it kept the local elites happy and lowered payments from London."[301]

At the time of the British Empire's decline, its currency was weakening, and "the British government imposed strict restrictions on the use of the pound sterling in trade credits with nonresidents."[302] The British pound had sunk so low in value at the end of World War II that "no one wanted to hold it."[303] As an alternative, British banks began to use other currencies when engaging in international transactions—such as the U.S. dollar—claiming that this was allowable under the relevant banking restrictions at the time.[304] These types of transactions were referred to as "Euromarket transactions" and the Bank of England did not penalize them.[305] Consequently, among other standard banking requirements, "reserve depository requirements were not applied to Euromarket transactions."[306] They were deemed to be foreign transactions that were technically not within the Bank of England's jurisdiction.[307] In short, these unregulated Euromarket transactions were considered early offshore banking transactions.[308] These unregulated markets ultimately became both feasible and popular beyond the shores of England.[309]

OFCs exist in different parts of the world where Britain had colonies, but the islands of the Commonwealth Caribbean have a high concentration.[310] For example, seven of the United Kingdom's current fourteen Overseas Territories, and three Crown Dependencies, are deemed OFCs.[311] These are the Overseas Territories of "Bermuda, Cayman Islands, British Virgin Islands, Gibraltar, Turks and Caicos, Anguilla, and Montserrat," and the

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[301] *Id.* at 124–25.

[302] *Id.* at 160.

[303] JOHN DARWIN, UNFINISHED EMPIRE: THE GLOBAL EXPANSION OF BRITAIN 352 (2013).

[304] PALAN ET AL., *supra* note 53, at 160.

[305] *Id.* at 161.

[306] *Id.*

[307] *Id.*

[308] *Id.*

[309] *Id.* at 167.

[310] *Id.* at 124.

[311] *Id.*

"Crown Dependencies of Jersey, Guernsey, and the Isle of Man."[312] A majority of the Overseas Territories are in the Commonwealth Caribbean, which makes them particularly worthy of further study and comparison with non-OFC jurisdictions of similar geography, colonial history and size where it concerns OFC development.[313] It bears noting that several independent Commonwealth Caribbean post-colonies are also considered OFCs.[314] These include Antigua and Barbuda, Barbados, Belize, Grenada, Saint Kitts and Nevis, Saint Lucia, as well as Saint Vincent and the Grenadines.[315]

C. Searching for State Capacity

The political climate in Britain's tiny Caribbean colonies and overseas territories provided a ripe atmosphere for OFC development during the post–World War II period.[316] Many of these jurisdictions had become interested in international finance because of what they thought it could do for their economies.[317] Two factors were particularly critical to the OFC enterprise in these places. First, nationalism was on the rise—with local elites vigorously making the case for political independence.[318] These elites wanted self-governance—or at least local legislative autonomy.[319] Second, there was a desire to transform their economies to serve the needs of growing populations.[320] For those colonies that ultimately achieved their sovereignty—predominantly between the 1960s and '80s—they were faced with serious economic

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[312] *Id.*

[313] *See, e.g.*, Moon, *Delaware's New Competition*, *supra* note 1, at 1423 (explaining that it is worth studying Bermuda, BVI, and Cayman because of their global prominence).

[314] BRUNER, *supra* note 7, at 21.

[315] *See* Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1067.

[316] *See id.* at 1060.

[317] *See id.*

[318] *See, e.g.*, CHARLES C. MOSKOS, JR., THE SOCIOLOGY OF POLITICAL INDEPENDENCE: A STUDY OF NATIONALIST ATTITUDES AMONG WEST INDIAN LEADERS 308 (1967).

[319] *See, e.g.*, Freyer & Morriss, *supra* note 125, at 1338.

[320] BERRY, *supra* note 270, at 17–35.

difficulties.[321] The colonial enterprise had nurtured plantation economies throughout most of the Caribbean to service the needs of the British Empire.[322] The elites in the post-colonies and remaining British Overseas Territories (BOTs) thought it was crucial to reorient the economies they inherited toward different and more productive types of commercial activities.[323] Further, after centuries of colonial rule, these small Caribbean jurisdictions were actively in pursuit of new and more sophisticated sources of economic growth.[324]

Economic diversification became the new goal, and business, community, and political leaders within these jurisdictions were eager to find new sources of foreign exchange to pay for the imports they required.[325] While this budding desire for self-governance and economic growth blossomed, Britain—London in particular—saw its small territories and former colonies as an ideal way to develop a network of offshore jurisdictions that could funnel business back to the Empire.[326] Some commentators note that:

> Serious discussions of the introduction of wealth taxes in Britain also created a growing demand for offshore products within the sterling area (as the exchange control area managed by the British and incorporating both colonies and some former colonies were known), as did the weakening of capital controls brought about by the British return to current account convertibility in 1959.[327]

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[321] *Id.*

[322] *Id.* Since the colonial enterprise was predominantly skewed toward external (British) interests as opposed to local ones, the economy that remained at the time of political independence required reform. *Id.* According to Alex Dupuy, "[t]he purpose of colonization was obviously to secure new markets and sources of raw materials, and wealth for colonizing powers." Alex Dupuy, *Slavery and Underdevelopment in the Caribbean: A Critique of the "Plantation Economy" Perspective*, 7(3) DIALECTICAL ANTHROPOLOGY 237, 238 (1983); *see also* ERIC WILLIAMS, CAPITALISM AND SLAVERY 98–107 (1994).

[323] *See* Dupuy, *supra* note 322, at 237–38; BERRY, *supra* note 270, at 17–35.

[324] *See, e.g.*, Freyer & Morriss, *supra* note 125, at 1303.

[325] *See, e.g.*, Griffith, *Economic Smallness*, *supra* note 269, at 939–58; *see also* Griffith, *Caribbean Countries*, *supra* note 269, at 25–27.

[326] *See* SHAXSON, *supra* note 74, at 87–106.

[327] Freyer & Morriss, *supra* note 125, at 1312.

Further, there was an abiding concern in Britain[328] that those colonies that had not pursued political independence would remain indefinitely dependent upon the Empire.[329]

One concern was the limited capabilities of these small jurisdictions.[330] According to Ronen Palan, "whereas large, heavily populated states have a great many instruments of competition at their disposal, the smallest states cannot realistically compete for large-scale production or manufacturing facilities, nor can they compete in high-value sectors."[331] With the potential for a steady flow of foreign investors, the offshore financial market promised to create a new growth engine for these small economies.[332] And, with that possibility, offshore financial services emerged as a viable development strategy.[333] The fundamental tools for this kind of activity—a ready market, attractive business laws, and skilled professionals—were within reach for even the smaller and more resource-constrained jurisdictions.[334]

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[328] But it would be a mistake to frame the British position as monolithic or uniform. *Id.* Interest groups within the government had divergent concerns. *Id.* Andrew Morriss and Lotta Moberg note:

> During internal British government debates over the establishment of tax havens in Britain's overseas territories, the British Treasury worried about revenue losses, the Foreign and Colonial Office about the fiscal sustainability of the territories and their budgetary impact on Britain, and the Bank of England about the implications for exchange control.

Andrew P. Morriss & Lotta Moberg, *Cartelizing Taxes: Understanding the OECD's Campaign Against Harmful Tax Competition*, 4 COLUM. J. TAX L. 1, 11 (2012).

