

On the issue of the United States, Russia, and Money Laundering

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I am testifying today in my capacity as Director of the Transnational Threats Initiative at the Center for Strategic and International Studies.

We published our first report on [Russian Organized Crime](#) and its global implications for U.S. National Security on September 29, 1997. Four days before its release, President Yeltsin told the upper house of parliament, known as the Federal Council, that "criminal elements have entered our political arena and are dictating our laws with the help of corrupt bureaucrats."

[The Russian Organized Crime \(ROC\) Task Force](#) is in the process of completing a companion report updating the ROC situation since the August 1998 crash. The report will be released before the end of this year.

The key findings of the 1997 report:

- Left unchecked, Russia is in danger of becoming a "criminal-syndicalist state" under the control of corrupt government bureaucrats, politicians, businessmen and criminals with which normal relations would be impossible.
- Russian Organized Crime (ROC) constitutes a direct threat to the national security interests of the United States by fostering instability in a nuclear-armed major power.
- Equally ominous is the challenge to national security and law enforcement posed by the transnational operations and alliances of ROC groups. According to the FBI, ROC groups now have relations with their criminal counterparts in 50 countries, up from 29 countries just two years ago. Overall, some 200 large, sophisticated ROC groups are now operating worldwide.
- ROC groups hold the uniquely dangerous opportunity to procure and traffic nuclear materials. Russia's former Minister of Defense, Igor Rodionov, has indicated that, without immediate payment of back wages, "the Defense Ministry cannot guarantee that some undesirable and uncontrollable processes will not develop in the armed forces."
- The criminal environment in Russia is often compared with the "robber baron" era of 19th century U.S. history. This is a false analogy. ROC groups stash untold billions abroad and seldom reinvest their ill-gotten gains to bolster the domestic economy through the building of modern infrastructure.
- The corruption that pervades every level of Russia's bureaucracy is the major impediment to combating OC in Russia.
- The processes of democratization and economic liberalization in Russia are being seriously undermined by ROC.

- The erosion of the government by ROC is imperiling cooperative efforts in the areas of peacekeeping, non-proliferation and economic restructuring.
- ROC has extended its tentacles throughout Russia's economy, which confers an aura of legitimacy to myriad illicit activities, including the manipulation of Russia's banking system and financial markets.
- In the absence of effective courts, a working judicial system, and consistent enforcement of established commercial and contract law, criminal elements have become de facto adjudicators. Protection rackets in effect have usurped the government's traditional legal functions and safeguards.
- Efforts within Russia to combat OC - by the government, the media, and others - have been weak, often sidetracked because of fear and bribery, and frequently derailed by assassinations.

The foreword to this report, co-signed by Judge William H. Webster, the former FBI Director and Director of Central Intelligence, and by me, concluded that, "If the forces of organized crime are not stymied, Russia will complete its devolution into a criminal-syndicalist state. The United States then would be faced with an agonizing reappraisal of its diplomatic and commercial relations with Russia."

What was a threat then is a reality today. Russia is a criminally-focused state from top to bottom.

The CSIS report on ROC was quickly endorsed by FBI Director Louis Freeh but dismissed by high-ranking Administration officials even though the intelligence community was well aware of the facts.

The genesis of the Transnational Threats Initiative at CSIS goes back to 1994 when a wealthy friend of mine with extensive Russian contacts at the highest level received a telephone call from Moscow asking him to take care of five Russians on their way to New York. It soon became apparent that the Russian visitors wanted an introduction to a Swiss banker in Nassau in the Bahamas where my friend kept a house.

A few days later, the Swiss banker called my friend and asked whether he realized what the five Russians wanted. "I suppose they wanted to open a bank account," he answered. "Yes, but do you realize for how much?" asked the banker. My friend guessed a few million dollars. It was \$2.5 billion, which the Russians wanted, deposited in several secrecy jurisdictions in untraceable accounts. After checking with Zurich headquarters, the Swiss bank turned down the business.

Three weeks later, I was on vacation in the south of France and found myself seated at a dinner next to a Swiss banker. After recounting the anecdote, he said, "What a coincidence. I had a Russian "walk-in" two days ago who had no introduction and wanted to deposit \$400 million, also in untraceable accounts in offshore tax havens.

1994 was also the year the late Claire Sterling, a much-honored investigative reporter, published a book titled "Thieves World," which documented chapter and verse on the global tentacles of ROC. Ms. Sterling had traveled the world, including several trips to Russia, to investigate the connections between Russian intelligence and security agencies, organized crime syndicates, and the so-called oligarchs who plundered Russia systematically under the guise of privatization schemes.

There was no doubt in Ms. Sterling's mind that this lethal mix enjoyed the protection of the powers that be in the Kremlin.

I also traveled extensively on behalf of CSIS' Transnational Threats Initiative without using any of Ms. Sterling's contacts. We deliberately avoided duplication. From Buenos Aires to Berlin, from

London to Lugano, from Bogota to Beirut, the pattern was identical - countless billions of dollars siphoned out of Russia to be laundered before buying commercial properties or being used to pay cash for lavish private residences in Europe's capitals and in the Mediterranean's luxury resorts, as well as to purchase yachts and private planes. I discovered scores of examples of properties ranging in price from \$5 million to \$75 million paid for by Russians in cash.

