

CHAPTER 7

THE RISE OF ORGANIZED CRIME



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THE NEW RUSSIANS: Russians pay their respects to a fallen gang member. Mikhail Kuchin, portrayed on his tombstone, is holding keys to his Mercedes Benz, a symbol of new Russian power. In the absence of market reforms in Russia, organized crime replaced the state as property distributor and dispute arbiter, while it stifled legitimate entrepreneurs.



As the Soviet Union was reinvented as Russia ... [t]he Russian problem was redefined from being one of organized power into one of organized crime.

James Kurth, *The National Interest*, Summer 2000

The Clinton administration's failed economic strategy for Russia and its embrace of corrupt officials like Viktor Chernomyrdin had serious negative consequences for Russia's battle against organized crime.

Paying the Price for Failure to Develop a Market Economy

The Clinton administration's failure to place primary emphasis on replacing Communism with the basic elements of the free enterprise system helped create the conditions in which organized crime has flourished. Without such essentials as effective legislated protections for private property, modern commercial codes, and honest, efficient, and speedy courts to enforce property rights, the "privatization" of government entities in Russia predictably resulted in chaos.¹

The Russian economy did not work. People who needed to make ends meet, to save or invest money, or to get something else done looked for alternatives. For those suffering miserable poverty, theft became an option. Counterfeiting found favor among some who went months without wages. The prevalence of a barter economy gave rise to opportunities for tax evasion, extortion, and "protection" from regulatory authorities. Lagging enforcement of intellectual property rights encouraged black-market entrepreneurs. A supply of private "enforcers" arose to meet the demand for a system of dispute resolution.

Thus, organized crime came to be responsible not only for grisly mayhem and violence, but also for functions as diverse as enforcing contracts and court judgments, providing personal security, and even allocating scarce resources (through bribes to corrupt officials). The ability of some Russian organized crime groups to draw upon the specialized expertise and contacts of former Soviet personnel further increased their ability to compete with the Russian government both in tech-

nological sophistication (in areas such as cyber-crime) and geographic reach.

Moreover, the continuing and pervasive role of government in the economy has provided an enormous impetus for organized crime:

[O]ne frustrated former Moscow prosecutor has summarized Russia's current organized crime problem: "The main way the mafia penetrates into the economy is via the bureaucrats. They are our main enemy. The mafiosi are only the second enemy."

Russia's reluctance to loosen remaining state economic controls ... is the biggest catalyst for crime. Businesses seek to evade what are perceived as unacceptably high taxes or overly restrictive regulations; mafia groups thrive by providing a means for them to do so Both at the federal and local level, government levies a daunting array of transaction costs on normal business activities. Rather than pay fees for countless licensing and permit requirements, firms choose to avoid official red tape by paying less costly bribes The mafia often plays the role of middleman in these situations, facilitating transactions between businessmen and corrupt government officials.²

Ironically, the successive privatization schemes promoted by the Clinton administration, far from remedying this problem, exacerbated it, creating an oligarchic economy that put many powerful individuals visibly above the law, demoralizing ordinary Russians, and setting a tone of pervasive lawlessness at the apex of the Russian economy. As the Center for Strategic and International Studies reported in its study of Russian organized crime,

The principal beneficiaries of privatization—conducted at "auctions" rigged in favor of pre-



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selected individuals or banks—have been the [organized crime] syndicates. According to the Analytic Center of the Russian Academy of Sciences, “55 percent of the capital and 80 percent of the voting shares were transferred, during privatization, into the hands of domestic and foreign criminal capital.”³

The oligarchic economy also tightened the stranglehold of official corruption over the Russian government and the large sector of the ostensibly “privatized” economy that it influenced. This official corruption both obstructed law enforcement and created a symbiotic relationship between corrupt government officials and organized crime, which assisted them in such tasks as laundering money.

The Clinton administration’s decision to base U.S.-Russian relations on Vice President Gore’s relationship with Viktor Chernomyrdin and a handful of other high officials also sent a strong public signal that the United States would not only tolerate but embrace figures clearly identified in the Russian media and public consciousness with corruption—further undercutting law enforcement, and demoralizing not only the out-manned and underpaid Russian foes of organized crime but also the Russian people.

The fact that Vice President Gore and other top-level Clinton administration officials were willing to be so closely linked to Chernomyrdin and others clearly known by the U.S. intelligence community to be involved with organized crime could not help but influence public attitudes toward criminal behavior. Low-level bureaucrats taking bribes for permits, soldiers selling weapons to criminal groups, and border guards willing to let anything through for a price⁴ all lived by this logic: after all, why should criminals and corrupt government officials be the only ones to benefit from Russia’s chaos?

The result was a vicious cycle of increasing crime and disorder, and a growing disillusionment with democracy and free markets:

[T]he privations of ordinary citizens stand in contrast to the opulent lifestyles of gangsters, corrupt politicians, and entrepreneurs of questionable integrity. This deviation has promoted the impression of a state hopelessly corrupt, out of control, and run by criminals who continue to use illicit means to hold onto the



AP Photo/Dennis Cook

A BETTER IDEA: Former World Bank Senior Vice President and Chief Economist Joseph E. Stiglitz, who took a more thoughtful approach to the establishment of a market economy in Russia, explained that there was an alternative to the Gore-Summers-Talbot “privatization” plan. He suggests that a bottom-up approach to privatization—selling off smaller enterprises first—could have avoided much of the looting of Russian enterprises. This approach, Stiglitz suggests, would have allowed for the establishment of a free-enterprise economy into which the large enterprises could then be privatized. Such a policy would have avoided the creation of the oligarch class, and limited the ability of the owners of newly-privatized businesses to obstruct the growth of competitors that worked against their venal interests. He analyzed the issue in the Keynote Address to the World Bank Annual Bank Conference on Development Economics, which he entitled “Whither Reform? Ten Years of the Transition.” He appears above at a news conference Apr. 26, 1999, at the start of the bank conference.

