

## **International Dimensions of Corruption: The Russian Case**

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### **ABSTRACT**

The globalization of the fruits of Russian organized crime and corruption have affected Russia's international image and undermined state capacity. The departure of illicitly gained billions quickly diminished the capacity of even a once formidable power. It deprived Russia of the resources it needs to rebuild the state infrastructure, service its debts and pay the salaries and pensions of its citizens. The failure of a former superpower to meet the basic needs of its citizens has served as a powerful lesson to the international community. This occurred, in part, because those who controlled the state's capital could move money abroad in enormous amounts and great rapidity.

Russia's corruption is not confined within Russia's boundaries. Russia's billions could not be laundered without the complicity and cooperation of professionals in banking, law, and accounting in many countries including offshore locations.

Russian corruption and organized crime has internationalized rapidly since the collapse of the Soviet Union in 1991. The political losers of the Soviet era were the financial winners of post-Soviet Russia, a rare case in history in which the discredited elite of the old political system enhanced their financial power after the collapse of the system they had run. Ironically, Russia's criminals and ex- nomenklatura (party elite) members have been among the most successful in capitalizing on the globalization of the world's financial markets. The collapse of the Russian economy in 1998 was, in part, a consequence of the Russian elites' ability to move large sums of money out of their banks into offshore havens.

Through their perfection of the vehicles of front companies, trust agreements and other mechanisms used to hide wealth, the corrupted and criminal elite have been the major beneficiaries of the expansion of safe havens in the globalized economy. Many of those involved in these complex financial operations are former KGB personnel who had experience moving funds abroad during the Soviet era. The highly proficient international lawyers they have hired to craft the trust agreements and foundations for the obscure locales where they park their money have made the tracing of these sheltered assets extremely difficult.

The capital which Russian organized crime has acquired has allowed them to invest significantly in real estate overseas and to enter financial markets in ways that are less easy to detect than through the purchase of commercial and residential real estate. Organized crime infiltration into the Russian domestic banking sector has facilitated the transfer of assets into legitimate financial institutions internationally. Unlike many organized crime groups operating in other regions, Russian organized crime repatriates little of its rapidly-made profits. The assets remain in safe havens overseas and do not return to develop Russian infrastructure, build hotels, buy farms or consumer industries as is the case with other international crime groups.

The financial flows of the September terrorists followed many of the same routes of the Russian money launderers – Switzerland, Cyprus and the offshore havens of the world. The failure to foster international cooperation, reduce secrecy and enhance

transparency of financial markets and meaningful international cooperation, not delayed by bureaucratic games and domestic political concerns, facilitated the deadly terrorist attack on the United States.

While the political motives of the terrorists who attacked the United States differ from those of the economically motivated criminals discussed in this paper, their financial modes of operation are similar. The trinity of transnational crime, corruption and money laundering are central to the perpetration of the crime of any transnational crime group. Russian globalized corruption taught us much about the serious faults of multi-lateral financial institutions, the limitations of individual states in investigating and combating high level international crime and money laundering. But it did not give us sufficient impetus to open, reform and internationalize our international financial system to address the tandem problems of transnational crime and corruption. Our failure to respond to the lessons of the Russian experience have had deadly and economically costly lessons for the world.

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<sup>1</sup> Claire Sterling, "Containing the New Criminal Nomenklatura," in *Global Organized Crime: The New Empire of Evil* eds. Linnea A. Raine and Frank J. Ciluffo, Washington, D.C.: Center for Strategic and International Studies, 1994, pp.106-111.

obscure locales where they park their money have made the tracing of these sheltered assets extremely difficult.<sup>2</sup>

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Abroad, Russian assets do not remain isolated. They are combined with the money laundering of the drug cartels, the Italian mafia, terrorist groups and others who seek to hide large amounts of money. This illicit money is blended both within Russia and abroad. Western government attempts to investigate this money laundering into western institutions have implicated prestigious financial institutions. Those laundering money seek the prestige, security and often invulnerability of financial institutions in leading western financial centers.<sup>3</sup>

The distribution of Russia's assets in financial banking centers and offshore havens throughout the world have brought a truly international dimension to investigation of Russian money laundering.<sup>4</sup> Remarkably, little effort has been made by central Russian authorities to recover the billions which lie abroad. Whereas Russian President Vladimir Putin has declared that the return of Russia's assets to the country is a top priority and former President Mikhail Gorbachev now heads a commission to develop strategies to recover Russian capital overseas,<sup>5</sup> their interests have not been matched by a similar commitment by top law enforcement to cooperate in international investigations needed to recover the money.

Many in the procuracy remain loyal to Yeltsin era functionaries who installed them in their positions. Other personally benefit from their failure to pursue high level corruption and crime. Due to this obstacle, key investigations in the United States, Switzerland and Great Britain have floundered for lack of Russian cooperation. This lack of cooperation costs Russia billions – the initial loss is compounded by the failure to recover Russia's plundered billions.

