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Corruption, Capitalists, and the Crime-State Nexus:  
Criminal Infiltration of the Russian Economy and Implications for the Future

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## Introduction

At the beginning of the twenty-first century, Russian organized crime has established itself as a major force in the economy of the Russian Federation, blurring the lines between legal and illegal economic activities. As early as 2001, it was estimated that organized crime controlled more than forty percent of the total economy of the Russian Federation.<sup>1</sup> The Russian Interior Ministry has estimated that “two-thirds of the Russian economy is under the sway of organized crime, including 40 percent of private businesses, 60 percent of state-owned enterprises, and more than half of the 1,740 banks.”<sup>2</sup> In the 2009 Index of Economic Freedom, the Heritage Foundation ranked the Russian Federation 146<sup>th</sup> in the world, with significant concerns regarding fiscal freedom, property rights, and freedom from corruption.<sup>3</sup> The World Bank has declared corruption the “single greatest threat to economic and social development.”<sup>4</sup> The continued influence of Russian organized crime over the Russian economy represents a direct threat to the future of the Russian Federation.

Economic infiltration by criminal groups has serious and long-term consequences, inhibiting economic development and undermining the legitimacy of institutions.<sup>5</sup> The presence of organized crime in a market economy clearly prevents healthy capitalistic competition. With crime groups providing protection rackets in an environment where the

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<sup>1</sup> Shelley, Louise, “The Price Tag of Russian Organized Crime,” *Beyond Transition* 8, no 1 (1997).  
<http://www.worldbank.org/html/prddr/trans/janfeb97/art4.htm>

<sup>2</sup> Blasi, Joseph R., Maya Kroumova, and Douglas Kruse, *Kremlin Capitalism: The Privatization of the Russian Economy* (Ithaca, N.Y.: Cornell University Press, 1997), [http://www.ciaonet.org/pbei/csis/watch-97-99/98\\_188/index.html](http://www.ciaonet.org/pbei/csis/watch-97-99/98_188/index.html)

<sup>3</sup> The Heritage Foundation, “Russia”, *2009 Index of Economic Freedom*, <http://www.heritage.org/index/Country/Russia#fiscal-freedom>.

<sup>4</sup> World Bank, “Anticorruption Overview” *Anticorruption*, [http://web.worldbank.org/WBSITE/EXTERNAL/ TOPICS/EXTPUBLICSECTORANDGOVERNANCE/EXTANTICORRUPTION/0,,contentMDK:21540659~menu PK:384461~pagePK:148956~piPK:216618~theSitePK:384455,00.html](http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPUBLICSECTORANDGOVERNANCE/EXTANTICORRUPTION/0,,contentMDK:21540659~menuPK:384461~pagePK:148956~piPK:216618~theSitePK:384455,00.html)

<sup>5</sup> Williams, Phil. “Introduction: How Serious a Threat is Russian Organized Crime?” in *Russian Organized Crime: The New Threat?* (London: Frank Cass & Co. LTD, 1997), 1-27.

state no longer maintains a monopoly on violence, competitors may resort to more protection and aggression instead of improving efficiency, cutting costs, or using innovation. Organized crime also has a vested interest in preventing development of property rights and other legal foundations necessary for a market economy.

The unique structure and function of Russian organized crime, combined with the chaotic political and economic transition the Russian Federation experienced in the 1990s, gave organized criminal groups unprecedented opportunities for control over major economic sectors. The accumulation of capital and wealth during ill-managed privatization and monetization efforts at the end of the twentieth century is currently being exchanged for political and social power. The continued strength and influence Russian organized crime exerts over the Russian economy remains a major impediment to a successful transition to democratic market institutions.

This paper examines the evolution of organized crime and corruption in relation to the Russian economy. A historical perspective of Russian organized crime's economic role during the Soviet Union is provided, followed by an examination of the factors that enabled unprecedented economic infiltration during the transition period and privatization. Next is an assessment of organized criminal influence in three crucial sectors of the Russian economy: banking, mineral-industrial, and energy. Finally, this paper examines current policies and their shortcomings, and provides a series of policy recommendations for lessening the economic influence of organized crime and ensuring the development of a properly functioning market economy in the Russian Federation.

