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Implications for the Development of the
Soviet Successor States and Foreign Countries**

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POST-SOVIET ORGANIZED CRIME:

Implications for the Development of the Soviet Successor States and Foreign Countries

Louise I. Shelley

Executive Summary

Organized crime has penetrated most of the newly independent states of the former Soviet Union at all governmental levels, and is assuming an important role in the political, economic and social evolution of these states, with consequences already being felt in Europe, the United States and parts of Asia. The collapse of communism may not lead to democratization and the transition to a competitive capitalist economy. Instead, the pervasiveness of organized crime may lead to an alternative form of development -- political clientelism and controlled markets. Domination by the Communist Party may be replaced by the controls of organized crime.

Organized crime does not necessarily preclude economic development, although it inhibits legitimate domestic and foreign investment, and deprives the states of capital and resources by exporting both. Rather, it limits the development of certain legitimate forms of investment and of open markets that benefit a cross-section of the population. The economy becomes dependent on illegitimate rather than legitimate economic activity.

Organized crime's domination of the economies of many of the successor states will determine many aspects of the post-socialist transition in the coming decades. It will not necessarily impede economic growth because, as the Italian experience has shown, high rates of growth are possible even with organized crime penetration into the central state. But it will preclude certain forms of development. A very unequal pattern of economic development may occur because organized crime thrives when there are great variations in economic conditions. Residents in areas with high rates of unemployment, and little prospect of development or investment, may accept the employment offered by organized crime, avoid or resist legal organs of authority, or cultivate illicit crops like drugs because they have limited economic alternatives. Therefore, the future development of labor markets and their organization will be determined to a significant degree by the evolution of organized crime groups. Free labor markets may not emerge because the coercion of organized crime groups may supplant that of the Communist Party. Formation of free labor unions may be inhibited, or they may be taken over by criminal elements. Environmental damage, such as was perpetrated in the Soviet period, may continue because organized crime entrepreneurs are more concerned with short-term profits than long term consequences.

**POST-SOVIET ORGANIZED CRIME:
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Soviet Successor States and Foreign Countries**

Louise I. Shelley

INTRODUCTION

Organized crime has penetrated most of the newly independent states of the former Soviet Union at all governmental levels. With such pervasiveness and with such infiltration into the society it ceases to be a crime problem but a phenomenon that will help determine the future course of development of the Soviet successor states. Moreover, as an international as well as a domestic phenomenon, its consequences are already being felt not only in Eastern Europe but also in Western Europe, the United States and parts of Asia.

The existence and pervasiveness of organized crime may preclude the transition to democracy, may limit personal freedom, legitimate foreign investment and open market economies. Since organized crime has already partially supplanted many of the weak governments of the successor states, the citizens may be trading one form of control for another. Domination by the Communist Party, may be replaced by the controls of organized crime. As in other societies, organized crime will limit free elections and freedom of the press and media¹. Labor markets once controlled by state planning and submissive trade unions will instead be subject to the intimidation of organized crime which is already a major employer. State ownership of the economy will be exchanged for control of the economy by organized crime groups with a monopoly on existing capital.

The collapse of communism may not lead to democratization and the transition to a competitive capitalist economy. Instead, the pervasiveness of organized crime may lead to an alternative form of development -- political clientelism and controlled markets. The control will come from the alliance of former Communist Party officials with the emergent organized crime groups, groups that currently control some 40% of the capital of the post-Soviet states.

The Distinctiveness of Post-Soviet Organized Crime

Organized crime is crime perpetrated with financial objectives. Violence is rarely indiscriminate but is used to promote the economic objectives of the organized criminal group. Most organized crime groups make the most significant share of their profits from the exploitation of the market for illicit goods and services (i.e. prostitution, gambling, drugs, contract killing, supply of cheap illegal labor, stolen automobiles)². These activities combined with the extortion of legitimate businesses provide the primary income sources of organized crime groups in most societies.

Post-Soviet organized crime encompasses all of these activities. Yet the most lucrative element of its criminality both within the former Soviet territory and abroad lies in the area of large scale fraud. In the United States, organized criminals from the former Soviet Union have perpetrated massive medicare frauds and gasoline tax evasion³. In Germany they have exploited the subsidies the German state provides Soviet military troops to promote multi-million dollar frauds⁴. This large scale fraud has deprived the German state of capital needed to rebuild its infrastructure. In Israel, organized crime groups counterfeited American dollars for export to the United States.

In the former Soviet states where there are almost no control mechanisms in place and the law enforcement apparatus collapsed along with the state, fraud can assume even larger proportions, especially at a time when there is a redistribution of the state's resources⁵. Most of the fraud entails the distribution of the state resources through illegal privatization of property, manipulation of the voucher system by which state property is being allocated to the citizenry and the appropriation of the strategic and other valuable resources of the former Soviet state.