### **The Sources of Corrupt Funds**

Russia's global corruption results from massive transfer of wealth in the late 1980s and 1990s to former nomenklatura and organized crime. The imposition of

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<sup>2</sup> Raymond Bonner, "Russian Gangsters Exploit Capitalism to Increase Profits," *New York Times* July 25, 1999, p.3.

<sup>3</sup> Investigations in the United States have implicated the Bank of New York and Citibank and in Switzerland such vulnerable institutions as the United Bank of Switzerland (UBS).

<sup>4</sup> Carla del Ponte, Federal Prosecutor of the Swiss Confederation, Statement to the Committee on Banking and Financial Services of the U.S. House of Representatives Hearing on Russian Money Laundering, September 21-22, 1999.

<sup>5</sup> Conference of National Investment Council Foundation, Moscow, Russia, June 26, 2001.

prohibition in 1986, the month in which Gorbachev came to power, resulted in the transfer of ten% of the national budget (the former share of state revenues derived from the sale of alcohol) to organized crime and corrupt party officials. This was followed by the introduction of private business and the privatization of state assets.

The Russian elite evolved quickly from a socialist model to one which resembled some of the corrupt states found in developing countries. As Anatol Lieven, commented, the Russian elite resembled the:

traditional Latin American ‘comprador’ type (with of course specific post-Soviet features), dependent for most of its wealth on controlling the state so as to extract soft loans, evade taxes and allow the unrestricted export of raw materials<sup>6</sup>

This new class of capitalists was formed rapidly on the basis of policies to create a capitalist economy. The reformers sought to create a class of entrepreneurs and were not concerned where the capital derived from or how it would be subsequently invested. The effort to promote privatization was dubbed the “prikhvatisatsiia” (the great grab), as those who had access to state capital appropriated it for themselves rather than creating a country of stakeholders in the country’s economic future.

There were several main sources by which this new entrepreneurial class enriched themselves at the cost of the state and the citizenry. These included conducting shadow operations with state budgetary resources. President Yeltsin acknowledged that the largest source of the private fortunes created in the transitional period was the appropriation of state budget resources.<sup>7</sup> Furthermore, the system of privileged banks set up by the central government allowed individuals to siphon off state resources. These funds were often intended to pay salaries and pensions of citizens. The banks received commissions for handling state budgetary resources.<sup>8</sup> Furthermore, they would often use the funds to make speculative investments that yielded them large profits. The appropriation and misuse of state funds were often merely a prelude to their shipment overseas.

Another major source of the looted billions were the natural resources of the Russian state, appropriated by the individuals charged with their management and development. In a period without sufficient regulation of shareholder rights, managers of these companies appropriated significant shares of the companies and did not respect the rights of minority shareholders. The most obvious cases of these are the transfer of valued assets of oil and gas holdings to offshore companies owned and controlled by the relatives of the firm managers. The most notable example is the situation of Gazprom and Itera which will be discussed subsequently.

Russians assets abroad, consequently, represent an amalgam of different sources. Russian officials estimates that this figure is upwards of \$150 billion, figures reaching as high as over \$300 billion. Current officials suggest that \$20 billion a year continues to

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<sup>6</sup> Anatol Lieven, *Chechnya Tombstone of Russian Power* New Haven and London: Yale University Press, 1998, p.3.

<sup>7</sup> CDSP April 9, 1997, vol. XLIX, No.10, p.5.

<sup>8</sup> Svetlana Glinkina, “The Shadow Economy in Russia,” paper presented at conference on money laundering in Budapest at the International Law Enforcement Academy, June 2000.

exit Russia for tax havens around the world. Some of these billions represent capital flight from businesses and individuals who do not trust the precarious, unregulated and dishonest Russian banking system. A significant share of these assets, however, could be considered laundered money, assets derived from an illegal act and subsequently moved into the legitimate economy in an effort to disguise the source of the funds. Significantly, a portion of this money is neither capital flight nor money laundering as the absence of laws regulating the privatization process or shareholder rights of businesses has allowed money to be siphoned out of companies without violating the criminal law.

Privatization proved to be the central mechanism for the acquisition of financial power by the former Party and Komsomol elite and members of organized crime. There were no legal mechanisms or safeguards to preclude the hijacking of the privatization process. Fraud was endemic. While wily members of the elite were able to enrich themselves rapidly, millions of average citizens lost their life savings through fraudulent stock funds, pyramid schemes and unregulated banks which collapsed with regularity. A decree against fraud in the privatization process was introduced only in 1993, after a significant share of Russian property had already been privatized. The riches obtained through privatization, fraudulent banking and stock schemes were commonly transferred abroad to an international financial community that welcomed these billions.