## Definition and Structure of Russian Organized Crime

One of the problems in understanding organized crime is the lack of a single, agreed-upon definition among states and institutions. The United Nations Protocol Against Transnational Organized Crime describes organized crime as a “structured group of three or more persons, existing for a period of time and acting in concert with the aim of committing one or more serious crimes or offenses established in accordance with this Convention, in order to obtain, directly or indirectly, a financial or other material benefit.”<sup>6</sup> INTERPOL – the International Criminal and Police Organization - states that organized crime is “any enterprise or group of persons engaged in a continuing illegal activity which has as its primary purpose the generation of profits irrespective of national boundaries.”<sup>7</sup> According to Jonathan M. Winer and Phil Williams, organized crime can be defined as any “economically motivated illicit activity undertaken by any group, association or other body consisting of two or more individuals, whether formally or informally organized, where the negative impact of said activity could be considered significant from an economic, social, violence generation, health and safety and/or environmental perspective.”<sup>8</sup>

The key aspect shared by all three definitions, and the one that will be the target of this paper, is the economic and financial motivations driving organized criminal groups. Financial crimes, including fraud and money laundering, are areas where Russian organized crime groups have particularly excelled. In fact, the ability of Russian

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<sup>6</sup> United Nations Office on Drugs and Crime, *United Nations Convention Against Transnational Organized Crime and the Protocols Thereto*, (Vienna: United Nations, 2004). <http://www.unodc.org/documents/treaties/UNTOC/Publications/TOC%20Convention/TOCebook-e.pdf>

<sup>7</sup> Organized Crime Research, “INTERPOL” Definitions of Organized Crime, <http://www.organized-crime.de/OCDEF1.htm#interpol>

<sup>8</sup> Winer, Jonathan M. and Phil Williams, “Russian Crime and Corruption in an Era of Globalization: Implications for the United States,” In *Russia's Uncertain Economic Future*, (New York: M.E. Sharpe, 2003). 97-124.

criminals to successfully infiltrate the Russian economy in such a short period of time sets them apart from many more established criminal organizations. More alarming still has been the unprecedented blending of economic penetration by both illicit and licit means. As their power and influence over the economy has increased, Russian organized crime groups appear to be relying less and less on more primitive criminal methods of extortion and violence and more on manipulation of the institutions and laws over which they now have political sway.

The unique structure of organized criminal groups in Russia has in part been a factor in their growth and rapid economic and transnational influence. Modern Russian organized crime, unlike more traditional groups such as the Italian Mafia or the Columbian drug cartels, is not based on strict hierarchies or ethnic/family ties.<sup>9</sup> Russian organized crime is primarily comprised of loose associations, driven by shared involvement in criminal activities. Small groups arise which draw “on different levels of society that contribute in different ways to the perpetuation of the crime activity.”<sup>10</sup> There are estimated to be thousands of these small groups operating within and across the borders of the Russian Federation.<sup>11</sup> The sheer size and scope of the Russian Federation would make a single mafia entity almost impossible to organize and run effectively. Without strong ethnic or familial connections, the main characteristic uniting Russian organized crime is economic.<sup>12</sup>

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<sup>9</sup> Fickenauer, James O. and Yuriy A. Voronin, “The Threat of Russian Organized Crime,” *Issues in International Crime NCJ 187085* (Washington, D.C.: GPO, 2001). <http://www.ncjrs.gov/pdffiles1/nij/187085.pdf>

<sup>10</sup> Shelley, Louise, “The Unholy Trinity: Transnational Crime, Corruption, and Terrorism,” *The Brown Journal of World Affairs*, XI, Issue II (Winter/Spring 2005). 101-111

<sup>11</sup> Ibid.

<sup>12</sup> Fickenauer, James O. and Yuriy A. Voronin, “The Threat of Russian Organized Crime,” *Issues in International Crime NCJ 187085* (Washington, D.C.: GPO, 2001). <http://www.ncjrs.gov/pdffiles1/nij/187085.pdf>

Another distinguishing trait of Russian organized crime, as well as other modern criminal organizations, is the focus on short-term profits and a lack of reliance on existing governmental and institutional structures.<sup>13</sup> This is particularly damaging to economic development in the Russian Federation. Organized crime has a vested interest in preventing proper free-market functions, stable and effective institutions, and the rule of law. As organized crime and corruption become more integrated into the system of economic interaction, even legitimate economic players, foreign and domestic, will be forced to rely on illicit and corrupt practices just to participate.