privileges of the elite formerly reserved for officials of the Communist Party.⁵

All of these pathologies were predictable responses to the lack of a genuine market economy and the rule of law. The criminal world’s mailed fist increasingly substituted for the invisible hand of the free market. Organized crime became “the dark side of private ordering—an entrepreneurial response to inefficiencies in the property rights and enforcement framework supplied by the state.”⁶





It was the devil's due for Russia's failure to develop a market economy in place of Communism—a failure abetted by the Clinton administration's economic strategy for Russia and its embrace of corrupt Russian officials.

Half the Economy

The impact of organized crime in Russia is staggering. Russian officials estimate that up to 50% of the nation's economy is in some way connected to organized crime.⁷ According to Russia's Ministry of Internal Affairs, by 1997 organized criminals owned or controlled about 40% of Russia's private businesses, 60% of state enterprises, and 50% to 85% of banks.⁸ Illegal drug traffic, the most recent manifestation of Russia's organized crime pandemic, is currently valued at between \$4 billion and \$7 billion per year.⁹ Russian firms must often pay 10% or more of their revenues in protection money to criminal organizations and bribes to corrupt officials.¹⁰

In February 2000, the Main Administration on Combating Economic Crimes disclosed that Russian law enforcement agencies had exposed 300,000 economic crimes in 1999¹¹—an average of one crime for each of the 300,000 legal entities registered in Russia to engage in foreign trade.¹² About 125,000 of those crimes were felonies.¹³ The Interior Ministry considered 90% of the economic crimes involving organized criminal groups “serious” or “very serious.”

Efforts by organized crime groups to launder illicit proceeds into the legitimate economy have resulted in the creation of large, sophisticated criminal networks in and out of Russia. The Interior Ministry reports that eleven large organized criminal groups, 95 “criminal communities,” and 1,000 “organized criminal groups” operate in Russia.¹⁴ These groups include 50,000 people organized into nearly 250 gangs controlling 5,000 companies, many with international reach.¹⁵ Russian organized crime groups operate in some 60 to 65 nations.¹⁶ Raymond Kerr, the head of an FBI-New York City police task force on Eastern European organized crime, described them as “spreading like an e-mail virus.”¹⁷

From Stalinist Purges to Organized Crime Hits

“Organized crime” is the ongoing and systematic commission of public offenses. In Russia, no other

term could be used to describe the contagion of money laundering, tax evasion, bribery, embezzlement, drug dealing, extortion, and contract murder that has taken such a deadly toll on the population since 1992.

The legacy of the Communist system that dominated Russia for over 70 years was human suffering, death, fear, and economic chaos. The culture of crime that has now infiltrated large parts of the Russian economy seems, for those Russians upon whom it has preyed, to be very much the same.

“Crime used to be a monopoly of the State under the old system,” Russia scholar Richard Pipes testified to the House Armed Services Committee. “It is now privatized.”¹⁸

“[T]he Communist Party of the old Soviet Union ... bore all the characteristics ... of a Mafia,” testified Brookings Institution Scholar Clifford Gaddy. “[B]ut it was an extremely well-organized Mafia. What we are seeing today is highly disorganized crime, and that is precisely why I think we are seeing so many of the characteristics that we associate with it, the brutality, the murders.”¹⁹

Nothing more vividly illustrates the horrible human toll than the growing epidemic of contract killings.²⁰ In St. Petersburg—the “crime capital of Russia,” where organized crime controls even the cemeteries—200 deaths have been labeled contract killings since 1997.²¹

The following is a sample of the hundreds of contract killings that have occurred just this year:

- **January 10, 2000:** Ilya Vaysman, 36, director of the St. Petersburg Baltika brewing company, was shot in the head and heart from a fifth-floor ledge a few feet from the kitchen window of his apartment. Suspected motive: a dispute over the disposition of expected investments. (Baltika's general director of marketing, Aslanbek Chochiyev, was shot to death as he was getting out of his Mercedes on July 1, 1999.)
- **February 2, 2000:** Valeriy Potapov, 36, the general director of the Baltisykaya Zarya timber company, was shot twice in the back of the neck near his house. Suspected motive: Property dispute.
- **March 11, 2000:** Dimitri Varvarin, 40, general director of the Russian-American Orimi compa-



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ny, was shot in the back of the neck at point-blank range as he left his car. Orimi was created in 1990 with the American firms NSTE and International Forest Technology, and controls recently “privatized” businesses in timber, furniture, and fuels, and is one of the biggest sellers of tea in Russia, Kazakhstan, and Ukraine. Varvarin personally owned a large block of shares in shipbuilding and timber businesses in Russia, and had taken part in the “privatization” of dozens of enterprises in St. Petersburg, Leningrad Oblast, Ukraine, Kazakhstan, and Belarus. Suspected motive: a real estate battle.