[329] Tony Freyer and Andrew Morriss note that:

> Given its concerns over being left with an expensive legacy of financially dependent territories, Britain's interest in the region focused on finding a means for fiscal self-sufficiency in the Caribbean. The Colonial Office was intent that Britain not be 'left with a residue of financially dependent territories such as Caymans, Turks and Caicos, and the British Virgin Islands.'

Freyer & Morriss, *supra* note 125, at 1318.

[330] *Id.* at 1312.

[331] PALAN ET AL., *supra* note 53, at 167; *see* Enriquez & Centeno, *supra* note 176, at 130–32; Soifer & vom Hau, *supra* note 178, at 1.

[332] *See generally* ROSE-MARIE BELLE ANTOINE, CONFIDENTIALITY IN OFFSHORE FINANCIAL LAW (2002).

[333] *See* PALAN ET AL., *supra* note 53, at 159–60.

[334] *See id.* at 184–85.

But, despite the social and economic forces pushing toward international finance, not all of Commonwealth Caribbean post-colonies would become OFCs—nor find economic growth.[335] And, of those who became OFCs, not all would become successful—as measured by the number of incorporations and investments flowing to their shores.[336] William Moon notes that "corporations traded on American securities markets like the New York Stock Exchange tend to cluster around only a handful of jurisdictions, suggesting that there is something more than tax motivating their behavior."[337] For example, as of 2018, 18.5% of foreign corporations[338] were incorporated in the Cayman Islands and 5.8% were incorporated in Bermuda.[339] BVI accounted for 4.5% of foreign incorporations.[340] According to Moon, "about a quarter of firms incorporated in foreign nations are accounted for by three jurisdictions ... the Cayman Islands, Bermuda and [BVI]."[341]

D. Institutional Learning and State Capacity

It is generally accepted that colonial history matters for development.[342] But scholars have only recently begun to explore how specific kinds of colonial experiences may have impacted current approaches to institutional development, including the rule of law, in the post-colonial period.[343] For example, legal scholars Ronald Daniels, Michael Trebilcock, and Lindsey Carson suggest that the various ways the British governed their colonies and the way citizens of those colonies responded to the chosen governance model mattered for "the long-run, stable commitment to legality" when the colony became a sovereign state.[344] The authors focus on specific features of British colonial governance.[345] They

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[335] *See* Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1060, 1064.

[336] *Id.*

[337] Moon, *Delaware's New Competition*, *supra* note 1, at 1426–27.

[338] Moon uses this term to refer to "firms incorporated in foreign nations"—that is, not in the United States. *Id.* at 1424–26.

[339] *Id.* at 1427.

[340] *Id.*

[341] *Id.* at 1426.

[342] *See, e.g.*, ATUL KOHLI, IMPERIALISM AND THE DEVELOPING WORLD: HOW BRITAIN AND THE UNITED STATES SHAPED THE GLOBAL PERIPHERY 1 (2020).

[343] *See, e.g.*, KOHLI, STATE DIRECTED DEVELOPMENT, *supra* note 23, at 1.

[344] Daniels et al., *supra* note 33, at 127.

[345] *Id.*

investigate "(1) the degree of representation in legislative bodies afforded to the indigenous population and (2) the extent to which indigenous and British common law courts and animating values were integrated, fostering the development of a localized common law jurisprudence."[346] In short, the authors suggest colonial history may have played a critical role in the "long-term persistence" of how law and legal institutions are perceived and designed for development in some places.[347]

But not all well-designed laws will serve their desired ends.[348] Some scholars of development note "it is not the case that once institutional rules are established, role occupants blindly follow. Instead, they constantly modify the rules, transform them, and bypass them in the course of their daily interaction."[349] Institutions are therefore only as effective as the actors who engage and change them—i.e., they are products of the social environment.[350] A key difference between successful and unsuccessful OFCs (or merely aspiring OFCs) in the area of regulatory competition may relate to social environment within which the state's institutional capabilities developed.[351]

Orlando Patterson proposes that institutional knowledge matters for development.[352] Indeed, it may reasonably be considered a type of state capacity.[353] Patterson suggests there are two types of institutional knowledge: "declarative and procedural."[354] The difference between the two is in the *how*.[355] "Declarative knowledge can be learned verbally, whereas procedural knowledge is learned only through observation and practice; it is, for example,

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[346] *Id.*

[347] *Id.* at 113; *see* Luigi Guiso et al., *Long-Term Persistence*, 14 J. EUR. ECON. ASSOC. 1401, 1410 (2016).

[348] *See* PATTERSON, *supra* note 33, at 22–38.

[349] Alejandro Portes, *Institutions and Development: A Conceptual Reanalysis*, *in* INSTITUTIONS COUNT: THEIR ROLE AND SIGNIFICANCE IN LATIN AMERICAN DEVELOPMENT, *supra* note 191, at 8.

[350] *See* NORTH, *supra* note 35, at 1018–23. According to Centeno and Portes, "[n]o doubt, 'institutions matter,' but they are themselves subject to ... 'the problem of embeddedness': The fact that the human exchanges that institutions seek to guide in turn affect these institutions." Centeno & Portes, *supra* note 164, at 8.

[351] Centeno & Portes, *supra* note 164, at 8.

[352] PATTERSON, *supra* note 33, at 25–26.

[353] *See id.* at 24–26.

[354] *Id.* at 25.

[355] *Id.*

the difference between knowing what a bicycle is and does and how to ride one."[356]

According to this thesis, "institutional learning and practice" may explain the divergent economic development outcomes of countries.[357] Countries must inherit an appropriate degree of "procedural knowledge" to effectively manage and adapt their institutions in ways that will produce high levels of economic (and social) gain in the long run.[358] While declarative knowledge (e.g., specific legal rules) is important, perhaps procedural knowledge is more critical for coordinating factors like network externalities, the influence of special interests on legal reform, and legal institutional isomorphism for economic competition.

IV. INSTITUTIONAL LEARNING AND OFC DEVELOPMENT

This Part explicitly connects the colonial history of Caribbean jurisdictions, the state capacity concept and the development of OFC status. It suggests that state capacity may have been harnessed in a particular manner in some Commonwealth Caribbean jurisdictions, which made them well suited for the OFC enterprise. More specifically, OFC state capacity may have emanated from specific types of institutional learning.[359] The cases of Barbados, Cayman Islands, and Jamaica—three Commonwealth Caribbean jurisdictions—demonstrate the differences in institutional learning during the colonial period and how this learning may have influenced both the decision to become an OFC and the level of success ultimately attained once that choice was made.[360]

Barbados, Cayman Islands, and Jamaica represent points on a spectrum. Cayman is a well-developed OFC.[361] Cayman is a territory of Britain and one of the world's most prominent OFC.[362]

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[356] *Id.*

[357] *Id.* at 22–24.

[358] *Id.* at 107–13. Patterson argues that Barbados's greater economic success compared to Jamaica's is due to a British colonial history that facilitated a greater degree of procedural knowledge about institutions of governance than the colonial history experienced by Jamaica, which only afforded leaders declarative knowledge. *Id.* at 107–09.

[359] *See infra* Section IV.A.

[360] *See infra* Section IV.A.

[361] *See* Moon, *Delaware's New Competition*, *supra* note 1, at 1426.

[362] *See id.* at 1448; Freyer & Morriss, *supra* note 125, at 1297–1300.

