



Russian Organized Crime

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On September 24, President Yeltsin said that "criminals have today brazenly entered the political arena and are dictating its laws, helped by corrupt officials. They can penetrate everywhere unless the whole of society, from top to bottom, joins in an effort to eradicate this scourge. Our policy on this will be very tough."

This was Mr. Yeltsin's seventh crackdown in six years against organized crime and corruption. Three years ago, President Yeltsin called his country, the Russian Federation, with 150 million people and over 20,000 nuclear warheads, "the biggest mafia state in the world... the superpower of crime that is devouring the state from top to bottom." The situation has not improved since then.

Grigory Yavlinsky, the leader of the reform "Yabloko" party, and a declared candidate for the presidency in 2000, was in Washington last week when he said, "A corrupted system of criminal power has been established in Russia and now poses the main threat to the economy... Not a single widely publicized [contract] murder, including of well-known journalists and the deputy governor of St. Petersburg, was successfully investigated in Russia over the last five years. A political will rather than the criminal code is needed to break the stranglehold of crime and corruption."

While there are numerous investigative stories by reporters covering Russian organized crime (OC), there is no comprehensive study assessing the breadth and depth of the threat, the extent to which (OC) and corruption are undermining privatization and Russia's transition to a market economy -- and perhaps most important of all, examining the implications for U.S. policy toward Russia.

CSIS released such a [study](#) September 29 (1997), the result of two years of work by a Task Force made up of experts drawn from the intelligence, law enforcement, corporate and academic communities. The report's key findings and a summary of its recommendations are attached to this testimony.

The CSIS report focuses on more than simply the organized crime problem in Russia. Much of the Russian state and economy is now on the verge of becoming a criminal oligarchy dominated by:

1. Corrupt officials at all levels of the bureaucracy, from government Minister to tax collector and low-level bureaucrat;
2. Successful, full-time professional crime syndicate bosses;
3. Businessmen for whom existing Russian law and Western norms of commerce are simply obstacles to be overcome in one way or another.

Russia's deputy Military Prosecutor, Lt. Gen. Stanislav Gaveto, captured the crime crisis well when he said Russia is faced with "the wholesale criminalization of the life of our entire society, every pore of the state mechanism is steeped in corruption and abuse..."

About two-thirds of the Russian economy is under the sway of OC, including 40% of private business, 60% of remaining state-owned enterprises and more than half of the country's 1,740 banks. Those are estimates of the MVD, Russia's Interior Ministry. Crime syndicates enjoy the protection of the ruling oligarchy which consolidated its power during Mr. Yeltsin's illnesses in 1996 and early 1997.

200 of Russia's largest crime gangs are now global conglomerates. There are some 280 ongoing criminal investigations of Russian organized crime involvement with U.S. counterparts.

Former First Deputy Minister of the Economy Vladimir Panskov recently wrote in Pravda that \$250 billion "leaked from Russia over four years." The Bank of France estimates that in 1994, Russians invested \$50 billion in 30 western countries. Interior Minister Kulikov's own estimates range from \$150 billion to \$300 billion. By way of comparison, total western aid to Russia from all western countries, principally Germany, and from international institutions, since 1992 is \$74 billion.

In his speech to the upper house of parliament last week, Mr. Yeltsin said he was considering an amnesty for those who have squirreled their ill-gotten gains abroad, with a levy of 10% to 15% of the sums involved to be paid to the state.

The old Soviet nomenklatura, with the help of criminal organizations, privatized the economy into their own hands, selling off state assets, rather than creating new ones, and exporting capital, rather than creating it.

The rule of law has been displaced by criminals and gang chieftains who are de facto adjudicators; "krysha," or roof, are the protection rackets that have replaced legal functions and safeguards.

The first round of privatizations supervised by Anatoly Chubais, now a First Deputy Prime Minister, consisted of rigged auctions in favor of pre-selected individuals or banks, with crime syndicates the principal beneficiaries. The Analytical Center of the Russian Academy of Sciences estimated that "55% of the capital and 80% of voting shares were transferred during the privatization process into the hands of domestic and foreign criminal capital." Prosecutor General Yuri Skuratov reported 2,000 privatization crimes in 1996 alone. His military counterpart said he had 6,000 major cases of corruption in the military last year, most of them committed by officers.

But Mr. Skuratov says he is "greatly troubled by the extremely incoherent official policy of counteracting crime. Practically no money has been allocated to anti-crime programs." and he concludes that "the fight against crime is a facade." Law enforcement agencies, according to Mr. Yeltsin's own Kremlin analytical service, "have been thoroughly compromised by organized crime."

In 1997, Russia's central bank reported that three commercial banks between them had diverted some \$500 million in federal budget funds into high-yielding securities markets. The banks claimed market losses, the money vanished, and the government was powerless to get its money back.