Another major source of the funds overseas are the proceeds of organized crime groups. Post-Soviet organized crime, almost unknown on a global scale until the collapse of the Soviet Union, have accumulated billions in assets during the 1990s. They have been able to generate such large profits because the most important groups have successfully expanded their operations internationally and even globally. While organized crime groups in certain countries engage in a limited range of illicit goods and services, Russian organized crime represents one of the world's most diversified forms of organized crime. Its activities span the full range of illicit goods and services including drugs, gambling, prostitution, trafficking in women and endangered species, arms sales, particularly the huge market for small arms. Many of its illicit activities are those not directly associated with organized crime, including illegal licensing arrangements, corrupted import-export operations and criminalization of the privatization process but they contribute to its enormous profitability. Major gains are made from the stripping of businesses that such groups have forcibly privatized and their control of the aluminum sector and other key elements of the resource driven economy.<sup>9</sup>

Russians are able to hide their money so successfully because they are at the forefront of the use of technology to exploit the globalized offshore economy. The true extent of Russian organized crime's capital resources will therefore never be known because much of it is parked in anonymous bank accounts and carefully masked trusts that are housed in offshore locations. There are literally over 10,000 Russian banks located in the Caribbean and this is just one area of the world that is used to house their money. Cyprus, Switzerland, Liechtenstein, Austria are also highly used by Russian organized crime. Even such far flung locations as the Marshall Islands and Nauru in the South Pacific are locales of significant Russian money laundering.<sup>10</sup>

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<sup>9</sup> Chrystia Freeland, *Sale of the Century Russia's Wild Ride from Communism to Capitalism* New York: Crown Business, 2000, Paul Klebnikov, *Godfather of the Kremlin* New York: Harcourt, 2000.

<sup>10</sup> See *Financial Havens, Banking Secrecy and Money Laundering* UN Crime Prevention and Criminal Justice Newsletter, Issue 34/35, 1998..

Two important illustrative examples, widely reported in the media, reveal the successful combination of front operations and offshore locales used to hide resources. More than a billion of Russia's treasury was transferred to a shell company, Fimaco, housed on the Isle of Jersey. The funds parked there were outside the scrutiny of IMF (International Monetary Fund) officials, trying to assess the resources of the Russian state.<sup>11</sup> Removed from Russian territory, these funds were also not available to pay citizens' salaries or pensions. In another case, a Russian citizen established the European Union Bank, an offshore bank in Antigua, that operated exclusively through the internet. The bank was closed before the Antiguan regulators were ever able to inspect its records. The depositors remained anonymous because the files were encrypted with such sophistication that they could not be opened by American law enforcement. Moreover, none of the depositors has come forth to file a complaint because the sources of their funds or their intentions were probably not legitimate.<sup>12</sup>

### **The International System Facilitates Corruption and International Crime**

The international community facilitates corruption in numerous ways. Of prime importance is the globalization of the international financial community that permits capital to flow rapidly and limits the ability to conduct due diligence on this capital. The failure to develop an effective regulatory and enforcement regime to oversee global financial markets has allowed illicit and grey capital to move with little hindrance. In the absence of a global regulatory regime, the Financial Action Task Force (FATF) had relied on domestic controls of each country. Many countries, in fear of sanctions for non-cooperation in money laundering, have passed legislation to outlaw money laundering and impose restrictions. Yet they have done little to ensure the needed enforcement measures are in place to make these laws effective.

Countries can be both sources countries for money laundering aboard as well as host countries to launder money of illicit origin from other countries. Russia provides a clear example of this phenomena because billions of its assets are laundered overseas and large quantities from elsewhere are moved through Russia. This phenomena is common to many of the former states of the USSR where casinos have proliferated that facilitate the laundering of illicit capital from overseas. In Russia, while money laundering from the drug trade and other activities goes on through casinos, it also occurs through legitimate sectors such as real estate. The recent investigation of SPAG (St. Petersburg Real Estate Holding Company), to be discussed more fully later, reveals this point.<sup>13</sup>

The development and proliferation of the Internet and the speed of financial transactions facilitated by computers have expanded money laundering opportunities and activities in the latter half of the 1990s. There are increasing numbers of websites that solicit money for transfer offshore. The rise of internet gambling and of virtual banking have made it possible to launder money without any infrastructure that can regulate

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<sup>11</sup> For a discussion of this see Global Organized Crime Project, *Russian Organized Crime and Corruption Putin's Challenge* Washington, D.C.: Center for Strategic and International Studies, 2000, p.32-35.

<sup>12</sup> *Financial Havens, Banking Secrecy and Money Laundering* and author's knowledge from a case she worked as a governmental consultant.