Finally, modern criminal formations such as Russian organized crime have significantly less interest in ensuring the existence of a properly functioning state.<sup>14</sup> More established criminal groups, such as the Italian Mafia, rely upon the government and institutions for survival through a perverse relationship that includes: corrupt links to officials, lucrative contract deals, and a general complexity that has developed over centuries. Russian organized crime does not rely on profitable government contracts rather “profits are made by destabilizing the state and its structures.”<sup>15</sup>

The process of economic infiltration by organized crime can best be summarized in the four main steps described by Winer and Williams.<sup>16</sup> The first tactics used by organized criminal groups were the most basic and include “murder and other violent attacks on personnel in a particular company or industry sector who might be an obstacle

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<sup>13</sup> Shelley, Louise, “Transnational Organized Crime: The New Authoritarianism,” in *The Illicit Global Economy and State Power*, H. Richard Friman and Peter Andreas (eds.), (Lanham, MD: Rowman & Littlefield Pub.1999).

<sup>14</sup> Shelley, Louise, “The Unholy Trinity: Transnational Crime, Corruption, and Terrorism,” *The Brown Journal of World Affairs*, XI, Issue II (Winter/Spring 2005). 101-111

<sup>15</sup> Shelley, Louise, “The Unholy Trinity: Transnational Crime, Corruption, and Terrorism,” *The Brown Journal of World Affairs*, XI, Issue II (Winter/Spring 2005). 101-111

<sup>16</sup> Winer, Jonathan M. and Phil Williams, “Russian Crime and Corruption in an Era of Globalization: Implications for the United States,” In *Russia's Uncertain Economic Future*, (New York: M.E. Sharpe, 2003). 97-124.

to takeover.”<sup>17</sup> Next, organized crime attempted “equity or share purchases designed to obtain a controlling interest in a particular company” either through coercion/violence or legal manipulation by way of front companies.<sup>18</sup> After control of shares had been established, organized criminal groups attempted to place personnel as company managers or in other similar positions of power – such as the board of directors.<sup>19</sup> Last, in an attempt at legitimization of the illegal practices listed in the previous three steps, organized crime groups sought support from corrupt politicians, who “lent their power and prestige to at least those parts that are legal and transparent.”<sup>20</sup>

### **Historical Perspective: A Basis for Economic Infiltration**

Russian organized crime has seen unprecedented growth in both the domestic and international economic realms over the last two decades, but its origins to the economy can be traced back to the Soviet Union. As early as the 1960s, groups of Russian criminals had gained influence and control over sizable portions of the consumer-driven Soviet economy.<sup>21</sup> Systems of informal favors, bribes, and corrupt government officials became an integral part of economic transactions in the Soviet period. From an early stage it became difficult to tell the difference between what was officially legal and officially illegal, thus creating an environment in which organized crime could thrive.

The early years of organized criminal activity in the Soviet Union were crucial; links to corruption in the government and influence in the informal economic sector would provide a base for the immense growth and development during and after the

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<sup>17</sup> Ibid.

<sup>18</sup> Ibid.

<sup>19</sup> Ibid.

<sup>20</sup> Ibid.

<sup>21</sup> Shelley, Louise, “Post-Soviet Organized Crime,” in *Russian and Post-Soviet Organized Crime*, Mark Galeotti (ed.), (Dartmouth: Ashgate, 2002).

collapse of the Soviet Union. The shadow economy helped early Russian organized crime develop important ties to corrupt government officials as well as establish strong economic influence over many important consumer goods. Illicit as well as licit wealth and assets accumulated towards the end of the Soviet period, providing organized criminal groups with the capital to successfully insert themselves into the newly developing transition economy.

The legacy of the Soviet command system left the newly formed Russian Federation without the proper structural basis for transition. Unlike most of the Western market economies, Russia lacked a history of democratic ideas and institutions. A command to market economy transition, combined with less-than-ideal privatization practices, led to the “emergence of large mafia empires which controlled whole spheres of the economy and industrial production.”<sup>22</sup> The first steps in creating an ineffective economic transition, however, occurred towards the end of the Soviet Union's existence. Both the 1987 Law on Joint Ventures and the 1988 Law on Cooperatives radically changed the landscape of the Soviet economy by allowing for private ownership of business and joint-venture enterprise in areas such as manufacturing, foreign-trade, and services. Organized crime groups were able to exploit weaknesses in both Perestroika-era reforms.