Today, Boris Nemtsov and Chubais, both First Deputy Prime Ministers, are engaged in mortal combat to wrest control of the economy from a semi-criminal oligarchy. A plot to assassinate Chubais was uncovered two weeks ago. His close ally, Mikhail Manevich, the deputy governor of St. Petersburg, was gunned down this summer on the city's main thoroughfare. He was scheduled to go public the next day with names and places of OC's involvement in privatization scams.

The limited successes of Chubais and Nemtsov are invariably matched, or even exceeded, by developments engineered by the oligarchy they are powerless to cope with. It should be noted these two reformers do not control the security services or law enforcement.

The broad impact of the crime-dominated state for U.S. foreign policy is illustrated by ~recent, allegations that Russian Space Agency Director Yuri Koptev was involved in transferring missile technology to Iran. Going against official Russian policy, Koptev was allegedly motivated by personal financial considerations.

The CSIS report, the second in a series of seven under the Center's Transnational Threats Initiative, dispels the widely held perception that Russia is a market economy run by a hot team of reformers. Many have argued that Russia's struggle against OC and corruption is the primitive accumulation stage of early capitalism, much like the American "robber barons" of the late 19th century.

A World Bank report says this is a dangerous assumption that does not hold up to critical analysis. America's early entrepreneurs rode roughshod over laws and created huge industrial enterprises that were of enormous value to society as a whole. Profits were ploughed back in the U.S., not sent abroad for safekeeping in anonymous bank accounts.

In the U.S., a self-correcting political and legal system curbed the excesses of the robber barons and capitalism matured.

In Russia, former Communist Party officials, KGB operatives, and OC syndicate chiefs, sold off state assets, did not create new ones, and moved scores of billions of dollars of plunder abroad, instead of reinvesting in Russia.

According to knowledgeable intelligence sources in several countries (U.S., Russia, the U.K. and Germany), the plunder began in early 1986 during the glasnost/perestroika phase of the Gorbachev regime. That is when certain key figures of the CPSU's Central Committee- concluded that omnipotence could soon turn to oblivion. So they began advanced planning for the redistribution of the funds and resources of the Soviet Union. These plans included transferring what was then under the control of the Property Section of the Central Committee (CC) -- the entire wealth of the country -- to new commercial structures outside the control of whatever followed glasnost and perestroika policies.

This overall plan required the creation of scores of banks hundreds of new commercial firms that could then be granted total control of state property at bargain prices. The banks later gerrymandered auctions for the privatization of major state-controlled enterprises, thus consolidating the oligarchy spawned by the CC's plan.

Lacking personnel experienced in banking and business, the CC's Administration Department turned to the KGB for additional manpower. By late 1986, the CC's informal planning committee delegated implementation of the plan to two senior officers of the KGB's First Chief Directorate whose assignments had included moving funds abroad for the CC's International Department and for their own operational purposes.

Planning meetings were chaired by CC Treasurer Nikolai Kruchin. Only two copies of the minutes of these meetings were made -- one for the CC official in charge of Administration for the Politburo, the other for then KGB Chairman Viktor Chbrikov.

The plan was carried out in four stages:

1. Suitcases and diplomatic pouches of cash, diamonds, gold and icons were sent abroad to generate the funds needed to sustain the new commercial- enterprises abroad and their foreign bank accounts.
2. Once the foreign infrastructure was in place, state enterprises, factories and organizations were ordered to transfer state funds to head offices in the Soviet republics - and thence to the west.
3. Trading firms were created to act as intermediaries to sell Russian resources, such as oil, non-ferrous metals, chemicals and cotton. These new trading entities received these materials at state subsidized "internal prices" and then sold abroad a few points below western prices. At one stage, oil prices in the west were ten times the "internal" Soviet price. Profits from these highly lucrative operations were deposited in tax havens in Cyprus, Switzerland, the British Channel islands, Ireland, the Cayman Islands, Antigua, Aruba, Panama, and Hong Kong. These funds, in turn, were available for so-called western investment" in Russia and the ex-Soviet republics under the cover of being "Western Joint Ventures." Such joint ventures were denounced by President Yeltsin in 1994 as "criminal enterprises." Most of them were created between 1989 and 1992.
4. In the final stage (1994-present), the new oligarchy built and consolidated highly sophisticated global conglomerates. Former agents of the KGB's Sixth Directorate, which was in charge of combating crime in the Soviet Union, resurfaced as key players in OC's business ventures.

A Russian businessman who was framed and coopted by OC and then betrayed when a scapegoat was needed under the guise of U.S.-Russian law enforcement cooperation spoke on condition his name would not be disclosed. "Today," he said, "to all intents and purposes, the mafia, the government, law enforcement agencies, the economy and the media are one and the same."

Grigory Yavlinsky, for his part says, "The path which Russia is traveling cannot be hidden forever. and the longer it is concealed, the higher the price will be -- for everyone... The false political picture of what is going on in Russia is creating the climate for business failure..."