<sup>13</sup> Mark Hosenball and Christian Caryl, "A Stain on Mr. Clean How A Money-Laundering Indictment Could Haunt Putin," *Newsweek*, September 3, 2001.

international banking operations. Instead, the rise of information technology and the growth of uncrackable encryption have provided the possibility of laundering money with greater facility and with almost perfect anonymity. All that is needed is a computer.<sup>14</sup>

The rise of the new information technology has made possible an incredible communications revolution, but it has led to the proliferation of money laundering in some of the most remote destinations in the world. Such locations include Vanuatu, Nauru, and the Marshall Islands through whose “banks” billions have been laundered in the last couple of years.<sup>15</sup> Facilitating the rise of virtual banking in offshore locations has been the willingness of major banks to receive funds that have been routed through these locales. While well-written software could potentially screen these transactions and prevent the absorption of these funds into mainstream banking centers, this has not occurred.

Money laundering is associated not only with sleazy individuals. Many individuals of high social status associated with respectable financial centers have been implicated in money laundering. Sometimes these individuals have failed to provide sufficient oversight but often they have reduced standards to obtain lucrative business. In the most extreme case, they are complicit in facilitating money laundering.<sup>16</sup> Transactions in financial havens are protected by high-ranking government officials, judges, politicians, bank directors and investment consultants who work together to provide financial services for international criminals.<sup>17</sup> Sometimes they are conscious of who their clients are, sometimes they fail to probe deeply enough into what should trigger signals as to a suspicious transaction by emissaries or family members of high level officials, top international crime figures or even terrorists.

The illicit movement of funds has proliferated because of the presence of many facilitators, the rise of underground banking (outside established financial institutions) and the difficulty of probing the actual source of funds. Many legislative and law enforcement efforts to combat money laundering are whereas the problems are global. Funds move internationally often without regard to international borders. Criminals and terrorists move money across multiple borders compounding the difficulties of individual states to trace the money flows and assemble a complete picture of the resources of the groups..

The legal institutions to combat money laundering move more slowly than the money flows. Therefore, a wire transfer moved through four jurisdictions in an hour, a typical move for a money launderer, will take law enforcement in the United States a year to unravel because of existing legal barriers. Law enforcers in countries without such resources as the United States may never be able to trace these transactions. In some

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<sup>14</sup> *Organized Crime, Corruption and Information Technology*. (2000).conference at American University, Washington, D.C, November 30-December 1, 2000.

<sup>15</sup> U.S. Department of State (2000) *Money Laundering and Financial Crimes*  
<http://www.state.gov/g/inl/rls/2000/index.cfm?docid=959>.

<sup>16</sup> Examples of this include Michael Abbell, formerly a high Department of Justice official, who was convicted of working as a money launderer for the Colombian drug cartels for whom he subsequently worked as a defense attorney. Another case is the indictment of Rudolf Ritter indicted in money laundering in Liechtenstein.

<sup>17</sup> Greg Mascolo, “An Invitation to Launder Money,” see [www.icij.org/investigate/mascolo.htm](http://www.icij.org/investigate/mascolo.htm).

cases, it is either legally impossible or physically impossible to obtain needed information on the money movement because of the bank secrecy, movement through offshore locales and the masking of funds ownership through trusts and front companies.

Several highly visible cases illustrate the internationalization of Russian assets and the role that various western actors play in facilitating this large scale financial movement. Western as well as Russian corruption is often key to these large scale financial transfers as investigations in the west reveal. These investigations highlight three different forms of the internationalization of corrupt assets 1) Movement of money through the banking system as exemplified by the Bank of New York and Citibank investigations; 2) Movement of tangible assets as in the Diamond ADA case; and 3) Liquidation of state assets by the transfer of large shares to offshore locales as in the case of Gazprom and Itera.

### **Movement of Assets through Foreign Banks**

Billions of Russian assets, many of them obtained by illegitimate means, have flowed into the United States and other countries since the collapse of the Soviet Union. The Bank of New York case is only the most visible case, but billions more have left in many other cases. The Bank of New York involved the movement of \$7 billion in Russian assets through multiple accounts at the bank. The money moved ranged from legitimate funds to funds tied to major Russian crime groups. It was the money linked to notable crime groups which alerted British intelligence to the mass financial movements through specific accounts of the Bank of New York.

When the Bank of New York case appeared in the newspapers, top policy makers were concerned that the vast sums of money flowing in from the former Soviet Union, some of it of illicit origin, could undermine our banking system<sup>18</sup>. Conversely, on the Russian side there is great concern that little of the looted assets have been returned. Moreover, many Russians feel that much political capital is being made from these cases in the west with little tangible benefit for Russia.