### **The Banking Sector: Financing Criminal Intent**

Money laundering and other financial crimes are critical to the operations of any organized criminal group. The Russian banking and financial sectors have been particular victims of organized crime and other illicit schemes since the transition period of the

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<sup>22</sup> Voronin, Yuriy, “The Emerging Criminal State: Economic and Political Aspects of Organized Crime in Russia.” in *Russian Organized Crime: The New Threat?* (London: Frank Cass & Co. LTD, 1997).



1990s. In 2000 the G-7 placed Russia on a list of 15 non-cooperative countries, highlighting the massive problems faced by the Russian Federation regarding financial crimes.<sup>23</sup> The result of organized crime groups obtaining major shares during the privatization of previously state-owned resources is the current existence of “criminalized banks, stock and commodity funds.”<sup>24</sup> And even financial organizations not directly under the control of organized crime groups “are subject to its extortion threats.”<sup>25</sup>

In the early years of energy sector privatization, problems with illegal and corrupt practices in the banking sector were already stirring controversy. During the controversial “loans-for-shares” schemes in 1995, many of the auctions of energy giants were tainted by accusations of insider trading and other illegal methods.<sup>26</sup> Often the organizations that came out on top were the very banks tasked with running the oil company auctions. Banks such as Menatep, Onexsimbank, and Imperial Bank, profited greatly from control over major oil companies like Yukos and Sibneft.

The links between organized criminal activity and the state are a clear continuation of corrupt official relationships practiced in the Soviet era. As recently as 2007, a major banking fraud scandal rocked the very foundations of Kremlin politics. Mr. Pugachev, a close banking ally of then President Vladimir Putin, was accused of fraud in a very public case. According to the article in the Eurasia Daily Monitor, “the Pugachev plight might serve as a striking example of using the endemic culture of fraud within contemporary

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<sup>23</sup> Winer, Jonathan M. and Phil Williams, “Russian Crime and Corruption in an Era of Globalization: Implications for the United States,” In *Russia's Uncertain Economic Future*, (New York: M.E. Sharpe, 2003). 97-124.

<sup>24</sup> Shelley, Louise, “Post-Soviet Organized Crime,” in *Russian and Post-Soviet Organized Crime*, Mark Galeotti (ed.), (Dartmouth: Ashgate, 2002).

<sup>25</sup> Ibid.

<sup>26</sup> Rutland, Peter. “Lost Opportunities: Energy and Politics in Russia,” *NBR Analysis* 8, number 5 (December 1997). <http://www.nbr.org/publications/issue.aspx?id=73>

Russia as a business rather than a political weapon, where bankers, officials, and supposedly ‘opposition’ communist deputies have all found common cause.”<sup>27</sup>

Continued corruption and illegal practices in the Russian banking and finance arenas will only serve to further the monetary foundations of organized criminal groups and their counterparts. Problems created in the 1990s are still affecting banking and financial institutions today; corrupt links with other industries such as the energy sector further complicate issues of legal and institutional reform. Additionally, corrupt ties to the highest positions in government severely undermine attempts at transparency on either side – regulators or regulated.

### **The Mineral-Industrial Sector: Uralmash and Friends**

Minerals, industry, and production have been key sectors in the economy of Russia since Stalin's massive reforms in the 1930s. The Uralmash machine factory in Ekaterinburg was one of the major industrial centers in the former Soviet Union. At the beginning of Russia's transition in the early 1990s, Uralmash was transformed from a state-owned industrial center to a joint-stock company.<sup>28</sup> In December 1996 Uralmash was again transformed, this time to create the Uralmah-Izhora Group, or OMZ. OMZ is currently the largest heavy industry company in Russia, with shares traded both domestically and internationally.<sup>29</sup>

The Uralmash criminal organization, referred to by police as the Uralmashevskaya criminal group or Uralmashevskie, does not share a name with the industrial center and surrounding area by coincidence. Early profits came from investments in local illegal

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<sup>27</sup> Zarakhovich, Yuri, “Putin's Banking Ally Accused of Fraud,” *Eurasia Daily Monitor* 6, Issue 70 (2009). [http://www.jamestown.org/programs/edm/single/tx\\_ttnews\[tt\\_news\]=34851&tx\\_ttnews\[backPid\]=27&cHash=772ba f4662](http://www.jamestown.org/programs/edm/single/tx_ttnews[tt_news]=34851&tx_ttnews[backPid]=27&cHash=772ba f4662)

<sup>28</sup> Wapedia Online “Uralmash,” <http://wapedia.mobi/en/Uralmash>.