- **March 22, 2000:** Sergei Krizhan, 44, general director of the Russian Construction and Trading Group joint-stock company, was shot to death while driving in his Jeep, along with his son, 20, an economics and finance student at St. Petersburg University. Krizhan owned and founded about 10 St. Petersburg firms specializing in export and import activity, consumer goods trade and production, repair and construction work, and realty operations. Three of the firms were directly related to Orimi.
- **April 4, 2000:** Gennady Ivanov, 45, director of the Kvarton firm, was killed on his way to work by a round of automatic weapon fire aimed at his Volvo. Eyewitnesses saw the killer slip into the archway of an apartment block where a car was waiting for him. Kvarton, with 4,000 employees, was created in St. Petersburg in 1994 and sells sewing threads, furniture fabric, and hosiery. It holds large blocks of shares in textile enterprises in St. Petersburg, Moscow, and Pskov.
- **April 10, 2000:** Igor Bamburin, 47, head of Shatl and founder and cofounder of several equipment and automobile firms, was shot in the head four times as he arrived at the home of his daughter, a Technical University student. Despite reports that five or six people witnessed the shooting, no arrest was made. Bamburin was previously an officer of the Regional Administration for Combating Organized Crime.
- **April 26, 2000:** Georgy Pozdnyakov, 44, co-owner of the “Hollywood Nights” nightclub, was shot three times in the head and chest at the St. Petersburg Railways University sports complex. Suspected motive: criminal conflict connected with the repartition of property. (Pozdnyakov belonged to the entourage of St. Petersburg oil magnate Pavel Kapysh, killed July 26, 1998 on Vasilyevskiy Island.)
- **May 22, 2000:** Dimitri Ogorodnikov, 36, chief of the Samara Internal Affairs Administration Department for Combating Organized Crime, was shot in the head five times in his automobile in the center of the city of Tolyatti. He was a 10-year veteran of the Special Rapid Reaction Detachment of the Regional Administration for Combating Organized Crime.
- **June 14, 2000:** Alexander Sinayev, 47, the owner of the Leneksbank commercial bank, was found shot twice in an Audi in Krasnodar in what the Territory’s Public Prosecutor’s Office called a contract killing. “Leneksbank was one of the first bankrupts in the Kuban,” TASS reported, “but Sinayev was able to pay back the deposits of over 15,000 depositors. He promised to settle up with all deceived depositors.”
- **June 16, 2000:** Alexei Kachkov, 40, who owned several flower shops on Leninskiy Prospect in Moscow, was shot six times at point-blank range in northeastern Moscow.
- **July 10, 2000:** Oleg Belonenko, 51, managing director of the huge Uralmash machine tool company, was shot twice in the head, days before he was to meet with President Putin, an example of how contract killings have reached high up into the business world. Belonenko’s driver was also killed.
- **July 26, 2000:** Sergei Novikov, 37, head of the only independent radio station in the Smolensk region, was shot dead outside his apartment block, 300 miles outside of Moscow, reportedly the 120th journalist killed in Russia since December 1991.
- **July 31, 2000:** Sergei Isayev, 49, the rector of the Russian Academy of Theatrical Art, was murdered in a contract killing in the settlement of Valentinovka, near the town of Korolev. “Never before in Russia have contract killings





of leaders of cultural establishments and higher educational establishments taken place,” said Russian Culture Minister Mikhail Shvydkoy in an Itar-TASS interview following the murder.²²

As is the case with virtually all of Russia’s contract killings, none of these has been solved.

Corrupt ‘Privatization’ of Russian Monopolies Breeds Money Laundering and Organized Crime

Organized crime was both a cause and an effect of Russia’s corrupt “privatization” process. Disappearance of government revenues due to corruption and organized crime encouraged the government to pursue its notorious “loans-for-shares” insider privatization auctions in 1995.²³ In turn, these auctions were themselves subject to manipulation by organized crime.

The unrealized potential gains for the Russian government from its corrupt conduct of the privatization process were substantial. Media reports of the prices paid by insider Russian firms at the auctions—and the subsequent, much higher, prices those firms charged to Western investors seeking shares—suggest that significant revenue was lost to criminal behavior. Further evidence of the cost of “privatization” is offered by comparison to the results of the privatization of considerably fewer and smaller enterprises in Central European countries, which proved vastly superior to Russia’s poor results.

The “privatization” process was carried out with direct assistance and guidance from the U.S. government. Janine Wedel, a noted scholar on Russian corruption, described the privatization process as inherently corrupt:

The ... flagship organization was the Russian Privatization Center, which had close ties to Harvard University. Its founding documents state that Harvard University is both a “founder” and “Full Member of the [Russian Privatization] Center.” The center received funds from all major and some minor Western donors and lenders: the United States, the IMF, the World Bank, the European Bank for Reconstruction and Development, the European Union, Germany, and Japan.

The center’s chief executive officer, a Russian from the Chubais Clan, has written that while head of the center he managed some \$4 billion in Western funds. The Chamber of Accounts, Russia’s rough equivalent of the U.S. General Accounting Office ... concluded that the “money was not spent as designated. Donors paid ... for something you can’t determine.”

When I interviewed AID-paid consultants working at the center, I was told that the funds were routinely used for political purposes.²⁴

The corrupt “privatization” of state enterprises has also reinforced organized crime by affording it unprecedented access to the resources of the Russian state. Money, technology, equipment, trained personnel from the military and security services, and vast state assets have been made available to organized crime groups via the long-established connections between the “privatized” firms, their management, and their customer-supplier networks.²⁵

The authoritative CSIS report “Russian Organized Crime” stated categorically that “[t]he principal beneficiaries of privatization ... have been the [organized crime] syndicates,” citing a Russian study that found that 55 percent of the capital and 80 percent of the voting shares transferred during privatization went into the hands of “domestic and foreign criminal capital.”²⁶

Stifling Competition in Chernomyrdin’s Energy Industry

A fundamental flaw in Russia’s “privatization” of huge state companies is that it created no new competitors. Instead, it produced “oligarchs [who] dominate Russian public life through massive fraud and misappropriation, particularly in the oil sector.”²⁷

Indeed, the energy sector—in which Viktor Chernomyrdin allegedly netted billions of dollars as a result of his participation in the “privatization” process—is a useful case study.²⁸ Nothing in the Gore-Summers-Talbott “privatization” strategy was designed to force the existing Russian energy industry to compete with new firms on price, or on innovations in production and delivery. As a result, Russian oil and gas companies failed to achieve any new efficiencies from competition. Had they done so, Russia might have been able to produce oil and gas in suffi-



cient quantities to compete even if world prices remained low.