Barbados is a sovereign nation, ex-colony of Britain, and a reasonably well-developed OFC.[363] Jamaica is also a sovereign nation and ex-colony of Britain, but it is not an OFC.[364]

This Part uses cases from the Commonwealth Caribbean for two key reasons. First, the jurisdictions in this region generally reflect a strong tie between British colonial heritage and OFC activity.[365] Specifically, this selection of jurisdictions control for the British common law tradition—i.e., declarative knowledge inherited during the colonial period. Christopher Bruner artfully notes that the connection of OFC activity to English legal origins in small jurisdictions "has been so frequently remarked upon that it is worth exploring, at least briefly, how far this might take us in describing and evaluating this category of jurisdictions."[366]

Second, these small jurisdictions provide more readily available and accessible case studies that can prove insightful to larger and more complex societies.[367] Economist Peter Blair Henry argues wealthier countries can learn important economic lessons about growth from smaller developing nations.[368]

As noted in Part II, some scholars argue that a state with a well-qualified and reasonably autonomous bureaucracy is well governed and capable of good policy choices.[369] In the case of OFCs, successful non-American jurisdictions like Cayman and Barbados, arguably have a well-developed bureaucracy of experts specially equipped to address financial regulations and adjust to changing international politics.[370]

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[363] *See* PATTERSON, *supra* note 33, at 89–96.

[364] *See id.*

[365] Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1064–66.

[366] BRUNER, *supra* note 7, at 28.

[367] Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1065–66.

[368] HENRY, *supra* note 42, at 17–19.

[369] *See supra* Part II; Fukuyama, *What Is Governance?*, *supra* note 146, at 360. Political scientist Francis Fukuyama suggests that if an "agency were full of professionals with graduate degrees from internationally recognized schools, one would not just feel safer granting them considerable autonomy, but would actually want to reduce rule boundedness in hopes of encouraging innovative behavior." *Id.*

[370] *See* Freyer & Morriss, *supra* note 125, at 1300; PATTERSON, *supra* note 33, at 104–05.

These experts understand the overarching policy directives of elected officials and are able to suggest and implement regulations geared at achieving these goals.[371] To the extent that these bureaucrats are professionals—accountants and lawyers, for example—they are typically self-regulated and bound by "professional norms that seek to preclude certain self-seeking behavior."[372] This combination of deep expertise, autonomy, and normative guidance suggests that the ability to coordinate key professional networks,[373] effectively blend public sector goals with private sector innovations,[374] and choose other jurisdictions with which the OFC should be isomorphic in terms of rules and institutional design.[375]

A. Learning Confidence in Lawmaking: Barbados v. Jamaica

Consider the cases of Barbados and Jamaica, two small Commonwealth Caribbean island ex-colonies of Britain.[376] Barbados has become an OFC in the post-colonial period, but Jamaica has not, despite both countries' inheritance of British common law institutions.[377] One explanation for this divergence could be the difference in size between the islands.[378] Jamaica has a land mass of 27,750 square kilometers and is just shy of three million people, compared to Barbados, which is 430 square kilometers with a population just over 280,000 people.[379] A smaller jurisdiction may

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[371] PATTERSON, *supra* note 33, at 107–08.

[372] *See* Fukuyama, *What Is Governance?*, *supra* note 146, at 361.

[373] *See* Freyer & Morriss, *supra* note 125, at 1336–41. (Here, this Article refers to those networks of professionals in the country, as well as those that flock to their shores from North American countries.)

[374] *See* Fukuyama, *What Is Governance?*, *supra* note 146, at 361.

[375] *See* PATTERSON, *supra* note 33, at 99–104.

[376] Legal scholars and social scientists have undertaken careful comparative economic, legal, and socio-historical studies of both island nations. *See, e.g.*, Daniels et al., *supra* note 33, at 131; PATTERSON, *supra* note 33, at 89–90; HENRY, *supra* note 42, at 21–44; Martin W. Sybblis, *Law, Growth, and the Identity Hurdle: A Theory of Legal Reform*, 95 TUL. L. REV. 867, 896–901 (2021).

[377] *See* PATTERSON, *supra* note 33, at 89–103.

[378] *Id.* at 87.

[379] *See* BERRY, *supra* note 270, at 11; Jamaica—World Bank Open Data—WORLD BANK, https://data.worldbank.org/indicator/SP.POP.TOTL?locations=JM [https://perma.cc/PP6L-Q5EQ]; Barbados—World Bank Open Data—WORLD BANK, https://data.worldbank.org/indicator/SP.POP.TOTL?locations=BB [https://perma.cc/5EF3-SKBG].

lack a substantial local corporate sector from which it can derive taxes and consequently may be more likely to look externally for revenue opportunities.[380] On a related note, as compared to larger jurisdictions, smaller jurisdictions may be more prone to legislative capture by external special interests because they may lack significant domestic constituencies to resist these interests.[381] But this explanation does not account for several larger countries than Barbados that are prominent OFCs—e.g., Singapore, with a population of over five million people.[382]

Another potential explanation for Barbados's status as an OFC and Jamaica's status as a non-OFC is how each country's community economic identity (CEI)—i.e., "public and recognizable identities developed by community leaders"[383]—was formed in the decades following the colonial period.[384] Indeed, it has been argued that CEI informs a community's development strategy and legal reform choices in the business arena.[385] But CEI itself is influenced by, among other factors, a jurisdiction's resources and historical choices, both of which implicate state capacity considerations.[386] Colonial history may play a critical role in the "long-term persistence" of resource constraints and perceptions about how development should unfold to support a new political and economic identity in the post-colonial period.[387] A look into the actual process of institution formation as a vehicle for state capacity could provide some insights here.[388]

For example, as of 1834—after the abolition of slavery—and contrary to the trend to abolish representative legislatures in colonial island outposts,[389] Barbados kept its representative

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[380] *See* Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1065–66; Dharmapala, *supra* note 287, at 663.

[381] Dharmapala, *supra* note 287, at 663–65.

[382] Singapore—World Bank Open Data, THE WORLD BANK, https://data.worldbank.org/indicator/SP.POP.TOTL?locations=SG [https://perma.cc/QJ9J-4LF3].

[383] Sybblis, *supra* note 376, at 871.

[384] *Id.* at 896.

[385] *Id.* at 930–31.

[386] *Id.*

[387] *See* Luigi Guiso et al., *Long-Term Persistence*, 14 J. EUR. ECON. ASS'N 1401, 1433 (2016).

[388] PATTERSON, *supra* note 33, at 104.

[389] *See* Jean-Paul Carvalho & Christian Dippel, *Elite Identity and Political Accountability: A Tale of Ten Islands*, 130 ECON. J. 1995, 2006–07 (2020); *see also* PATTERSON, *supra* note 33, at 41.

legislature.[390] This was due to a unique socio-history of slavery which made Barbadian colonists feel sufficiently comfortable and less threatened by the ex-slave population to make the island home and build durable institutions.[391] This choice may have inadvertently served an important role in the islands post-colonial development.[392] The retention of the legislature allowed Black Barbadians—albeit at a slow pace—the early ability to participate in the local legislature.[393] This allowed them early exposure

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[390] Carvalho & Dippel, *supra* note 389, at 1996–97 (noting that Barbados did not terminate its legislative assembly and "was also the only island [of ten studied] not to experience significant change in the composition of the political elite, with the old [W]hite elite holding more than 90% of assembly seats.").

[391] PATTERSON, *supra* note 33, at 40–42.