The CSIS report sets out to shed light on this false picture. The big battles that remain to be fought will determine whether Russia follows the road to the rule of law of the U.S. and Europe, or the one that leads to further consolidation of crime-dominated oligarchies.

Boris Nemtsov argues that those who defend the monopolies in their current form are consciously or unconsciously defending OC and corruption. On the economic front, the battles that lie ahead

are for tax reform, breaking up the monopolies, establishing transparency in commercial practices, improving corporate governance. For any of these battles to be won, a reliable enforcement and regulatory regime must be created to replace the "krysha," and other forms of private intimidation and extortion as the means for settling business disputes. Interior Minister Kulikov estimates that one third of business expenses go to bribing officials. His MVD Ministry issued a 30-page report which says "the main conclusion of criminologists and economists who compiled the report was that the state of law and order in the area of organized crime offers no ground for optimism."

Prosecutor General Yuri Skuratov said that "the growing scope of organized crime and the overall crime situation in the country are so complicated and dangerous that if we do not take decisive steps in the near future we shall be forced to concede the victory of the criminal communities."

Russian OC operates with criminal counterparts in some 50 foreign countries. Law enforcement is faced with a new breed of transnational criminals with hightech methodologies. The scope for large-scale international fraud to flourish undetected grows in tandem with the power and speed of computers, which now doubles every nine months.

The "European Union Bank" established itself in Antigua in the mid-1990s. It advertised itself as the first full-service Internet bank and drew depositors from all over the world. This summer it suddenly went off the 'Net and its two Russian owners took off with all the depositors' money. The bank, it now turns out, had been established by a Russian OC syndicate.

In a digitalized global economy, income streams can no longer be linked to geographic locations. Our policy-planners and decision-makers are yet to come to grips with a highway on which traffic moves at the speed of light, which spans the globe, without road sips, traffic lights or speed cops; without international borders, with no need for customs, immigration officers or tax collectors. and, more alarmingly, an environment that tends to leave law enforcement in the dust.

Bob Weaver, the head of the Secret Service's Electronic Crimes Division, stated the obvious when he said that our laws are behind the eight ball; that the explosion of technology and the Internet give criminals the advantage to do more, better and faster, with instant global capabilities. Law enforcement agencies, he added, simply do not have the resources, the training and the equipment to target cyber criminals.

The coming wave of cyberterrorism will present an even greater challenge. New, highly educated, computer literate generations of terrorists are not thinking in terms of truckloads of explosives, nor briefcases of sarin gas, nor dynamite strapped to the bodies of fanatics, as Hamas and Islamic Jihad do today. Tomorrow's hightech terrorists are plotting attacks with one's and zero's, at a place where we are most vulnerable -- namely the point at which the "physical" and the "virtual" worlds converge, the place where we live and function and the place in which computer programs function and data moves.

The National Information Infrastructure (NII) is extremely vulnerable to disruption from either physical or logical attack. This insecurity has created what DOD calls "a tunnel of vulnerability previously unrealized in the history of conflict."

Would-be terrorists have been experimenting with the 'Net. They clearly perceive a global reach for their activities as they train themselves with the tools of information-warfare. Last January, the Defense Science Board's Task Force on Information Warfare issued a little noted report that called for "extraordinary action" because "current practices and assumptions are ingredients in a recipe for a national security disaster." It predicted that by 2005, attacks on U.S. information systems by terrorist groups, international crime syndicates and foreign espionage agencies would be "widespread."

The CIA treats information warfare as one of the two main threats to national security -- the other being NBC weapons of mass destruction. The myth persists that we have not been invaded since 1812. Yet cyberattacks are now a daily occurrence. The fact is that four out of five of our major corporations have been successfully intruded -- but only 17% of them admit in confidential surveys that they have alerted law enforcement agencies. Firstly, they do not wish to undermine consumer confidence and shareholder value by exposing themselves to possible leaks, and secondly, they believe there is little law enforcement can do about it given its meager resources.

Foreign espionage agencies, including some of allied countries, have used hacker networks brazenly to overcome triple electronic firewalls and sniff out proprietary secrets from some of our hightech firms. Today there are already eight hostile or potentially hostile nations have developed the required technology and skills to wage information warfare by means of electronic sabotage and lethal destruction. and 120 nations have developed computer attack capabilities.

Meanwhile, cybercrime pays -- big time. The Chaos Computer Club (CCC), a German hackers group based in Hamburg, demonstrated on national TV that they can use Microsoft Internet technology to steal money from one account and put it into another without the use of personal ID or PIN number during an online banking transaction.

Law enforcement's capabilities are now from five to ten years behind the transnational crime curve. Its agencies should be given authorization to order state-of-the-art computer systems as soon as they become available, thus bypassing the 49 months it now takes to order, acquire and install a new system (vs. 9 months in the private sector).