The large scale investigation of money laundering of billions in assets through the Bank of New York and of \$800 million of suspicious funds through Citibank illustrate the vast sums of Russian money which can be moved through American banks without triggering warning signals from American banks. Large sums have been moved through the banking systems of other countries as the Swiss investigation of Mabetex, the firm associated with the Kremlin reconstruction, and the investigation of the Russian treasury assets placed in the Isle of Jersey reveal. Even though these investigations originate in one country, they draw numerous other countries into the case because of the international movement of funds. In the Bank of New York case, the assets in the investigated accounts had or would subsequently move through approximately 40 different countries.<sup>19</sup>

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<sup>18</sup> Hearings of U.S. House of Representatives Banking and Financial Services Committee, Russian Money Laundering, September 21, 1999.

<sup>19</sup> Timothy L. O'Brien and Lowell Bergman, "Law Enforcement Rivalry in U.S. Slowed Inquiry on Russian Funds," *New York Times* 29 September 1999, at [www.nytimes.com/library/world/global/092999russia-inquiry.html](http://www.nytimes.com/library/world/global/092999russia-inquiry.html).

The Bank of New York case illustrates the difficulties of detecting Russian money laundering in the United States.<sup>20</sup> Placement of illicit funds in a powerful institutions such as the Bank off New York made it possible for these illegal money flows to be sustained for several years without attracting the attention of American investigators. Rather, it was British investigators, as previously mentioned, who brought these suspicious transactions to the attention of American law enforcement authorities.

Russian authorities offered little cooperation because many highly placed officials and their associates were implicated in the investigation. Without assistance from the Russian side, it was difficult to pursue a money laundering case against individuals in Russia and made it harder for American investigators to pursue suspects on our side. The only individuals to be indicted in the investigation were a couple of mid-level bank employees without whose assistance the money could not have entered into accounts at the Bank of New York.<sup>21</sup>

A recently released U.S. General Accounting Office (GAO) report reveals that the Bank of New York case was not an exception. Enormous sums of questionable money were also moved through Citibank. The investigation, conducted by the investigative branch of GAO at the request of an investigative committee of the U.S. Congress, examined the possibility of Russian money laundering in the United States. The investigators traced US\$800 million of such funds that had been moved into the U.S. banking system by one Russian. He did this by registering companies in the “offshore location” of the State of Delaware, which protects the anonymity of corporations. The money was subsequently moved into accounts in the private banking sector of Citibank.

No legal action had been taken against the bank, any of the account holders or against the individual who had managed to move these funds of unknown origin. Without knowledge of the source of these funds, only possible with the cooperation of Russian authorities, it was not possible to prove that the money is actually laundered funds as opposed to capital flight. Yet the presence of such large wire transfers in such a limited number of accounts suggested that this might be money laundering.<sup>22</sup> The GAO report explains how sophisticated money launderers can exploit significant loopholes in United States to move large amounts of questionable money through a leading American institution.

### **Movement of Tangible Assets**

Russia has lost millions in assets not only because money can be wire transferred out of the country but also because large quantities of tangible assets could be physically moved as well. During the immediate post-Soviet period, high level officials who controlled the ministries with oversight over Russian treasures and valuable non-liquid assets appropriated the resources under their charge for themselves. No system was in place to safeguard the national treasury or the Central Bank. One criminal case

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<sup>20</sup> *Russian Organized Crime and Corruption Putin's Challenge* , p.8.

<sup>21</sup> Timothy L. O'Brien and Raymond Bonner, “Banker and Husband Tell of Role in Laundering Case,” *New York Times*, February 17, 1999, p.1.

<sup>22</sup> Senate Committee on Governmental Affairs, Permanent Subcommittee on Investigations, 2000, *Suspicious Banking Activities Possible Money Laundering by U.S. Companies Formed for Russian Entities*, GAO publication No.GAO-01-120.

investigated in the United States dramatically illustrates the valuable and rare items which could be transferred out of the country and used for the personal benefit of Russian officials and their associates.

In 1993, Russian officials transferred one half billion of Russian state assets abroad including tons of diamonds, jewelry, silver, and gold from the Russian national treasury to the United States. The perpetrators of these crimes established a diamond store in San Francisco and sold pre-Petrine coins in Los Angeles. Many of these valuable and historical Russian state assets were melted down for gold bullion. This theft was perpetrated by the head of the State Treasury, Bychkov, and implicated such other officials as the Deputy Prime Minister and the Minister of Finance and the head of the Russian Committee for Precious Metals and Gem Stones, high government officials closely associated with Yeltsin who had direct access to the wealth and ancient treasures of Russia.<sup>23</sup> This theft became apparent to U.S. authorities only because the Russian perpetrators tried to recruit San Francisco police to accompany the diamond shipments and the size of the shipments alerted American customs officials.<sup>24</sup> The extravagant lifestyles of those setting up the diamond business also brought visibility to the Russian perpetrators who tried to ingratiate themselves with San Francisco government officials. Ultimately, some of the assets were available for repatriation to Russia because FBI, Customs and IRS agents seized many of Golden Ada's assets just as they were to be shipped out of the country.