[392] Carvalho & Dippel*, supra* note 389, at 2021–22. According to Patterson, the geography of Barbados—especially physical landscape and relative mildness of the climate—played an important role in making colonists feel welcome and willing to invest their time and energy in building local institutions. PATTERSON, *supra* note 33, at 40–42. Factors, including greater access to suitable land for sugar plantations and the ability to sufficiently control rebellions, also made the island desirable to colonists. *Id.* at 38–39. For example, Patterson notes that "[f]ar more committed to residence on the island, Barbadian [W]hites were likelier [than their Jamaican counterparts] to regard the island as their permanent home rather than to yearn for the leisurely life of an absentee landlord in Britain." *Id.* at 44. Where it concerned the post-emancipation period, Patterson argues:

> So confident was the Barbadian elite of its control of the Barbadian working class that Barbados was the only Caribbean island not to abolish its system of elite representative government in the latter half of the nineteenth century in favor of direct Crown colony rule from Britain out of fear of being taken over by the increasingly educated colored groups. The Barbadian Assembly remained in place until the 1950s, which contributed to securing a three-hundred-year history of legislative continuity. Another remarkable expression of the elite's self-confidence appeared much earlier, as the island's police force was composed entirely of Afro-Barbadians by 1842, a mere four years after the abolition of slavery.

Id. at 64.

[393] *See* Daniels et al., *supra* note 33, at 138–41. Economists Jean-Paul Carvalho and Christian Dippel, suggest that Barbados's geography was important to the post-colonial franchise of Blacks. *See* Carvalho & Dippel, *supra* note 389, at 2022. The island "consisted of flat limestone rather than rugged volcanic stone." *Id.* The consequence was significant. *See id.* According to the scholars:

> This meant plantations comprised of 95% of land on the eve of emancipation, compared with under 50% elsewhere in the Caribbean. Therefore, post-emancipation Barbados had no hinterland that [B]lack citizens could purchase, so they obtained

to the power and promise of the legislative process long before the country achieved political independence 132 years later in 1966.[394]

By contrast, and as a direct result of its own socio-history of slavery, in 1865 the legislative body in Jamaica was dissolved.[395] This was done "at the request of [W]hite colonists concerned about the emerging political power of the former slaves in their colony."[396] Black Jamaicans experienced arbitrary state rule and were excluded from meaningful opportunities for practice with self-governance.[397] Jamaicans, therefore, inherited a post-colonial state, including a bureaucracy, which had limited experience with the type of governance[398] necessary for the rapid economic growth required of the small post-colonial developing jurisdiction.[399]

The difference between Barbados and Jamaica—and other British post-colonies for that matter—suggests that common law inheritance and historical connections to Britain alone were not sufficient for OFC formation or subsequent competitiveness.[400] Experience with building and operating legal institutions may have mattered more.[401] Arguably, Black Barbadians had greater experience with law making during the colonial period and were therefore empowered by their ability to influence social policy, placing opportunities like offshore finance squarely within their institutional capabilities.[402] Black Jamaicans would have to wait

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> the franchise at a much lower rate than elsewhere. As such, the share of new elites in the Barbadian assembly remained below 10% throughout the nineteenth century. Changes in the composition of the Barbadian assembly were so muted that institutional change never became necessary ....

Carvalho & Dippel, *supra* note 389, at 2022.

[394] Daniels et al., *supra* note 33, at 138–41, 139 n.101.

[395] *Id.* at 140.

[396] *Id.* at 131.

[397] *Id.* at 140 n.103.

[398] Commentators note that: "after nearly a century of political and economic exclusion, Jamaica's [post-colonial] leadership focused on reorienting the state apparatus to further the interest of indigenous Jamaicans (who were almost all [B]lack working-class citizens), rather than crafting a limited government with institutionalized checks and balances." *Id.* at 140–41.

[399] *See* PATTERSON, *supra* note 33, at 28–29.

[400] DAM, *supra* note 40, at 49–55.

[401] PATTERSON, *supra* note 33, at 37.

[402] According to Daniels et al.,

> By retaining its representative legislature, Barbados continued to provide its residents with a means of popular expression

until 1944 to experience self-government.[403] To the extent that better governance is impacted by how a government deploys laws and legal institutions for the general public welfare, earlier exposure to lawmaking and the actual method of institutional learning are important variables to consider.[404]

Rather than viewing small island ex-colonies and existing BOTs as homogenous places that are immediately receptive to legislative capture in pursuit of foreign income, it is worth paying close attention to early strategies of both the colonizer and the colonized regarding how institutions actually developed.[405] For example, more deeply entrenched British political and legal institutions emerged in Barbados by virtue of a colonial choice to build a "settler elite democrac[y]."[406] This meant the British colonists saw the island as a new and permanent home and invested in churches, schools, "institutions of private property, parliamentary democracy, the rule of law, and functioning judiciaries."[407] The colonists did not have the same perception of Jamaica.[408]

> through formal government channels, thereby opening opportunities for the development of diverse interests—divorced from those of the state apparatus—that could in turn continue to foster the institutional elements necessary for the functioning of a rules-based, impartial, accessible, and efficient legal system.

Daniels et al., *supra* note 33, at 139.

[403] According to Daniels et al.,

> In 1865, they voted to dissolve the legislative council and switched to crown colony status in order to maintain their monopolistic control of economic and governmental power. The new nominative council structure did not afford any scope for elected seats and consisted solely of [W]hite representatives; although a small handful of elective seats were introduced by the Colonial Governor in 1885, burdensome financial requirements for office-holders persisted and ultimately limited the ability of [B]lacks to run for office. Blacks remained politically disempowered, while power remained largely concentrated in the hands of a small group of [W]hite British landholders and merchants until the institution of universal suffrage in 1944.

Daniels et al., *supra* note 33, at 140.

[404] PATTERSON, *supra* note 33, at 112–13.

[405] Daniels et al., *supra* note 33, at 155–58.

[406] PATTERSON, *supra* note 33, at 112; *see also* Daniels et al., *supra* note 33, at 155–58.

[407] PATTERSON, *supra* note 33, at 112.

[408] *Id.* at 111–14.

According to Patterson, British colonists viewed Jamaica as unwelcoming due to its relatively harsher climate and terrain, which made it less conducive to the development of dense sugar plantations—a resource of great interest to them. The mountainous terrain was also more conducive to frequent slave uprisings.[409] As a result, the colonist were disinclined to make the island a permanent home and, consequently, the quality of institutional learning and governance capabilities that emerged there were lower than in Barbados.[410] This colonial history set the stage for social instability and political turmoil in the early post-colonial years—which are not attractive for foreign investment or suitable for growth.[411]

In addition to gaining greater social and political stability in the colonial period than Jamaica, Patterson argues that Barbadians did not merely copy British institutions; they were able to master them.[412] This proficiency may account for the state capacity to effectively engage in OFC activities.[413] With it came the ability to (1) capitalize on professional networks, (2) incorporate private sector innovation without significant legislative capture, and (3) strategically choose the types of laws and regulations that best fit its growth policies—not merely copy them from other jurisdictions.[414]

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[409] *Id.*; *see also* TREVOR BURNARD, JAMAICA IN THE AGE OF REVOLUTION 3 (2020); TOM ZOELLNER, ISLAND ON FIRE: THE REVOLT THAT ENDED SLAVERY IN THE BRITISH EMPIRE 4 (2020).

[410] *See generally* PATTERSON, *supra* note 33.