<sup>29</sup> OMZ Group Online, “Company Profile.” <http://www.omz.ru/eng/overview/profile/>

alcohol production.<sup>30</sup> The early accumulation of money and capital by illicit means would later be used to invest in the licit economic sphere, following the pattern of many other Russian organized crime groups.

Like many state-owned companies facing rapid privatization and tight governmental monetary policy from economic shock therapy, Uralmash factory found itself with an excess of products to sell and a shortage of cash.<sup>31</sup> It was at this point that the Uralmashevskaya criminal group stepped in to offer “cash in exchange for a number of properties belonging to the enterprise, including the massive factory club building.”<sup>32</sup> It was this venture into the licit economy through illicitly generated profits, which enabled the Uralmash crime group to begin penetration of the heavy industrial and mineral economic sectors.

Recalling the steps to economic infiltration outlined by Winer and Williams, the Uralmash crime group has followed a similar trajectory. Beginning with racketeering and violent methods to extort local businesses, the group sought to take profits from illicit activities and invest in the legitimate economy thus gaining large portions of important local and regional enterprises like the Uralmash machine factory.<sup>33</sup> The organized crime group was then able to create a monopoly, using the economic and political influence to seek ties with local and regional governments, as well as politicians. The attempted legalization of economic actions through political support culminated when the crime

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<sup>30</sup> Volkov, Vadim. *Violent Entrepreneurs: The Use of Force in the Making of Russian Capitalism*, (Ithaca: Cornell University Press, 2002).

<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

<sup>33</sup> Ibid.

group “registered as the Social-Political Union (OPS) Uralmash and actively sought to achieve legitimacy with support from the local population.”<sup>34</sup>

The Russian aluminum sector has also been plagued with accusations of links to organized crime, corruption, extortion and violence. Industry giant, RusAl, has particularly been the center of unwanted attention recently. In 2000, Mikhail Zhivilo and several other plaintiffs filed suit in the United States against Oleg Deripaska, head of RusAl, along with more than six other major Russian businesses. Citing the United States Racketeering-Influenced and Corrupt Organizations Act, the plaintiffs accused Deripaska of “fraud, money laundering, extortion and complicity to murder.”<sup>35</sup> Zhivilo in particular was seeking damages for what he called an “illegal bankruptcy” of the Novokuznetsk Aluminum Factory, of which he used to be director. Following the bankruptcy, RusAl gained control of the factory. Despite such claims, the case was dismissed; the judge stating that the lawsuit was the responsibility of Russian, not United States, courts.

However, Oleg Deripaska and RusAl will have to face a lawsuit on foreign soil thanks to the recent decision by a judge in the United Kingdom. Mikhail Chernoy has filed suit against Deripaska and RusAl, claiming he deserves “compensations for 20-percent stock of RusAl that he allegedly owned.”<sup>36</sup> The decision to hear the case in the United Kingdom reflects greatly on outside perceptions of the rule of law in the Russian court system. The judge’s concerns “that possibly and very likely Chernoy will not be

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<sup>34</sup> Volkov, Vadim. *Violent Entrepreneurs: The Use of Force in the Making of Russian Capitalism*, (Ithaca: Cornell University Press, 2002).

<sup>35</sup> Pronina, Lyuba, “U.S. Rejects \$3Bln Suit Against RusAl,” *The Moscow Times* (2003), from Metal.com.ru. <http://metal.com.ru/analytics/publication.php?id=89>

<sup>36</sup> Standart News Ltd. “The Reverse Side of Rusal,” *Enquiry*, (2008). <http://paper.standartnews.com/en/article.php?d=2008-07-16&article=24514>

able to have a fair and objective trial in a Russian court”<sup>37</sup> highlight the negative view many hold of the Russian judicial process.