The investigation proceeded with sporadic cooperation from the Russian authorities.<sup>25</sup> American officials shared information with a trusted Russian investigator who spent weeks examining legal records. His credibility with American investigators was enhanced when he was beaten up on his return to Russia.<sup>26</sup> Other Russian investigators were not allowed to pursue their work and many inquiries to Russian authorities from American law enforcement remained unanswered because of the political pressure applied to the General Procurator's office not to cooperate on this investigation.

The difficulties in securing cooperation with Russia and other post-Soviet governments in cases involving high level corruption, bank fraud and money laundering have made many American prosecutors reluctant to take on such cases. Major Swiss investigations into organized crime and money laundering have been stymied after using thousands of man hours of investigative time. While investigations such as the Bank of New York and Golden Ada cannot remain uninvestigated. American prosecutors, if given discretion, may choose not to invest their energies in cases linked with the former Soviet Union. The oscillations in cooperation often lead to lengthy and unsuccessful efforts to stem money laundering out of Russia and to repatriate assets.

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<sup>23</sup> David E. Kaplan, "The Looting of Russia," *U.S. News and World Report* August 3, 1998.

<sup>24</sup> The author met one of the FBI agents at Quantico who had been informed by a San Francisco policeman of this suspicious activity.

<sup>25</sup> Interview with member of the organized crime strike force in Los Angeles working on this case., March 199.

<sup>26</sup> Kaplan.

## Liquidation or Dilution of State Assets

Among Russia's most valuable assets are its natural resources. While some of these can be physically removed such as the diamonds in the Golden Ada case, they do not provide as much revenue as the income flows which result from the sale of Russian oil and gas. Some of the richest individuals in Russia are those which have managed to obtain management and ownership rights over the Russia's privatized oil and gas operations, the crown jewel of which is Gazprom. Throughout the Yeltsin years, Viktor Chernomyrdin as prime minister enjoyed enormous political protection for his significant Gazprom assets. Chernomyrdin is now listed by Forbes magazine as one of the 400 wealthiest businessmen in the world, a rating based on the on the percentage he holds of Gazprom.<sup>27</sup>

The assets and revenues of Gazprom are one of the largest financial sources of the Russian government. One of the major steps taken by Putin has been to place his own person in a leadership position at Gazprom and to reassert control over all elements of the company. Private shareholders and government officials have suggested that valuable assets of Gazprom, like gas fields, have been transferred improperly to outside companies such as Itera.<sup>28</sup> Itera, a company registered in Jacksonville, Florida, has emerged from nowhere as a major player in the oil and gas sector. A four month audit of Gazprom, initiated after Putin had asserted control over the company, revealed that assets had been allowed to "slip away" but no evidence has been found indicating that these assets were transferred in violation of Russian law.

Asset stripping from Gazprom is not confined to Itera. Billions in assets of the energy giant have ended up in the hands of Gazprom family members, through the Hungarian registered company of Interprocom.<sup>29</sup> The complex mechanisms by which the assets of Gazprom are transferred to companies outside of Russia makes it very difficult to document the cash flows, examine the shareholder ownership or provide accountability to the company. When assets are housed offshore, the revenues can be moved to bank accounts outside of Russia and consequently never enter into the financial accounting of the company or be subject to taxation within Russia.

The establishment of companies such as Itera and Interprocom, which permit the movement not only of the revenues but substantial shares of a company overseas, can only be done with the assistance of top level legal advisors both at home and abroad. The fact that auditors have difficulty establishing whether an illegal transfer occurred means that Russian laws have been structured since inception to allow for the liquidation of Russian assets and the deprivation of shareholder rights.

Apart from the Gazprom-Itera case, significant shares of other enterprises have been moved to offshore locations through elaborate trust arrangements consistent with the laws of the locale. As a result, significant shares of the Russian oil and gas industries are now parked in British offshore islands and different islands of the Caribbean. Not only do these offshore islands hold the trusts on significant shares of these businesses, but the profits of these businesses then flow with ease through the banking sectors of these offshore locales.

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<sup>27</sup> Kerry A. Dolan and Luisa Kroll, "The World's Richest People," *Forbes*, June 21, 2001.

<sup>28</sup> Sabrina Tavernise, "Gas Giant in Russia Told to Guard its Assets," *New York Times*, July 31, 2001.

<sup>29</sup> Anna Raff, "Audit: Itera-Gazprom Ties are Above Board," *The St. Petersburg Times*, July 13, 2001.

## **The Role of Russia in Laundering Illicit Foreign Assets**

Foreign money laundering in Russia by transnational crime groups has rarely been investigated by Russian law enforcement. Instead, information on foreign crime groups operating within Russia comes from foreign law enforcement who have traced groups under surveillance into Russian territory. Italian investigators traced their crime groups to cafes and other businesses in Ekaterinburg in the Urals, German investigators discovered that Colombian groups had laundered money through the St. Petersburg real estate market.<sup>30</sup> Even though Russian authorities insist that the war in Chechnya is being funded by foreign terrorist groups, no visible controls have been enacted to stem these money flows.