[411] *See generally* EVELYNE HUBER STEPHENS & JOHN D. STEPHENS, DEMOCRATIC SOCIALISM IN JAMAICA: THE POLITICAL MOVEMENT AND SOCIAL TRANSFORMATION IN DEPENDENT CAPITALISM (1986) (providing a detailed historical account of Jamaica with a focus on the interaction of economics and politics).

[412] *See* PATTERSON, *supra* note 33, at 115.

[413] According to Patterson:

> British elite [W]hites, and increasingly upper-class [W]hite Americans, find the Barbadian social system extremely congenial, and this has partly accounted for the growth of a flourishing offshore banking sector and expatriate [W]hite community, a trend enabled by nimble legislative maneuvering.

PATTERSON, *supra* note 33, at 107.

[414] *Id.* at 7–8; *see also* Enriquez & Centeno, *supra* note 176, at 133. These abilities were on full display in the 1970s and 1990s when the country faced financial hardship due to international economic crises. *See* Henry & Miller, *supra* note 271, at 9–11. Policymakers controlled government spending, brought

Barbados's mastery of its legal institutions was also on full display over the past few years, as the country reformed its OFC sector.[415] Despite vigorous and consistent opposition from national leaders, the tiny Caribbean island was listed on European blacklists for its lack of transparency in international tax matters.[416] Accusations have primarily come from the European Union (EU) and the Organization for Economic Cooperation and Development (OECD), which represent some of the wealthiest nations.[417] In the wake of this effort to shame some OFCs, the ongoing discourse over international tax policy took a curious turn in the Barbadian parliament recently.[418] The parliament repealed legislation that granted tax preferences for international business companies (IBCs)[419] and now treats these entities as regular

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public and private sector actors together and facilitated joint sacrifices—including price constraints and wage cuts that helped to spur an economic revival. *Id.*

Henry and Miller suggest that:

> Countries have no control over their geographic location, colonial heritage, or legal origin, but they do have agency over the policies that they implement. Of particular importance for small open economies (i.e., most countries in the world), is the response of policy to macroeconomic shocks such as a fall in terms of trade. Pedestrian as it may seem to say, changes in policy, even those that do not have a permanent effect on growth rates of GDP per capita, can have a significant impact on a country's standard of living within a single generation.

Id. at 11.

[415] *OECD Says Barbados Will Not Appear on its Forthcoming List of Uncooperative Tax Havens*, ORG. FOR ECON. COOP. & DEV. (Jan. 31, 2002), https://www.oecd.org/ctp/harmful/oecdsaysbarbadoswillnotappearonitsforthcominglistofuncooperativetaxhavens.htm [https://perma.cc/G48H-ZUT3]; *Barbados Removed From EU's Blacklist*, INV. BARB. (May 17, 2019), https://www.investBarbados.org/news/barbados-removed-from-eus-blacklist/ [https://perma.cc/2DLR-KS8N].

[416] Mia Mottley, *Remarks of the Honorable Mia Mottley, Attorney General & Minister of Home Affairs of Barbados*, 35 GEO. WASH. INT'L L. REV. 411, 414 (2003).

[417] *See, e.g.*, Morriss & Moberg, *supra* note 328, at 11; INV. BARB., *supra* note 415; ORG. FOR ECON. COOP. & DEV., *supra* note 415.

[418] *See* Mottley, *supra* note 416, at 416.

[419] International Business Companies (Repeal) Act, 2018–40. An IBC is a foreign company that is registered in Barbados, but does business elsewhere. Mike Godfrey, *Barbados to Shutter IBC Regime, Remove Harmful Tax Provisions* (Nov. 16, 2018), https://www.lowtax.net/news/Barbados-To-Shutter-IBC-Regime-Remove-Harmful-Tax-Provisions-96950.html [https://perma.cc/5EVS-7TTW]. These companies opt to register in Barbados because of special tax preferences

Barbadian companies.[420] The result is that "domestic and international tax rates" have converged.[421]

At first glance, this move appears to have undercut the country's status as an OFC, since there is no clear tax-related carveout or preference for foreign business entities—one defining feature of OFCs.[422] It also undermines the argument that legislative capture explains many OFCs' choice of legislation.[423] Presumably, foreign firms, corporate lawyers and influential accounting firms would have pushed the country's lawmakers toward continuing to enact friendly tax legislation.[424] The recent developments in Barbados support the thesis that OFC governments tend to have the capacity to reform in creative ways and coordinate policy goals with the private sector efficiently.[425] Three points bear highlighting from Barbados's legislative strategy.

First, while the corporate tax rates in Barbados are still lower than in the United States,[426] the country's leaders perceive their advantage in the competition for IBCs as hinging on more than just low taxes—hence their departure from the status

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they receive and the country's company laws and legal institutions. *Id.* According to Invest Barbados, a government agency focused on economic development:

> An International Business Company (IBC) is a company that is licensed to carry on business in manufacturing, trade or commerce from within Barbados for customers residing outside of Barbados. An IBC may therefore manufacture, process or otherwise prepare products for export outside of Barbados or provide services to non-residents of Barbados.

International Business Companies (IBC), GO BARB., https://barbados.org/ibc.htm#.YTI3BdNKhQI [https://perma.cc/77RB-T4YB].

[420] Henderson Holmes, *Barbados: A Global Business Centre*, BUS. BARB, (Mar. 16, 2020), https://businessbarbados.com/industries/Barbados-global-business-centre/ [https://perma.cc/5XFP-7BA3].

[421] *Id.*

[422] BRUNER, *supra* note 7, at 48.

[423] Moon, *Delaware's New Competition*, *supra* note 1, at 114.

[424] *See id.*

[425] DIONNE & MACEY, *supra* note 15, at 26.

[426] Corporate tax rates start at 5.00 percent on income of US $500,000 or less, and they decrease to 1.00 percent for income above U.S. $15 million. *Tax Rates—General*, INV. BARB., https://www.investbarbados.org/investing-in-barbados/setting-up-in-barbados/revised-tax-regime/ [https://perma.cc/84DK-LEJE]. The United States currently has a corporate tax rate of 21.00 percent. *See* Curtis Dubay, *Corporate Tax Rates and a Financial Transactions Tax in 2020*, 112 A.B.A. BANKING J. 49, 49 (2020).

quo.[427] Second, the country has demonstrated that its real strength resides in strategic policy making.[428] More precisely, their facility with lawmaking allows for an apparently seamless transition to a new era in their international business pursuits that maintains complementarity between the state's policy goals and the legal, bureaucratic, and private sectors of the country.[429] Third, Barbados's actions suggest that leaders have made the calculation that foreign corporations will maintain their affiliation with the country—despite the loss of preference—because of its overarching laws and legal institutions.[430] According to one commentator, "Barbados was confident in being a first mover in this tax reformation space because it has always prided itself on being a jurisdiction of substance rather than competing in the race to the bottom posed by zero tax environments."[431]

B. Procedural Knowledge in Cayman—Learning Through Trial and Error Alone

While Barbados provides a ready contrast to Jamaica in its institutional learning and subsequent development of OFC status, Cayman tells an even more compelling story. Cayman is one of the more well-known OFCs in the world.[432] While Barbados's institutional prowess may have evolved in part from the long-term investments in government, legal institutions, education, as well as other facets of social life during the colonial period,[433] Cayman had a different trajectory.[434] Its development was fueled

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[427] *See* Holmes, *supra* note 420. To date, other Caribbean OFCs have not similarly reformed the regulatory infrastructure of their offshore sector. *Id.*

[428] *See, e.g.*, PATTERSON, *supra* note 33, at 32.