Despite attempted legitimization of activities by groups like Uralmash, public opinion still associates these groups with the criminal activities of the 1990s. Accusations of murder and extortion directed at the top businessmen in the Russian Federation, regardless of accuracy, reflect the seriousness of the underlying criminal economic culture. Further, the fact that economic rivals are deciding to try disputes through the court system instead of the streets represents a dangerous transformation in the power and influence of Russian economic criminals.

### **The Energy Sector: Oil/Gas Giants and Official Corruption**

A major share of the Russian economy depends on profits from natural resources and energy. According to estimates from the World Bank, the oil and gas sector generated more than 60 percent of Russia’s export revenues, and accounted for 30 percent of all foreign direct investment (FDI) in the country.<sup>38</sup> In his testimony before the United States Senate Foreign Relations Committee, former Radio Free Europe/Radio Liberty Ukraine Director Roman Kupchinsky pointed out the links between Russian organized crime and the Russian energy sector. “Russian organized crime,” Kupchinsky stated, “with the tacit support of the Kremlin, is playing a significant role in expanding the Kremlin’s economic hegemony throughout the former USSR and the Warsaw Pact countries.”<sup>39</sup>

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<sup>37</sup> Ibid.

<sup>38</sup> Energy Information Administration, “Russia: Background,” *Country Analysis Briefs*, U.S. Department of Energy, (2008). <http://www.eia.doe.gov/cabs/Russia/Background.html>

<sup>39</sup> Kupchinsky, Roman, “Russian Energy Sector Opaqueness: Testimony before the Senate Foreign Relations Committee,” in *Special Feature on Eurasian Energy*, Ogel 3, (2008). <http://www.ogel.org/article.asp?key=2780>

The former head of Yukos, Mikhail Khodorkovsky, was publicly arrested and sentenced to jail for fraud and tax evasion in 2005.<sup>40</sup> Former President Putin hailed the move as a crackdown on economic crime and corruption resulting from suspect privatization practices of the previous decade.<sup>41</sup> Three of Russia's top oil companies, Yukos, Sibneft, and Lukoil, were all privatized using the less than transparent “loans for shares” auctions in the mid-1990s, and all three have become major players in the Russian and world economies. The Lukoil website gives a clear summary of the size and importance of the company not only to Russia, but the world: “The Company has around 1.3% of global oil reserves and 2.3% of global oil production. LUKOIL dominates the Russian energy sector, with almost 19% of total Russian oil production refining.”<sup>42</sup>

Like the banking and industrial sectors, the energy and natural resource portion of the Russian economy is marred by accusations of official corruption. The energy sector continues to face the consequences of inefficient and sometimes illegal privatization practices a decade earlier. The ability of organized criminal groups to establish a presence in transnational companies vital to the Russian Federation economy makes eliminating corrupt enablers in government a top priority. The fact is many of the Russian organized criminals have political backing on top of the sheer economic monopoly on vital natural resources such as gas and oil.

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<sup>40</sup> Belton, Catharine, “Kremlin Reloading After Shot at Yukos,” *The Moscow Times*, (December 30, 2003), in *CDI Weekly*, <http://www.ncjrs.gov/pdffiles1/nij/187085.pdf>

<sup>41</sup> Goldman, Marshall I., “Putin and the Oligarchs,” *Foreign Affairs*, (November/December 2004), <http://www.foreignaffairs.com/articles/60263/marshall-i-goldman/putin-and-the-oligarchs>

<sup>42</sup> Lukoil Oil Company, “General Information,” *Company Information*, [http://www.lukoil.com/static\\_6\\_5id\\_29\\_.html](http://www.lukoil.com/static_6_5id_29_.html)

## Current Problems and Recommendations

The Russian Federation has taken some crucial steps since the problems of transition and privatization in the 1990s. Russian Criminal Code contains provisions for some economic crimes, including fraud, money laundering, and extortion.<sup>43</sup> In 2003 former President Vladimir Putin established an Anti-Corruption Council. Russia ratified the United Nations Convention against Corruption, and the current President, Dmitri Medvedev, has given several speeches and interviews citing the importance of the rule of law.