Many other crime groups from Asia and the Middle East benefited from Russia's unregulated casinos; but they exploited the privatization process and the range of sectors of the legitimate economy through which they could launder money. This activity is particularly pronounced in the Russian Far East where North and South Korean, Vietnamese, Chinese and Japanese crime groups operate.<sup>31</sup> Aiding this process was the dollarization of the Russian economy, the reliance on cash and the lack of reporting requirements in the banking and currency exchange sector. Central to the capacity to launder money in Russia was the complicity or willful blindness of Russian local, regional and national officials. The money laundering law passed in mid-2001 may make it more difficult to launder money but its impact has yet to be seen.

## **Money Laundering an International Problem – Russian Role**

Money laundering on a large scale has existed since the 1960s. Throughout the Cold War era dictators moved money to safe havens without questions being raised. With the rise of the international drug trade since the late 1960s, money laundering has expanded exponentially as increasingly large amounts of money need to be moved into the legitimate financial system. Covert arms sales have been facilitated for decades by money laundering. Terrorist operations were financed by the various forms of illicit activity and the movement of money through financial havens. Even though many in government and the financial world knew that significant illicit sums were being laundered, tracing illicit money flows was a low priority compared to larger strategic interests.<sup>32</sup>

In the 1990s, more attention was focused on money laundering, a consequence of multiple factors. In the aftermath of the Cold War, the incentives to protect dictators who were opponents of communism ended. International drug trafficking organization represented at least 2% of the world's economy. Massive money laundering out of

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<sup>30</sup> Hosenball and Caryl.

<sup>31</sup> Anna Leonidovna Repetskaya, "Status of Russian Organized Crime," presentation at the Transnational Crime and Corruption Center at American University, Washington, D.C., November 3, 1999 and Vitaly Nomokonov ed. *Organizovannia prestupnost', tendentsii, perspektivy bor'by* Vladivostok: Far Eastern University Press, 1999.

<sup>32</sup> *Observatoire Geopolitique des Drogues*, 18. (The World Geopolitics of Drugs). (2000). Can be located on the World Wide Web at [Http://www.ogd.org](http://www.ogd.org)

Soviet successor states derailed international expectations for a smooth transition away from the Communist system.

The Russian economic collapse in August 1998 was a wake-up call for the international community on the domestic and international costs of massive money laundering. Despite billions in financial aid and loans from multilateral organizations, the standard of living of Russian citizens was lower at the end of the 1990s than at the beginning. An important lesson of the Russian experience – the economy of even a former superpower can be devastated by money laundering to major financial centers and offshore locations.

The Russian collapse reduced the legitimacy of the World Bank and the International Monetary Fund. A share of the Russian treasury was found in the offshore Island of Jersey at the time Russia was asking the international lending institutions for more money. Moreover, there is some evidence that the IMF bailout to Russia in August 1998 failed to stabilize the economy because a significant share was diverted abroad by oligarchs and politically connected financial institutions under their control.<sup>33</sup>

At the close of the 20th century, an international consensus emerged that coordinated action was needed against international money laundering. European countries with large social welfare infrastructures to support are highly dependent on tax revenues. The loss of tax revenues to offshore havens has been a driving force for European action. The prime motivator for action in the United States has been the fight against drugs. The Financial Action Task Force (FATF) threatened to impose sanctions on countries without an adequate legislative framework to address money laundering. In response to these threats, Russia after many years, finally adopted a comprehensive money laundering law in June 2001.

### **Problems of Russian Cooperation in Fighting Money Laundering**

Law enforcement relations now assume a role in international diplomacy. Initially, this new role for law enforcement was a response to drug trafficking. Issues in the diplomatic agenda now include counterfeiting, arms trafficking, terrorism, money laundering and many other organized crime related offenses.<sup>34</sup> To promote international law enforcement engagement, personnel from many U.S. government law enforcement agencies are posted as liaisons in many embassies overseas. The internationalization of law enforcement is not unique to the United States; law enforcement representatives are present in over a dozen embassies in Moscow. The United States as well as many other countries have created legal, policy and operational structures to guide police and prosecutorial cooperation with many foreign countries.<sup>35</sup>

Just as the Cold War era was characterized by problems of distrust, issues of verification of information and lengthy negotiations over treaties, the same problems now

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<sup>33</sup> *Russian Organized Crime and Corruption Putin's Challenge*, pp.32-34.

<sup>34</sup> Ethan A. Nadelmann "The Americanization of Global Law Enforcement: The Diffusion of American Tactics and Personnel," pp. 123-126 and Jonathan Winer, "International Crime in the New Geopolitics: A Core Threat to Democracy," p.53-64 in *Crime and Law Enforcement in a Global Village* ed. William F. McDonald Cincinnati, Ohio: Anderson Publishing Co, 1997.