[429] *Id.* at 83. This is unsurprising, since scholars theorize that Barbados's colonial past prepared the state to govern effectively and commit to the rule of law. *See id.*; Daniels et al., *supra* note 33, at 128–36.

[430] *See* MEDIA RES. DEPT., INDEPENDENCE RESOURCE BOOKLET 2014: CELEBRATING 375 YEARS OF PARLIAMENTARY DEMOCRACY & 48 YEARS OF INDEPENDENCE 1966–2014 5 (2014).

[431] Holmes, *supra* note 420.

[432] *See* Freyer & Morriss, *supra* note 125, at 1297–98; Dharmapala & Hines, *Which Countries*, *supra* note 15, at 1066; ORG. FOR ECON. COOP. & DEV., *supra* note 415.

[433] *See* PATTERSON, *supra* note 33, at 21–27; *see also* Daniels et al., *supra* note 33, at 131, 138–39, 159.

[434] *See infra* Section IV.B.

by early functional independence and the autonomy to craft an economy and society suitable to the needs of Caymanians.[435] This likely gave its early leaders the opportunity to build their governance capabilities first hand and strategically lay the foundations for the jurisdiction's economic future.[436] A detailed sociological historiography of Cayman, such as the one provided by Patterson for Barbados and Jamaica, is currently unavailable, but a few key points about how the jurisdiction developed the state capacity for international finance can be gleaned from the work of scholars across disciplines.[437]

Cayman's development strategy was arguably inductive.[438] Leaders followed opportunities where they arose and leveraged the social and physical endowments that were available to them.[439] One could articulate Cayman's approach in terms once used to describe China's development: "incremental, selectively adaptive, or more perceptive."[440] As an initial matter, Cayman's story is extraordinary, not only because it is now recognized as one of the top "emerging 'laboratories' of corporate law,"[441] but because of the jurisdiction's growth from an early, unsophisticated history as an isolated set of islands known for "provid[ing] turtle-meat for 'hungry ships'" to its current world status[442] as one of the wealthiest BOTs.[443]

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[435] Freyer & Morriss, *supra* note 125, at 1301. It bears noting that Cayman is comprised of three islands. They are Grand Cayman, Cayman Brac and Little Cayman. John E. Kersell, *Government Administration in a Small Microstate: Developing the Cayman Islands*, 7 PUB. ADMIN. & DEV. 95, 97 (1987). The islands "have a total area of approximately 100 square miles. Grand Cayman is situated 178 miles west-nor-west of Jamaica and 480 miles south of Miami ... largest island of the three is Grand Cayman, with an area of about 80 square miles." SIR VASSEL JOHNSON, AS I SEE IT: HOW CAYMAN BECAME A LEADING FINANCIAL CENTRE 31 (2001).

[436] Freyer & Morriss, *supra* note 125, at 1301.

[437] *See, e.g.*, *id.* at 1339–40; Howard A. Fergus, *The Cayman Islands: Britain's Maverick Caribbean Colony*, 29 J. E. CARIBBEAN STUD. 1, 2–3 (2004).

[438] *See* Freyer & Morriss, *supra* note 125, at 1299–300.

[439] Fergus, *supra* note 437, at 2–3.

[440] DAM, *supra* note 40, at 269 (noting that Deng Xiaoping has described China's development path as "crossing the river by feeling for stones").

[441] *See* Moon, *Delaware's New Competition*, *supra* note 1, at 1406.

[442] *See* Fergus, *supra* note 437, at 2–3.

[443] *Id.* at 2. Freyer and Morriss note that "between 1960 and 1980, the Cayman Islands went from being of the least developed, both legally and economically,

Cayman's prominence is a product of sustained institution building geared toward international finance in a most competitive world economy.[444] Like many island colonies in the Caribbean, Cayman had minimal state capacity for development prior to the 1960s.[445] The island became a British colony in the 17th century and quickly became a "colony of a colony" since it was administered by the British from the colony of Jamaica.[446] Curiously, perhaps because of its remoteness, the territory was effectively left to manage its own internal affairs during the early colonial period and became known for its rugged independence.[447] One scholar noted that "[e]ven [Cayman's] governors, though responsible to the Governor of Jamaica until 1962, rarely referred anything to Kingston and more rarely received any but the most general instructions therefrom."[448]

Unlike many British colonies in the Caribbean, Cayman did not experience the same type of agricultural (sugar) plantation economy—primarily because its geography was not conducive to this kind of activity.[449] As a result, there were fewer slaves and more racial intermixing occurred.[450] Some scholars argue that better race relations in Cayman proved helpful where governance was concerned, since there was less conflict around race matters.[451] A notable departure for Cayman's governance came in 1959, when its formal relationship with Jamaica[452] came to an end.[453] Cayman sought to remain a BOT, as opposed to becoming

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jurisdictions in a poorly developed region to surpassing its former colonial power in GDP per capita terms, and developing a sophisticated body of financial law." Freyer & Morriss, *supra* note 125, at 1300.

[444] Fergus, *supra* note 437, at 1.

[445] *Id.* at 6.

[446] *Id.* at 2.

[447] *Id.* at 3 (noting that "[t]he British Parliament placed [Cayman] under the legislative authority of Jamaica in 1863"); *see also* Kersell, *supra* note 435, at 96.

[448] Fergus, *supra* note 437, at 7 (noting that air transportation was established in the 1960s and with it "the rapid growth in tourism").

[449] *Id.* at 2.

[450] *Id.* at 3.

[451] Freyer & Morriss, *supra* note 125, at 1329–30; *see* Kersell, *supra* note 435, at 97.

[452] Jamaica became a sovereign country in 1962. JOHNSON, *supra* note 435, at 10.

[453] *Id.* at 112; *see also* Freyer & Morriss, *supra* note 125, at 1312–13.

politically independent, but with greater internal autonomy over its political and legal affairs.[454]

In a detailed analysis of Cayman's development as an OFC, Tony Freyer and Andrew Morriss highlight the efforts made by local leaders to create a legal environment[455] that balanced multiple interests.[456] These included a constitutional order that "promoted a regulatory and tax competitive advantage that avoided capture and resisted both corruption and abuse better than many other jurisdictions."[457] Cayman's success is likely also a product of the country's self-reliance and a sustained and systematic effort to build the capacity for international business.[458] Consider that, as of the early 1800s, Cayman had a high rate of illiteracy, lacked well-developed legislation, and arguably lacked a meaningful representative government—given that Caymanians were governed from Jamaica.[459] With no commercial banks until 1908,[460] Caymanians relied on "a largely barter-based domestic economy."[461] A few remarkable steps were taken by the island's leadership to advance the economy from this state.[462]

First, during the 1960s, Cayman recognized its potential as an OFC.[463] It had developed to this point without a direct tax; "its government's total income was derived only from indirect taxes."[464] Since this was a natural baseline for the country, it was feared that any change might deter investors.[465] Perhaps more

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[454] *See, e.g.*, Freyer & Morriss, *supra* note 125, at 1308–16.

[455] Freyer and Morriss used "archival sources, participant interviews, and a wide range of other materials" in their research and analysis. *Id.* at 1297.

[456] *Id.* at 1300.

[457] *Id.*

[458] *Id.*

[459] Fergus, *supra* note 437, at 4–5.