However, a brief look at current Russian policy regarding the economy, organized crime, and corruption quickly finds numerous shortcomings. First, the Russian government has not provided a single, comprehensive legal definition for organized crime.<sup>44</sup> Not clearly defining the size and scope of the problem makes other effective legislation nearly impossible. In recent years the state has also made significant effort to re-exert control over critical economic sectors, most notably oil, natural gas, and other components of the energy sector. Reasserting state control over the most profitable economic sectors is dangerous and strengthens the possibility of the creation of a rentier state. Privatization, for good or ill, has already occurred across the Russian economy. The government should instead focus on economic transparency and protection of the basic foundations of a market economy through clear, unified regulations and protection of property rights.

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<sup>43</sup> Russian-Criminal-Code.com, "Crimes in the Sphere of Economics," The Criminal Code of the Russian Federation, <http://www.russian-criminal-code.com/PartII/SectionVIII/>

<sup>44</sup> Finckenauer, James O. and Yuriy A. Voronin, "The Threat of Russian Organized Crime," *Issues in International Crime NCJ 187085* (Washington, D.C.: GPO, 2001). <http://www.ncjrs.gov/pdffiles1/nij/187085.pdf>

The privatization that has occurred since the collapse of the Soviet Union has occurred on a large scale. Statistics from official agencies in Russia indicate the majority of the economy is privately owned.<sup>45</sup> According to one report, “72 percent of large and middle-sized enterprises” and “roughly 82 percent of small shops and retail stores” had undergone privatization.<sup>46</sup> There has been an increase in the number of property owners since the transition out of a command economy; however, ensuring property rights of newly obtained assets is necessary for a market economy to function properly.<sup>47</sup>

An effective system of courts is an important component for the enforcement of property rights essential for a healthy market economy. Regardless of preexisting components of Russian law, charges must actually be brought to court and backed by the proper rule of law. Almost none of the hundreds of contract killings carried out against business owners and entrepreneurs during the 1990s have led to prosecutions in court, let alone jail time for any involved. Many recent killings and kidnappings of industry officials have not led to proper trials or convictions. If present business and industrial leaders lack faith in the ability of the judicial system to function effectively, they will be more likely to seek protection from outside actors like organized criminal groups who, conversely, are responsible for business insecurity.

Recent appointments by Russian presidents have done little to assuage fears about the ineffective judiciary and failure of the rule of law. In 2005 it was announced Anton Ivanov would be the chairman of the Russian Supreme Arbitrary Court. The appointment was suspect however, given that Ivanov “never worked as a judge, and given the fact that

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<sup>45</sup> Varese, Federico, *The Russian Mafia*, (Oxford: Oxford University Press, 2001), 22.

<sup>46</sup> Blasi J., Kroumova, M., and Kruse, D., *Kremlin Capitalism: Privatizing the Russian Economy*, (Ithaca: ILR/Cornell University Press, 1997).

<sup>47</sup> Varese, Federico, *The Russian Mafia*, (Oxford: Oxford University Press, 2001), 23.



half a year prior to his appointment he was appointed first vice-director general of 'Gazprom media,' notwithstanding the fact that he is old friends with Dimitri Medvedev with whom he was classmates at the Leningrad National University (Putin's alma mater)."<sup>48</sup> More disturbing was that after the appointment of Ivanov, "several Supreme Arbitrary Court judges, the chairman of the Moscow and 14 other regional arbitrary courts, as well as tens of judges from first-instance courts were replaced - many with former classmates of Ivanov and Putin from Leningrad National University."<sup>49</sup>

The Kremlin needs to distance itself from associations with major energy and industrial sectors. Despite the large amounts of power allocated to the President under the Russian constitution, a more effective system of vetting candidates for Presidential appointments, combined with outside review from a neutral party, will help to quell future allegations of cronyism and corrupt links between the economic and political spheres.

Development of new laws and regulations regarding economic and organized crime go hand in hand with a properly functioning court system. A clear and effective tax system, combined with enforced punishments for tax evasion schemes, would be a major aid in attempting economic transparency. A tax code did not exist in the Russian Federation until January 1999 and even now the system is mired by complications and confusing bureaucratic processes.<sup>50</sup> Roman Kupchinsky's testimony before the United States Foreign Relations committee also brought to light a critical failure in the Russian government's policy, chiefly that the state "does not have a Foreign Corrupt Practices Act

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<sup>48</sup> Standart News Ltd. "The Reverse Side of Rusal," *Enquiry*, (2008).  
<http://paper.standartnews.com/en/article.php?d=2008-07-16&article=24514>

<sup>49</sup> Ibid.