Instead, lacking the ability to produce profitably for world markets, the new owners of Russia's production companies resorted to such artifices as selling oil below cost to holding companies they controlled, which would then resell the oil at the market price. The results were highly profitable to the oligarchs, but not to the shareholders in the production company—often including the state.²⁹

Other oil and gas industry tactics have included stock scams, transfers of shares through offshore entities for the benefit of managers at the expense of other shareholders, and other schemes that amounted to theft of corporate property.³⁰

The unanticipated and unintended consequence of this non-market “privatization” for U.S. policy was that, as first charged by former Democratic Senator Bill Bradley, the Clinton administration found itself promoting higher oil and gas prices in an attempt to help Russia—but to the obvious detriment of consumers in the United States.³¹ As the *Washington Post* reported on April 30, 2000, the Clinton administration worked to encourage “the OPEC cartel to reduce production, and thus raise prices, last year.”³²

By joining OPEC's price-fixing efforts, the Clinton administration aligned itself with the interests of the oligarchs once more. Even when the world prices of oil and gas increased (with Energy Secretary Richardson, in his words, “caught napping” while oil prices rose),³³ Russia's oligarchs were enriched, while the shareholders they had cheated saw few of the benefits of higher prices. And while higher oil prices have generally helped Russia mitigate the effects of the August 1998 economic collapse, this has come at the direct expense of higher U.S. gasoline and home heating oil prices.

Legacy of Russia's Organized Crime in the 1990s

Organized crime undermines the Russian economy in a variety of ways, directly and indirectly. Beyond the horrible human toll in lives and property, the costs of organized crime include money spent on “protection” and bribes, and the significant burdens this places on small business; the lost tax, customs, privatization, and other revenue to the state; the loss of

domestic and foreign investment, which is the consequence of crime's undermining confidence in the Russian economy; and the loss of individual Russians' life savings, the result of the corruption of Russian banks. Political corruption, too, is both a significant cause and effect of organized crime activity.

Through its traditional methods of discouraging competition with illegal tactics, ranging from threats to murder, organized crime has increased the risks for small and medium businesses operating in Russia. The increased costs of organized crime have made the already labyrinthine process of starting and opening a business in Russia even more difficult, scaring off would-be entrepreneurs and inhibiting the development of both a market economy and a Russian middle class.

Lost Tax Revenue

The economic consequences of tax revenue lost from organized crime are devastating. In August 1998, the State Tax Service estimated that 60% of cash turnover in the economy takes place in transactions hidden from the government in order to evade taxes.³⁴ Other Russian estimates suggest that the volume of unreported economic activity may be up to one-half the size of Russia's official economy.

Tremendous budgetary pressures on the Russian government have influenced some of Moscow's most damaging policy decisions—including both the “loans-for-shares” privatization fiasco and the Russian government's willingness to take on tens of billions of dollars in IMF and other debt. Higher tax collections would have made such policies less desirable to the Russian government.

The Russian government has also lost significant revenue from customs payments as a result of smuggling, and the grant of customs exemptions to organized crime groups and corrupt businesses. An example of the latter is the import-fee exemption granted to the National Sports Fund—a supposed non-profit organization established in 1993 by Boris Yeltsin's former tennis coach—which permitted it to import not only sporting goods but also alcohol and tobacco tax-free, at a cost to the Russian government of several billion dollars. The total cost to the Russian government of such illicit exemptions is undoubtedly in the tens of billions of dollars annually.³⁵

The failure to collect taxes on criminal transactions has also exacerbated the Russian government's





An American Victim of Russian Organized Crime

One particularly gruesome case of organized crime involves Paul Tatum, who on November 3, 1996, at age 41, was shot in the back 11 times with an AK-47. He died at the bottom of the stairs to the Moscow subway, just yards from the Radisson-Slavjanskaya hotel, of which he was a joint owner.

The slaying was immediately identified as an organized crime hit.

Tatum was the first U.S. businessman murdered in Moscow. Then-Russian Interior Minister Anatoly Kulikov said one lead the Russian government was following connected Tatum's murder to a long dispute over the ownership and management of the hotel with his partner, the Moscow city government. Tatum's Americom Business Centers held a 40% share in the hotel.

Officially, however, the Russian government turned up no suspects—even though *USA Today* was able to interview 150 people in eight countries in connection with the case, and found many who knew that Paul Tatum was a marked man.

Neither the Clinton administration nor the Russian authorities seriously pursued any culprit in connection with this contract slaying. As has proven the case with nearly all of Russia's organized crime hits, the murder went unsolved and unpunished.

"Moscow observers state that more business deals have been cut in the lobby bar of the Radisson hotel than anywhere else in Russia," the hotel bragged in a 1993 news release. However, *USA Today* reported that the Radisson-Slavjanskaya quickly became "a place where competing factions of bodyguards at times engaged in open warfare in the hallways." Respectable Russians refused to meet visiting U.S. business and government leaders in the hotel because of its reputation as a haven for gangsters. Nonetheless, the hotel was a favorite of both President Clinton and Vice President Gore.