[460] JOHNSON, *supra* note 435, at 31.

[461] Freyer & Morriss, *supra* note 125, at 1305.

[462] *See infra* notes 463–92 and accompanying text.

[463] Howard Fergus notes that "[t]he Cayman Islands hit the scene as an offshore financial center around 1966 and gained the distinction of being a premier center after some 17 years." Fergus, *supra* note 437, at 7.

[464] JOHNSON, *supra* note 435, at 111 (noting that indirect taxes included "customs import duty ... sale of stamps, company registration and annual fees, banks and trust companies licensing fees, tourist accommodation tax," etc.).

[465] *Id*. Vassel Johnson argues that "Cayman ... developed well without the need to introduce any form of direct taxes such as income tax, corporation tax, capital gains tax, sales tax, inheritance tax, death dues etc." *Id.*

important, places like Bermuda, Bahamas,[466] Curacao, and "the Channel Islands and Europe generally" were already on the path to developing a reputation as tax havens[467] and provided a ready model. Second, while pre-existing OFCs provided a road map for the development of an international business sector,[468] Cayman had its own unique history and challenges and needed a path that best suited its reality.[469] In other words, a modified type of isomorphism was required.[470] Not only did Cayman have to decide which countries or jurisdiction to be isomorphic with, it also needed to determine the degree to which any other OFCs path was suitable for its political, social, and economic circumstances.[471] For example, as a consequence of the severed relationship with Jamaica, a new constitution was required that simultaneously maintained a connection with Britain[472] as a territory and

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[466] Bahamas became a sovereign country in 1973. *Our History*, BAHAMAS (Aug. 22, 2021), https://www.bahamas.com/our-history [https://perma.cc/9836-JTH3].

[467] Freyer & Morriss, *supra* note 125, at 1311.

[468] *See id.* at 1302, 1311.

[469] *See* Fergus, *supra* note 437, at 2–3 (identifying notable historical differences between Cayman and other OFCs).

[470] *See supra* notes 126–28 and accompanying text.

[471] *See* Freyer & Morriss, *supra* note 125, at 1300.

[472] A continued connection with Britain meant that Cayman could benefit from British legal institutions—which were credible to investors—and could also enjoy the "collaborative promotion of the offshore financial center." *Id.* at 1319. The credibility of Cayman's legal system is connected to its "English legal origins." *See* BRUNER, *supra* note 7, at 29–30. There is an argument that the common looms strong in the scholarship and policies addressing business friendly legal institutions. *See, e.g.*, Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131, 1132 (1997); La Porta et al., *Economic Consequences*, *supra* note 180, at 287; Ross Levine, *Finance and Growth: Theory and Evidence* 2–3 (Nat'l Bureau of Econ. Rsch., Working Paper No. 10766, 2004); DARON ACEMOGLU ET AL., A REVIEW, *supra* note 180, at 3; *see also* Besley, *supra* note 180, at 101. British Overseas Territories like Cayman rely wholly on the English common law or modifications thereof. *See* Michael J. Burns & James McConvill, *An Unstoppable Force: The Offshore World in a Modern Global Economy*, 7 HASTINGS BUS. L.J. 205, 219–20 (2011). This means that legal decisions are guided by judicial rulings in England, not to mention that the Judicial Committee of the Privy Council in England is the court of last resort for the vast majority of Commonwealth Caribbean OFCs. *Id.* Following English law provides OFCs with "well-defined and alienable

allowed for increased autonomy over domestic affairs.[473] A new companies law was also needed to allow "Cayman to register the companies on their own, without any reference to Jamaica or anywhere else."[474] And, on a similarly practical note, the islands considered it beneficial to establish an airline to transport tourists and investors to its shores and found it necessary to resolve its persistent problem with "mosquitos and sandflies."[475] The latter solutions were crucial to welcoming tourists, a good portion of whom would be interested in the financial sector.[476]

Third, Cayman built a network of experts.[477] With a small population, a "nascent Civil Service,"[478] few educational institutions,[479] and a handful of lawyers[480] on the island, outside experts were welcomed in the early days of international business.[481] Indeed, "an important source of policy innovation for Cayman was [a] slowly growing group of expatriate professionals."[482] These professionals would prove invaluable to the early business laws, including "Banks and Trust Companies Regulation Law" and "Trusts Law."[483] Ultimately, Cayman created the Cayman Island Monetary Authority (CIMA), an independent regulatory body with a mission to ensure that international banking standards are met and that crimes—like money laundering—are prevented.[484]

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private property rights; [and] a formal system of contract law that facilitates impersonal contracting"—core tenets of the New Institutional Economics ("NIE"). Davis & Trebilcock, *supra* note 23, at 903. Similarly, NIE scholars realize that the best of contract and property rules amounts to very little without an independent and reliable judiciary to enforce them. *See* DAM, *supra* note 40, at 93–122.

[473] *See* Freyer & Morriss, *supra* note 125, at 1312–13.

[474] *Id.* at 1315.

[475] *See* Fergus, *supra* note 437, at 7; JOHNSON, *supra* note 435, at 147.

[476] JOHNSON, *supra* note 435, at 147.

[477] *Id.*

[478] Freyer & Morriss, *supra* note 125, at 1320.

[479] *See* Kersell, *supra* note 435, at 98.

[480] *See* Freyer & Morriss, *supra* note 125, at 1326.

[481] *See id.*

[482] *Id.* at 1326, 1333.

[483] *Id.* at 1326.

[484] *See About Us*, CAYMAN ISLANDS MONETARY AUTHORITY (Aug. 22, 2021, 2:29 PM), https://www.cima.ky/about-us [https://perma.cc/Y974-GLFP]; *see also* Freyer & Morriss, *supra* note 125, at 1378.

Fourth, Cayman has sought to ensure that the legislation and regulation of the offshore sector is not captured by special interests.[485] The early days of international finance leaned heavily on private sector experts—lawyers, accountants and bankers—but there has subsequently been a determined and persistent effort to keep the government at the helm of the ship and fully in charge of the industry.[486] This approach has been described by scholars as one of "collaborative policymaking."[487] In practice, this meant that "government and business sectors worked together to develop an effective regulatory structure that both safeguarded the jurisdiction's reputation and facilitated profitable financial activity that provided law firms, accountants, insurance companies, company agents, and others with profits and the government with resources from fees."[488]

This is undoubtedly a delicate balance. The government seeks to maintain credibility in terms of transparency and fidelity to the rule of law with legitimate investors, but does not want to overregulate.[489] If it does, it could "[kill] the goose that laid the golden eggs."[490] Political leaders are well aware of the likelihood and dangers of legislative capture and seek to minimize the risks of too much special interest influence, while gaining from the benefits of innovation that comes from the private sector.[491] The presence of CIMA helps to ensure an acceptable standard of quality among the banking sector and to offset the strong influence of corporate actors.[492]

The special interest aspect to offshore finance is complicated.[493] But, it is likely that where commentators end in their analyses largely depends on their starting point.[494] If one begins with the assumption that the United States (or another wealthy

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[485] *See* JOHNSON, *supra* note 435, at 111–12.

[486] *See* Freyer & Morriss, *supra* note 125, at 1301, 1388–90; *see also* JOHNSON, *supra* note 435, at 111–12. Freyer & Morriss, *supra* note 125, at 1297.

[487] Freyer & Morriss, *supra* note 125, at 1297.