<sup>50</sup> Varese, Frederico, *The Russian Mafia*, (Oxford: Oxford University Press, 2001), 18.

– the Kremlin and Russian law enforcement agencies tend to close their eyes on how Russian energy companies – be it the private oil company Lukoil or the state owned oil company Rosneft or Gazprom - conduct business abroad.”<sup>51</sup>

The Russian Federation is also in desperate need of stronger government regulatory agencies and institutional oversight. Basic legal foundations and criminal code have been created over the last fifteen years, but a weak government has prevented strong enforcement of Russian laws. Government weakness is in part due to corruption. Systemic and institutionalized corruption must be considered when addressing the economic problems of organized crime. Corruption is a critical facilitator of organized crime in practically any environment. Transparency International placed the Russian Federation at 121 out of 163 countries on their Corruption Perception Index, with an abysmal score of just 2.5 out of 10.<sup>52</sup>

Macroeconomic policies focusing on diversification and stabilization must also be considered. Continued reliance on profits from the energy and natural resource sectors makes the Russian economy extremely vulnerable to market fluctuations and other instability. The government of the Russian Federation, in addition to securing rights and legal protections for business owners and industrial sectors, should strive to promote enterprise growth in sectors like consumer goods, electronics, and services. The Russian government should work more closely with international authorities, such as the United Nations and its G-8 and G-20 economic partners, to develop targeted strategies for continued economic development and transparency.

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<sup>51</sup> Kupchinsky, Roman, “Russian Energy Sector Opaqueness: Testimony before the Senate Foreign Relations Committee,” in *Special Feature on Eurasian Energy*, Ogel 3, (2008). <http://www.ogel.org/article.asp?key=2780>

<sup>52</sup> Transparency International, “Russia,” *Corruption Perceptions Index*, (2008), [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi](http://www.transparency.org/policy_research/surveys_indices/cpi)

## **Conclusion: Implications for the Future of the Russian Economy**

Organized crime's successful infiltration into major sectors of the Russian economy represents a major setback to successful development of a properly functioning market economy, the rule of law, and democratic institutions. "The gangsters who operated before the privatization years have converted themselves and their outfits into respectable businesses. They control, directly or indirectly, large enterprises and their trading and export operations – thus keeping money laundering and capital flight operations largely in their own hands."<sup>53</sup> The majority of remaining organized crime groups "have simply adapted themselves to the new economy of the 21st century – undertaking the necessary corporate "restructuring."<sup>54</sup>

New and disturbing trends, such as the "corporate raiding" identified by Thomas Firestone and others, suggest how crucial a transparent and effective court system and rule of law will be for the future of the Russian economy.<sup>55</sup> Entrenchment in the political and economic systems has allowed Russian organized crime groups to manipulate the judicial system and exploit weaknesses in regulation and legal protection of property. Countries such as the United States and Great Britain should be careful not to undermine the authority of the Russian judicial system when allowing cases such as the Chernoy-Deripaska dispute to proceed. Foreign court authorities should instead aid the Russian judicial system in its reforms, sending legal representatives and observers in order to help establish the proper rule of law.

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<sup>53</sup> Transparency International, "Russia," *Corruption Perceptions Index*, (2008), [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi](http://www.transparency.org/policy_research/surveys_indices/cpi)

<sup>54</sup> Editorial, "A Culture of Crime" *The Russia Journal*, Issue 84, (July 23, 2001), <http://www.russiajournal.com/node/4041>

<sup>55</sup> Firestone, Thomas, "Criminal Corporate Raiding in Russia," *International Lawyer* 42, number 4, (Winter 2008).

The list of reforms needed to successfully eliminate Russian organized crime's economic influence is lengthy. Some of that burden should be shouldered by international partners of the Russian Federation. Successful international cooperation on many levels is required, ranging from a concise, universally accepted definition of transnational organized crime to multilateral solutions addressing the continued integration of world economic markets. Domestically, breaking the corrupt ties between organized crime, government, and business – the same ties which helped Russian criminal groups gain a foothold in the Soviet economy – is a key step to ending economic infiltration by Russian organized crime. But anti-corruption measures cannot be effectively implemented without a strong civil society, a free and independent media, and support for the rule of law.

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