Despite the fact that the first contract killing of a U.S. businessman in Russia was so publicly connected to a dispute over Tatum's claim that he had been cheated out of ownership of the Radisson-Slavjanskaya by the Moscow city government, and despite Congressional urging to President Clinton that he stay elsewhere in Moscow because of the hotel's connections to organized crime, the president stayed at the hotel on his next visit to Moscow.

SOURCES: Nick Allen, "Radisson Claims Business as Usual," *Moscow Times*, Dec. 5, 1996; Vanor Bennett, "Slaying Victim's Russian Partner Loses U.S. Visa," *L.A. TIMES*, Dec. 1, 1995; M.J. Zuckerman, Kevin Johnson, and James Kim, "Murder and intrigue: A dream dies hard in Moscow," *USA TODAY*, June 9, 1997.



AP Photo/Sergei Karpukhin/fis

PAUL TATUM: Above, in a 1994 photo. Below, mourners reach to touch his coffin during a funeral service in Moscow, Nov. 14, 1996. He was eulogized as a stubborn dreamer who died standing up to danger. Contract killings have become common in Russia as means of settling business disputes. The hotel that was the subject of the business dispute involving Tatum was a favorite of Clinton administration visitors to Moscow.



AP Photo/Sergei Karpukhin



History's Biggest Money Laundering Scandal

In the summer of 1999, the Clinton administration's Russia policy—already under fire in the wake of the 1998 collapse of Russia's economy, which many Russians blamed on bad American advice—suffered another setback.

On August 19, 1999, the *New York Times* reported that billions of dollars were thought to have been laundered from Russia through the Bank of New York. Initial reports in the *Times* and elsewhere suggested that as much as \$10 billion may have passed through Bank of New York accounts, with the knowledge and approval of several bank employees. More than two-thirds of the money came from the tiny Pacific island-nation of Nauru, not previously known as a financial center. And many of the transfers originated at a Moscow bank chaired by a financial advisor to the Yeltsin family known as the “ghost of the Kremlin” for his secretive ways.

Subsequently, three bank employees—Lucy Edwards, former vice president of the Bank, Peter Berlin, her husband, and Svetlana Kudryavtsev, who worked for Edwards—entered guilty pleas in connection with the case. Another vice president was fired for allegedly failing to report supplemental income from Russian clients and yet another employee resigned because of the scandal.

A year later, in August 2000, a Swiss judge investigating the possible use of banks there to launder a 1998 IMF loan to Russia carried out two raids in Switzerland. In August 2000 the judge traveled to the

unfunded wage³⁶ and pension debts³⁷ to state sector employees³⁸ and retirees.

Lost Confidence

The most significant cost of Russian organized crime has been its contribution to the widespread loss of confidence in the nation's economy. Not only have foreign investors been scared away, but potential Russian investors have mounted a sustained capital flight that has depressed investment and domestic savings, stifled job creation, and robbed the government of opportunities for revenue growth.

Most estimates of capital flight from Russia since its independence exceed \$200 billion; some are as high

United States to determine why investigators here had largely ignored requests for information about possible links to the Bank of New York case since January, in what is now acknowledged to be history's largest money laundering scandal.

The Money Trail

Russia's lack of hard currency, and the contemporaneous flows of billions in hard currency from the IMF to Moscow, made it appear that the United States and other Western countries had provided the necessary liquidity for money laundering to occur.

In September 1998, British authorities alerted the FBI to an extraordinary volume of money being transferred in a significant number of transactions.

Two years later, the Clinton administration has yet to recognize that its policy of pouring large amounts of dollars into the Russian central government was financing not a transition to free enterprise but rather capital flight on a massive scale.

The Spin: More Willful Blindness

Then-Deputy Treasury Secretary Lawrence Summers, at a House Banking Committee hearing in September 1999, denied any connection between IMF money and Bank of New York laundering: “With respect to the Bank of New York, there's no evidence that...there were any IMF funds diverted in that context.”

as \$500 billion. Irina Khakamada, a reformist parliamentarian who chairs Russia's National Anti-Corruption Committee, estimated the cost to Russia of capital flight at a stunning \$20 billion per month.³⁹ Treasury Secretary Summers, in recent House testimony, provided a low estimate of \$15 billion per year.

Even the most conservative estimates of Russian capital flight dwarf actual foreign investment in Russia, as well as IMF lending and international financial aid flows into Russia.⁴⁰

A Drag on Banking

Organized crime in Russia exerts significant direct control over the nation's banking system. As the CSIS





Summers acknowledged, however, that capital flight “drains perhaps \$15 billion a year from the Russian economy.” Whether IMF funds were directly laundered through the Bank of New York, or instead fueled capital flight by providing the means for Russian oligarchs to convert rubles to dollars, it was clear that IMF funds were financing capital flight from Russia.

Deny and downplay was the strategy for Deputy Secretary of State Strobe Talbott, as well. In a *Newsweek* interview, Talbott minimized the multi-billion dollar scandal with a dismissive plea to “calm down, world.” Then, resorting to a standard spin technique—treating breaking news as if it were unimportant because it is really “old news”—he added: “We have been aware from the beginning that crime and corruption are a huge problem in Russia and a huge obstacle to Russian reform.”

The IMF's Köhler, in office just three months, had a less defensive explanation at the National Press Club in August 2000: “Part of the mistakes we made was mostly because we had been too euphoric, relying on rhetoric about reform programs. We need to see more implementation of the good ideas.”