<sup>35</sup> Ethan Nadelmann, *Cops Across Borders: The Internationalization of U.S. Criminal Law Enforcement* University Park, Pa.: Pennsylvania State University Press, 1993.

affect international cooperation in the law enforcement area. Many familiar problems endure including problems of reliability of information, issues of corruption and problems of verification of crucial evidence. Requests for case and bank information remain unanswered. Negotiations can stall if they prove unfavorable to highly placed Russian officials. Compounding the technical problems of cooperation in investigations is that misinformation on cases is presented in the mass media.<sup>36</sup>

In the absence of Russian cooperation, cases involving Russian organized crime and high level corruption abroad must rely on mutual information sharing among different foreign countries. Cooperation is often absent because Russian law enforcers have learned the high costs of cooperation with western authorities. Highlighting this problem was the humiliation of Prosecutor General Yuri Skuratov on national television and then his grounding by Russian authorities who denied his right to travel to Switzerland to investigate high level Russian corruption.

Russia's limited cooperation in international investigations results from corruption and the subordination of the procuracy to the interests of the ruling elite but also from problems of mutual distrust and ignorance. Neither side sufficiently understands the laws, procedures and investigative methods of the other country. Often foreign law enforcement personnel are unaccustomed and untrained to operate in the international arena, particularly in a society such as Russia, where law is very often subordinate to politics. Russian investigators and prosecutors, in turn, feel frustrated by the legal safeguards and the lack of coordination among different foreign law enforcement which produce interminable delays and prevent the return of looted Russian assets.

## **Conclusions**

The Russian economic collapse in August 1998 and the subsequent Bank of New York investigation reveal that transnational crime, corruption and money laundering are interwoven in ways not properly understood. The Bank of New York case revealed that corrupt and highly criminal money can be blended with legitimate; enormous sums moving internationally can provide a cover for any illicit activity. Russians alone were not responsible; financial rewards for Bank of New York officials contributed to western bank complicity. Hindering attempts to punish the perpetrators was domestic law enforcement corruption in Russia and political pressure on the investigators, illustrating the limits of law and international law enforcement in addressing illicit financial flows.

The consequences for Russia of the August 1998 collapse were severe and the reverberations of this collapse were felt in financial markets throughout the world. Many hoped that this severe crisis and the accompanying one in Asia would serve as a basis for profound reform in the international financial system.

This fundamental reform was not forthcoming. The core problem remains that national sovereignty prevails in the face of a global economy. State based laws are

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<sup>36</sup> Sergei Avdeev, "Politseiskaia akademiia amerikanskii syshchiki priekhali nabirat' siia opyta i russkikh militsionerov," *Izvestiia* April 1, 2000, p.1. provided incorrect information on a colleague suggesting that she was an investigator. The visibility of this article made this more than a journalistic mistake. Distortions in the American media occurred because incorrect information was deliberately fed to an American journalist. See Timothy L. O'Brien, "Doubts Raised About Source in Bank of New York Inquiry," *New York Times*, Jan 17, 2000, on the web at [www.russianlaw.org/nyt-sel-article.htm](http://www.russianlaw.org/nyt-sel-article.htm).

decisive whereas money flows internationally across multiple jurisdictions with enormous rapidity. Measures implemented after 1998 addressed the surface of the problem, requiring countries to develop money laundering laws and policies to implement this legislation. Greater transparency of international financial markets, curtailment of abuses in offshore financial havens and greater vigilance over the source of funds in international financial centers was not achieved. Without such changes, massive flows of both licit and illicit money continued to flow outside Russia. The costs of partial reform in the international financial system are clear not only for Russia but now for the international community in the wake of the September terrorist attack on the World Trade Center and the Pentagon.

The financial flows of the September terrorists followed many of the same routes of the Russian money launderers – Switzerland, Cyprus and the offshore havens of the world. The failure to foster international cooperation, reduce secrecy and enhance transparency of financial markets and meaningful international cooperation, not delayed by bureaucratic games and domestic political concerns, facilitated the deadly terrorist attack on the United States.

While the political motives of the terrorists who attacked the United States differ from those of the economically motivated criminals discussed in this paper, their financial modes of operation are similar. The trinity of transnational crime, corruption and money laundering are central to the perpetration of the crime of any transnational crime group. Russian globalized corruption taught us much about the serious faults of multi-lateral financial institutions, the limitations of individual states in investigating and combating high level international crime and money laundering. But it did not give us sufficient impetus to open, reform and internationalize our international financial system to address the tandem problems of transnational crime and corruption. Our failure to respond to the lessons of the Russian experience have had deadly and economically costly lessons for the world