Little known outside the intelligence community is the fact that the clandestine stripping of Russia's assets began as early as 1985 and 1986 when key members of the Soviet Communist Party's Central Committee (International Department) concluded that President Gorbachev's glasnost and perestroika would lead to the collapse of Communism. This is when these Central Committee members turned to the KGB for assistance in moving abroad precious metals and stones and liquid assets. The KGB was the only organization familiar with western conduits willing to handle this clandestine traffic.

When the Soviet empire began to implode in 1989, many of these Communist apparatchiks and their KGB associates became instant businessmen.

Russia's much touted instant market economics and democratic politics were little more than a sham. Prosecutor-General Yuri Skuratov ridiculed President Yeltsin's seven major crackdowns on organized crime and corruption in 1997 as a Potemkin village. "It is a charade," Mr. Skuratov said in an interview, "there is neither the will at the top nor the resources to do much about it."

Mr. Skuratov was framed in a sex scandal by the security service earlier this year and then suspended by Mr. Yeltsin for poking around the Kremlin's labyrinthine financial structure. But the Russian Parliament twice declined to endorse the suspension and Mr. Skuratov continues to speak out in interviews. He now says that \$3.9 billion of the IMF's \$4.8 billion loan last year never reached Russia but was sold by the Russian Central Bank directly to 18 commercial banks controlled by the oligarchs.

The cult of secrecy in Russia's Byzantine politics thwarts all attempts at transparency. The rule of law is non-existent. Moscow's chief of police said publicly that 90% of his officers were on the take. Security services are part of the problem, rather than part of the solution. They run their own kryshas, or "roofs" of protection, or do so in collusion with criminal gangs. Key sectors of Russian industry are under the sway of organized crime, particularly those that earn hard currency, such as mining, petroleum, natural gas and arms manufacturing.

Former First Deputy Prime Minister and former Interior Minister Anatoly Kulikov recently told our ROC Task Force at CSIS that about half of the Russian economy is controlled by "shadow systems" that run illegal operations. Mr. Kulikov estimates the amount of capital flight since 1992 at close to \$300 billion. Some 55 offshore secrecy jurisdictions from Vanuatu in the Pacific to island nations in the Caribbean and a dozen countries from Bahrain to the Bahamas were eager to take in Russia's dirty laundry.

In 1995 and 1996, about \$1 billion a month came into Cyprus from Russia and another \$1 billion went in and out of Israel. The money laundering activities uncovered recently by the FBI at the Bank of New York (BONY) are not unusual. They have been duplicated by scores of banks the world over. Wealthy individuals have parked an estimated \$8 trillion in offshore tax shelters that guarantee secrecy. There are also approximately one million corporations anonymously chartered in these secrecy jurisdictions that sell naturalization and a new passport for \$50,000 (Dominica charges \$75,000, including a spouse and two children).

These facilities make it easy for Russia's 200 plus organized crime groups to operate in 58 countries, up from 50 two years ago, according to the FBI.

Corruption in the Russian military, where everything and anything is for sale, has worsened substantially since the August 17, 1998 financial meltdown. Apart from elite Special Forces units, it is a beggar's army. Last winter, soldiers were told to fend for themselves by scrounging for food in the countryside. These dismal conditions in the military increase the likelihood of criminal diversion of theft of nuclear weapons and/or fissile materials, given that Russia still has some 20,000 nuclear weapons.

The failure of the Russian state is made clear in a just published book titled, "Money Unmade: Barter and the Fate of Russian Capitalism," by David M. Woodruff of MIT. If anything, Mr. Woodruff has underestimated the part that greed and corruption played in the process of national disintegration. Russians have been bitter about how what they perceive as American capitalism made them poor (40% of the population is now living below the poverty line of \$38 a month); now they are now bitter about being weak. This plays into the hands of anti-American ultra nationalists.

The totalitarian temptation has existed in Russia for the past 1,000 years. It is now rearing its ugly head again after a decade-long taste of gangster capitalism.

Last week, Secretary of State Madeleine K. Albright called on President Yeltsin to make fighting corruption a top priority. The Administration, like Inspector Renaud in the movie classic *Casablanca*, is shocked that there is gambling going on in the Kremlin. "The problem is real and must be taken seriously," said Mrs. Albright. The problem has been glaringly obvious since 1991 and repeated warnings that it was undermining U.S. foreign policy objectives as well as diverting U.S. financial assistance and IMF loans were repeatedly dismissed as exaggerations.

It is hardly surprising, therefore, that Russian nationalists have convinced themselves that the U.S., not content with its Cold War victory, was also bent on wrecking the Russian economy.

The Administration has invariably invoked the need to give priority to strategic arms control and economic reforms, rejecting the notion that the emergence of a criminal state was in direct contradiction with U.S. objectives.

Gen. Boris Gromov, chairman of the subcommittee on Arms Control and International Security of the Duma's Committee on International Affairs, said this week that the lamentable state of the Russian military was "a direct result of western indifference" to the way the Kremlin robbed the armed forces of the resources needed to maintain cohesion. "Yeltsin's so-called reforms," Gen. Gromov said, "have brought nothing to the majority of the Russian population but disappointment."

Saul Bellow once said that a great deal of intelligence can be invested in ignorance when the need for illusion runs deep. The Administration's need for illusion in its Russian policies has been an evergreen commodity since the collapse of the Soviet Union.