But the bad ideas had already done their harm.

In addition to raising awareness about the extent of Russian money laundering and capital flight, the Bank of New York scandal triggered concern that Russian criminal groups and individuals had infiltrated Western financial institutions. As the *Economist* reported, the money-laundering scandal “confirms that the evil of organized crime is woven into Russian life—and that it is starting to infect the rest of the world.”

study concludes, “[Organized crime] shaped the post-Communist banking industry and now manages or influences it. And bank regulators complain they are powerless to sanction or close banks in which evidence of criminal wrongdoing has been established beyond the shadow of a legal doubt.”⁴¹ The study further noted: “Banks are central components of [organized crime] activity [in Russia] both as a primary target of extortion and as the main vehicle for extensive money laundering.”⁴²

Organized crime imposes indirect costs on Russia's banking system, as well. Russians are fearful of keeping their rubles in banks because they believe corrupt bank employees are likely to inform organized crime groups of the accounts in exchange for a cut of money

What Did They Know and When Did They Know It?

House Banking Committee Chairman James Leach noted that while the British authorities notified the FBI about the Bank of New York irregularities in September 1998, the Treasury Department claimed not to have learned of the investigation until April 1999.

In any event, the administration continued to support IMF lending for Russia even in the face of hard evidence of massive looting. “The Congress,” Chairman Leach noted when Summers testified, expects “substantially greater coordination within the Executive branch.”

Washington Post columnist David Ignatius was not so statesmanlike in asking bluntly: “Did Al Gore know about the massive lootings?”

SOURCES: Raymond Bonner and Timothy L. O'Brien, “Activity at Bank Raises Suspicions of Russian Mob Tie,” *N.Y. TIMES*, Aug. 19, 1999, p. 1; *WALL ST. J.*, Mar. 29, 2000, p. B5; Ann Davis and Paul Beckett, “Bank of New York Executive is Fired for Not Reporting Pay Linked to Benex,” *WALL ST. J.*, Mar. 13, 2000, p. A15; John Thornhill and Thomas Catan, “NY bank in money laundering probe,” *FIN. TIMES*, Aug. 20, 1999, p. 2; Paul Beckett, Michael Allen, “Bank of New York Probed on IMF Aid,” *WALL ST. J.*, Aug. 23, 1999, p. A3; Deputy Treasury Secretary Lawrence Summers, testimony before the House Banking Committee, Sept. 21, 1999; John Tagliabue, “Swiss Take New Look at Transfers of I.M.F. Aid for Russia,” *N.Y. TIMES*, July 26, 2000, p. C3; Charles Clover, “Swiss Confirm IMF/Russia Credit Inquiry,” *FIN. TIMES*, July 25, 2000; “Russian Organized Crime: Crime Without Punishment,” *THE ECONOMIST*, Aug. 28, 1999, p. 17; Michael Hirsh, Owen Matthews, “The Gangster State,” *NEWSWEEK*, Sept. 6, 1999, p. 35; Richard W. Stevenson, “U.S. Officials Acknowledge Early Notice of Bank Case,” *N.Y. TIMES*, Sept. 8, 1999; Chairman James A. Leach, House Banking Committee hearing, Sept. 21, 1999; David Ignatius, “Who Robbed Russia?” *WASH. POST*, Aug. 25, 1999. Russia reduced its IMF debt from \$16.3 billion to \$12.7 billion from July 31, 1999 to July 31, 2000, according to IMF figures.

to be extorted from the account holder. Partly as a result of these fears, ordinary Russians held an estimated \$80 billion outside the banking system as of 1998.⁴³

Organized crime thereby robs the economy of the opportunity to efficiently pool savings to invest in mid-to large-scale productive enterprise. The reluctance by Russian consumers to trust the banking system because of the influence of organized crime also worsened cash shortages at the nation's banks during Russia's economic collapse in 1998.

Guilt by Association

By eroding public confidence in the private economy—and by stunting the establishment and growth of



legitimate business—organized crime has limited the emergence of a pro-free enterprise reform constituency, making it more difficult to achieve the public consensus necessary to enact legislation to legalize free enterprise.

The fact that so many wealthy Russians criminal-ly obtained a large proportion of the wealth that now exists in Russia has significantly discredited legitimate commercial activity. This problem is particularly acute in Russia because of its limited experience with a market economy.

Beyond undermining support for a truly competitive market economy, the rise of organized crime has meant aggressive support in the Russian political system for the *opposite* of reform. In what has been derisively termed “reinventing government,” crime bosses and leaders of illicit businesses thwarted police investigations and placed themselves and their allies in high office—including seeking seats in Russia’s State Duma—not only to legislate to their advantage, but also, on a more practical level, to win immunity from investigation and prosecution.⁴⁴ Staff positions in the Duma have been notoriously made available for sale.⁴⁵

Duma committee chairmen have been accused of holding committee meetings or hearings on an issue of importance to an individual or enterprise in return for cash payments. Members of Vladimir Zhirinovskiy’s Liberal Democratic Party of Russia, a notoriously mercenary extremist party, are widely suspected of selling their votes on particular legislation to the highest bidder.

At the regional and local level, organized crime groups have intervened directly in the election process, financing candidates, buying votes, and intimidating opponents. This highly visible corruption of Russia’s political system has only further weakened public support for continued democratization.

Organized crime also affects overseas businesses, including U.S. firms seeking to do business in Russia. Some companies are merely approached to pay protection money or bribes; others suffer more seriously when their investments in joint ventures are looted by Russian partners. The resultant lawlessness threatens to infect governments and economies around the world with the consequences of money laundering, bribery, extortion, and their attendant social pathologies.