[488] *Id.* at 1301.

[489] *See id.*

[490] *See id.*

[491] *See id.* at 1300.

[492] *See id.* at 1394–95.

[493] *See* Moon, *Delaware's New Competition*, *supra* note 1, at 1405–06.

[494] *See id.* at 1432–33.

nation) is the reference point for comparative analysis, there may likely develop concerns that American special interests are influencing the political and legal apparatus on a nearby small island and will then depart for those shores to take advantage of various legal and tax benefits.[495] But, if one begins from the perspective of the offshore sector, it is possible to see special interests as contributors to a vibrant and competitive sector—i.e., merely sources of technology and not dictators of how that technology is ultimately used.[496]

In summary, institutional learning is an important component of state capacity. How countries develop and the choices they make are a function of how and what they learn along the way.[497] Two examples of institutional learning can be gleaned from the OFCs of Barbados and Cayman.[498] On the one hand, Barbados—in contrast to Jamaica—learned the art of governance by practicing, engaging, and building on the institutions developed by colonists during the colonial period.[499] On the other hand, Cayman learned the art of governance by trial and error through its own determined exploration.[500]

CONCLUSION

In the past few years, scholarly attention has been drawn to the development of competitive OFCs that provide sophisticated corporate law for American firms.[501] While commentators acknowledge that these jurisdictions are leading a form of revolution in the corporate law arena,[502] the depth of this revolution is not yet fully understood.[503] If OFCs provide examples of good governance, scholars, policymakers, and development practitioners should seek to learn how these jurisdictions cultivated these governance skills for purposes of economic development.[504] Instead

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[495] *See id.* at 1429.
[496] *See* Farber, *supra* note 101, at 183.
[497] *See supra* text accompanying notes 54–56.
[498] *See supra* Part IV.
[499] *See supra* text accompanying notes 383–88.
[500] *See supra* text accompanying notes 432–34.
[501] *See supra* text accompanying note 12.
[502] *See supra* text accompanying note 12.
[503] *See supra* text accompanying notes 21–22.
[504] *See supra* text accompanying notes 39–40.

of focusing exclusively on where American firms are inclined to incorporate, greater scholarly effort should also be focused on why some OFCs are more successful than others and, specifically, what role their internal capabilities play in the process.[505]

This Article introduced the concept of state capacity to the legal academic discourse on OFCs and suggests that state capacity can be conceptualized as a jurisdiction's manner of institutional learning.[506] Under this approach, it is possible to unpack the development trajectory of prominent OFCs to understand how the leaders in these jurisdictions have managed to effectively coordinate network externalities, the immense pressures of corporate interests, and the need to choose appropriate business legislation.

Perhaps it has been difficult to analyze OFC development objectively because of the predominant assumption of some scholars and policymakers about the character of the international economy.[507] There is an implicit understanding of the United States—and the Global North more generally—as the default reference points from which all other countries and regulations should be judged.[508] In other words, legitimacy is assessed from and by the standards of Western countries and institutions. Hence, other jurisdictions—particularly small OFCs in the Global South—are viewed as "offshore," both geographically and maybe even as a metaphor for being on the periphery of world power, technological advancement, and even morals.[509]

While some scholars argue for the right of OFCs to create their own rules,[510] concerns have been raised as to the laxity of the laws in these jurisdictions and the potential harm these jurisdictions may bring to American corporations—and, by extension,

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[505] *See supra* text accompanying note 54.

[506] *See supra* text accompanying note 54.

[507] *See, e.g.*, Katharina Pistor, *The Standardization of Law and its Effect on Developing Economies*, 50 AM. J. COMP. L. 97, 98 (2002).

[508] *Id.*

[509] *See, e.g.*, Meyer et al., *supra* note 141, at 158; Terence K. Hopkins & Immanuel Wallerstein, *Patterns of Development of the Modern Worlds-System*, 1 REV. (FERNAND BRAUDEL CTR.) 111, 113 (1977); *see also* Steven A. Dean, *FATCA, the U.S. Congressional Black Caucus, and the OECD Blacklist*, 168 TAX NOTES FED. 95 (2020).

[510] *See, e.g.*, Morris, *Regulatory Competition*, *supra* note 155, at 102–46.

American society.[511] A view of OFCs from the theoretical frame of state capacity may provide new insights to the ongoing discourse—as well as reorient our collective scholarly perspective.

OFCs are jurisdictions like many others with strengths and weaknesses, but their importance has been underappreciated due to a sordid narrative focused on criminality and permissive laws.[512] The tales of tax evasion and other crime generally associated with OFCs imply that only a small group of wealthy companies and individuals, as well as well-placed policymakers and professionals in these jurisdictions, gain from the sector.[513] Arguably, since William Cary broached the phenomenon of a race among American states for corporate charters, attention has been skewed to a narrow set of potential winners and losers.[514] But as we enter a period in American life, and across the world for that matter, where there is a growing interest in inequality and inclusive economic growth,[515] there is reason to ask if regulatory competition should serve a larger public purpose.

It is important to note that the state capacity framework that this Article proposes is not meant to be normative. Sociologists Miguel Centeno and Elaine Enriquez suggest: "whether a state uses its capacity to enact policy preferences for 'good' or 'bad' ends does not negate the empirical reality of that state's ability."[516] Notwithstanding, it bears inquiring into what kind of state can promote the type of regulatory competition that brings forth flourishing to a wide swath of its citizens without making private sector, unelected actors de facto legislators.[517]

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[511] *See, e.g.*, Moon, *Delaware's New Competition*, *supra* note 1, at 1453; *see also* Moon, *Regulating Offshore Finance*, *supra* note 5, at 17.

[512] *See* Morriss, *Regulatory Competition*, *supra* note 155, at 102.

[513] *See, e.g.*, Valpy FitzGerald & Erika Dayle Siu, *The Effects of International Tax Competition on National Income Distribution*, *in* INTERNATIONAL POLICY RULES AND INEQUALITY: IMPLICATIONS FOR GLOBAL ECONOMIC GOVERNANCE (Jose Antonio Ocampo ed., 2019).

[514] *See, e.g.*, Cary, *supra* note 2, at 701.

[515] *The Case for Inclusive Growth*, MCKINSEY & CO. (April 28, 2021), https://www.mckinsey.com/industries/public-and-social-sector/our-insights/the-case-for-inclusive-growth [https://perma.cc/JUP3-2M87].

[516] Enriquez & Centeno, *supra* note 176, at 136.

[517] *See, e.g.*, AMARTYA SEN, DEVELOPMENT AS FREEDOM 149–55 (1999); GREGORY ALEXANDER, PROPERTY AND HUMAN FLOURISHING 1044 (2018) (discussing how property law can be used to facilitate flourishing among property owners and non-property owners alike).

If jurisdictions like Cayman and Barbados, with humble origins, can enhance their economic fortunes in a just a few decades,[518] scholars should be eager to study how their policy choices regarding offshore finance are socially embedded in—and therefore influenced by—their lived reality.[519] Perhaps the most obvious implication of this Article is that OFCs are a law and development success story[520]—but only if we appreciate that legal institutions are only as good as the actors willing and capable of using them effectively.

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[518] *See, e.g.*, Freyer & Morriss, *supra* note 125, at 1300.
[519] *See, e.g.*, EVANS, *supra* note 176, at 5.
[520] *See, e.g.*, Davis & Trebilcock, *supra* note 23, at 902–04.