Arms Sales to Colombia’s Narco-Insurgency

Organized crime in Russia is also contributing to global instability. The arming of Colombia’s Marxist rebel groups with smuggled weapons made in Russia has profound foreign policy consequences. The Revolutionary Armed Forces of Colombia (FARC) and the National Liberation Army (ELN), violent Marxist groups seeking to overthrow the government, now control about half of Colombia, directly threatening the continued existence of civil government there.⁴⁶ These groups are also heavily involved in narcotics trafficking: out of the \$4 billion annual Colombian drug trade, FARC and the ELN are now presumed to net an estimated \$600 to \$900 million each year.

Four-fifths of the cocaine and more than 60% of the heroin entering the U.S. now comes from Colombia.⁴⁷ Behind this growth in cocaine exports is a growing relationship between Russia’s organized crime and Colombia’s drug lords.⁴⁸

Colombian intelligence officials suspect that Russian criminal syndicates are exchanging sophisticated Russian weapons for Colombian drugs.⁴⁹ This has enhanced the military power of Colombia’s Marxist rebels and international drug cartels, further destabilized the government of Colombia, and facilitated the entry of additional narcotics into the United States.⁵⁰

In the last three and a half years, Colombian police have seized over 700 new Russian-made AK-47 assault rifles that were destined for FARC and ELN. Colombian police confirm that these weapons are unlike the Soviet weapons used in earlier Central American wars, and of much more recent vintage.⁵¹

A system has developed by which FARC and ELN guerrillas exchange illegal narcotics for sophisticated Russian weaponry. In this way, the latest Kalashnikov assault rifles and Dragunov sniper rifles have been shipped to Colombia in the same transport containers originally used to transport the drugs.

This burgeoning weapons trade with Colombia’s Marxist insurgents thus threatens not only U.S. anti-proliferation objectives, but also U.S. regional security interests in Central America and the domestic struggle against illegal narcotics in the United States. The U.S. counternarcotics effort is now pitted directly against smuggled Russian arms. American taxpayers, and





American interests, now face the effects of organized crime in Russia in this hemisphere.

Nor are Russian drug and weapons smuggling limited to Colombia or the Western hemisphere. According to Barry McCaffrey, Director of the President's Office of National Drug Control Policy, Europe now consumes between 80 and 130 tons of cocaine a year, and at least 10 tons of this cocaine is shipped through Russia, with Russian criminal groups controlling the routes.⁵² As the 1997 CSIS study found, "[organized crime] groups also are facilitating narcotics trafficking along new transit routes from major heroin-producing areas in Asia (the Golden Triangle and Golden Crescent) that cross the former Soviet Union, thus avoiding searches by West European law enforcement agencies along the more traditional routes."⁵³ Similarly:

[Organized crime groups] are trafficking increasingly in weapons by exploiting corruption, subhuman living conditions, and chronically late wages in the Russian military. This leverage gives them access to arms stockpiles. Theft and illegal sale of weapons, hardware, and narcotics are moved by military transport vehicles that cannot be searched by law enforcement officials. Western intelligence agencies believe that short- and medium-range missiles have been smuggled to customers in the Middle East in this manner.⁵⁴

The Gulf Between Clinton's— and Yeltsin's—Words and Deeds

Organized crime's political influence has also had a more subtle effect: neutering the government's willingness to confront and punish violations of law. The result has been a significant gulf between both the United States and Russian governments' stated policies with respect to organized crime, on the one hand, and their actual behavior, on the other.

For example, Boris Yeltsin launched seven campaigns in eight years as president to combat organized crime. Yet organized crime groups expanded because punishment was generally limited to low-level officials and those out of favor with the Kremlin. The growth of organized crime in the face of ineffective government campaigns against it has contributed to public cynicism.

Similarly, official statements of concern about money laundering were unmatched by action. The Russian government, in fact, served as an enabler of money laundering. On June 23, 2000, the G-7's Financial Action Task Force identified Russia as one of 15 nations that was "uncooperative" with international efforts to combat money laundering.

The Russian government's ostentatious introduction of new measures to fight corruption has routinely been followed by extensive public discussion of which individuals and political opponents are the "real" objectives and targets. The influence of Russia's so-called oligarchs over Russia's mass media has heightened this cynicism, as press outlets are viewed as the mouthpieces of particular economic and political groups, rather than defenders of the public interest. Under such circumstances, each new effort at reform has been met with increasing skepticism.

The Clinton administration, mirroring the policies of its Russian partners, has similarly failed to mount an aggressive challenge to organized crime in Russia. The administration has attempted to address organized crime merely as a technical law enforcement problem with programmatic assistance to Russian authorities. The administration has concentrated on programs such as law enforcement training and developing an FBI presence in Moscow.

Clinton administration law enforcement officials claim these efforts to combat Russian organized crime are succeeding, crediting FBI Director Louis Freeh with establishing an aggressive Eastern European organized crime policy when he took office in 1993.⁵⁵ But in fact the administration's technical orientation to Russian organized crime cannot substitute for its failure to address the underlying economic and legal causes of organized crime.

A serious U.S. policy to help combat organized crime in Russia would also have required a significantly more candid assessment of the various Russian political players with whom Vice President Gore and other top administration officials were dealing, and a far greater willingness to distance themselves from corruption. As the democratic politician Grigory Yavlinsky has noted, "political will rather than the Criminal Code is needed."⁵⁶ The administration's close association with officials suspected of corruption did little to encourage that political will in Russia.



Likewise, the Clinton administration failed to make the issue of organized crime a significant priority in its official discussions with Moscow. Yevgeny Yasin, a reform-oriented former senior official in Russia with key economic responsibilities during much of the Yeltsin era, recently criticized the Clinton administration for failing to cooperate in addressing corruption and capital flight. Yasin complained that Russian attempts to raise these issues and seek U.S. assistance as early as the 1995 Halifax Summit were dismissed.⁵⁷

Deputy Secretary of State Strobe Talbott has also admitted that the Clinton administration did not give sufficient priority to the problem of Russian money laundering.⁵⁸

Statements of concern by the Secretary of State, and pro-forma discussions of organized crime as one among a long list of agenda items at the semi-annual meetings of the Gore-Chernomyrdin Commission, were a poor substitute for genuine moves to show the Kremlin the seriousness of American resolve to fight organized crime, and to make explicit the threat that it poses to United States and Russian national interests. The Clinton administration never made explicit any consequences for Russia's failure to address organized crime, either in the form of loan conditions or the withdrawal of U.S. cooperation on other fronts. Indeed, when combined with the administration's unwillingness to confront the evidence of corruption by its principal interlocutors in Russia, the Clinton administration's tepid approach to Russian organized crime amounted to tacit acceptance.

Three years ago, CSIS's task force report on Russian organized crime included among its recommendations:

Stringent requirements to ensure transparency in Russia's use of foreign aid, as well as multilateral loans and export financing, should be implemented and enforced to insulate the funds from [organized crime] and to ensure that the funds reach their intended destination.

Close U.S. government identification with corrupt elements of Russia's political establishment risks serious popular backlash inside Russia. The United States must avoid the appearance of unqualified support for what is routinely seen as a kleptocratic establishment.

Such linkage reinforces a growing popular perception that democratic political and market economic systems are merely code words for rapacious criminality. The United States should address this perception by increasing its public diplomacy discussion of the causes of and cures for [organized crime in Russia].⁵⁹

Such recommendations were ignored by the Clinton administration. For example, when Deputy Secretary of State Strobe Talbott and then-Deputy Treasury Secretary Lawrence Summers met with Anatoly Chubais at Talbott's home in May 1998 (where Chubais sought a new IMF bailout to stave off the disaster that occurred three months later),⁶⁰ why would corrupt Russian officials believe that American protests over corruption were more than public relations? By that time, Chubais had become wealthy by participating in the privatization process he was charged with supervising. He had also simultaneously been responsible for the management of the Russian Privatization Center, which has never produced an accounting for its use of \$116 million in U.S. direct aid.⁶¹

In the Summer 2000 issue of the *National Interest*, E. Wayne Merry, a former diplomat at the Moscow Embassy, summarized the problems with the Clinton administration's approach:

Washington officials claimed to be 'shocked, shocked' when the government-sanctioned corruption and theft of public property in Russia could no longer be hidden. They then piously demanded that Russian governance be all the things the Treasury and IMF had insured it would not be: honest, accountable, transparent, law-based, public-spirited. ... [W]hat remains "classified" is much worse.

The Rise of Putin: The Russian Public Reacts to Organized Crime

The impact of organized crime on Russian democracy has proven grave. It has generated a deep sense of personal insecurity among Russians and widespread perceptions of declining public morality. Public opinion polls, which understandably rank crime among Russians' greatest concerns, also show the extent to which organized crime has undermined the Russian public's support for freedom and democracy.





Because the rapid growth in organized crime and Russia's efforts at political and economic reform occurred simultaneously, the public mind closely linked the two. As a result, the ideas of democracy and market-oriented economic reform have also been widely discredited in Russia, and are widely assumed to be inconsistent with greater order:

Widespread violence and crime in Russia are even beginning to generate nostalgia for authoritarian rule. Flagrant lawlessness has resulted in a resurgence of politicians who promise to re-establish order and fairness using brute force. Increased criminal activities fueled the backlash that contributed to ultranationalist Vladimir Zhirinovsky's electoral success in 1993. Zhirinovsky's platform included on-the-spot executions of criminal gang leaders by firing squads and the wholesale seizure of assets thought to be criminal.⁶³

Yet it is ironic that the primary reason organized crime has grown into such a significant parasite on the Russian economy was the top-down "privatization" of state-owned monopolies, instead of the bottom-up legalization of entrepreneurial activity that was (and still is) necessary to enable start-up enterprises without criminal roots to compete in a genuine market. It was the lack of a genuinely competitive market economy that created the conditions for organized crime to

flourish. Rather than unleashing the disciplinary power of competitive markets, the Gore-Summers-Talbott policy of massively underwriting the Russian central government had the effect of indirectly funding organized crime through IMF and World Bank loans.⁶⁴

President Vladimir Putin's success in capitalizing on the public's longing for greater order can only be understood in this context. Taking into account the fact that some 62% of Russians are not confident in the ability of the country's police forces to protect them,⁶⁵ it should not be surprising that Putin's background as a KGB Lieutenant Colonel and head of the Federal Security Service (FSB), the KGB's principal successor agency, enhanced rather than impaired his popular appeal. His KGB past has contributed significantly to a public perception that he will "get tough" on organized crime. His election was a gamble for Russians, nonetheless: they have only hope, and no guarantee, that he will not similarly crack down on civil liberties, freedom of speech, and democracy.

Which way Putin and Russia will go is yet unclear. But this much is certain: the rebirth of authoritarianism because of a popular backlash against organized crime in the wake of both Russia's and America's failure to promote genuine free enterprise there is now a genuine possibility in Russia. Its return would be a tragic beginning indeed for the 21st century.