Financial fraud assumes such a significant role in the crime commission of organized crime because there is a strong influence of the crime patterns of the Soviet period on the successor states. The most pervasive crime in the Soviet period was embezzlement or theft from the state which was not perceived as criminal by most citizens⁶. A culture of financial manipulation was pervasive among managers of state businesses who constantly engaged in illicit activity to cover up their inability to achieve unattainable state production targets. Citizens failed to distinguish between state and private property⁷. The constant need to commit

fraud to survive in the state bureaucracy provided the preconditions for the large scale fraud perpetrated in the post-Soviet organized period. This fraud reached massive proportions when the resources of the Soviet state were up for redistribution and former Soviet officials in conjunction with traditional organized crime groups could operate in the more lucrative foreign environment.

In contrast, the activities that form the basis of organized crime in most societies were tightly controlled in the Soviet period. Until perestroika, Soviet law enforcers maintained strict controls over daily life and limited such deviant activity as gambling, prostitution or trafficking in narcotics⁸. Therefore, international prostitution and drug trafficking are only now beginning to develop as key activities of post-Soviet organized crime⁹. Western law enforcement, prepared to investigate more traditional forms of organized crime, is only now adjusting to the methods needed to investigate the large scale and sophisticated frauds committed by post-Soviet groups.

Post-Soviet organized crime groups apply traditional means of intimidation -- extortion and violence -- differently. Unlike the extortion of organized crime in the United States, Italy and Germany which extracts a fixed but tolerable amount from the businesses within its territory¹⁰, Soviet organized crime groups go for short term profits rather than long term relationships calculated to allow both organized crime groups and businesses to prosper. They extract so much that they often force the businesses out of existence.

The level of violence used by the Soviet organized crime groups is also often unknown in the markets in which they are operating. For example, the USSR had relatively low rates of inter-personal violence and much of it was committed within residences rather than in public areas¹¹. Post-Soviet organized crime has changed the dynamics of crime in Russia and other successor states by escalating both the quantity and the visibility of violence. Crime specialists in Germany contend that the offenses committed by the recently arrived post-Soviet organized crime are much more violent than the traditional crime patterns in Germany. Whereas specialists in Belgium and the Netherlands suggest that the violence used against prostitutes brought to these countries by post-Soviet and Eastern European organized crime groups exceeds that known previously against prostitutes¹².

The relationship between organized crime and the political system in the successor states is different from that observed in the United States. It is more similar to the situation which exists in Italy or Colombia, yet distinctive features exist. American organized crime exists primarily at the municipal level¹³. In many major American cities, it is an important economic and political force. But its influence at the state and federal level is much more circumscribed. In Italy and Colombia, the influence of organized crime is most profoundly felt in certain regions where it has in many ways supplanted the authority of the central state¹⁴. Furthermore, in these two countries politicians at the national level have represented the interests of different organized groups¹⁵. Post-Soviet organized crime's influence on politics exists at the municipal, regional and national levels. Although its power is not as entrenched as in Italy, it has benefitted from the power vacuum at all political levels to expand its influence at an unprecedented rate. Capitalizing on the political and economic collapse of the Soviet state, it has become an alternative power poised for future growth as it has the resources to fund candidates in forthcoming elections at the local and national levels.

THE IMPLICATION OF ORGANIZED CRIME PENETRATION INTO THE STATE

Comparing post-Soviet organized crime with Colombia or Italy rather than the United States reveals the consequences and costs of pervasive organized crime activity. In both Colombia and Italy, there have been significant political, economic and social costs which have touched all sectors of the society¹⁶. The penetration of organized crime into the state has limited democracy. Economic growth has occurred but it has been very unequally distributed within the societies. Homicides have increased in areas with concentrations of organized crime. Both Colombia and Italy have discovered that once organized crime penetrates the state, the state -- even with the investment of significant manpower, economic resources, the application of intense repression and the sacrifice of many well-meaning individuals -- can not disassociate the state from organized crime.

The former states of the USSR which lack the resources and the will to combat the organized crime phenomenon may be in worse shape than Italy or Colombia. The consequences of their impotence will be apparent in the future political, economic, social and

cultural development of their society. As in Italy and Colombia, the consequences of such organized crime will be not only a domestic concern but one with broad international implications. Yet the USSR with its nuclear weapons which may fall into the hands of organized crime poses an even greater threat to the world order.

DOMESTIC IMPLICATIONS

Economic Consequences

Many societies measure the costs of organized crime primarily in economic terms. In the former Soviet Union, the economic costs are important but comprise only part of the costs of this pervasive phenomenon. The very rapid growth of organized crime may have a crucial impact on the development of many economies of the successor states because they are in a crucial transitional period.

The Sicilian mafia was able to infiltrate the economy and the political development of the island because its flowering coincided with the industrialization of this region¹⁷. While industrialization has already occurred in many regions of the former USSR, the economic transition that is underway is just as important. The transition from a centrally planned communist economy to a free market capitalist economy requires a fundamental reorganization of the structure of society. If organized crime groups can infiltrate the economy at this crucial phase of transition, then, as in Sicily, it may be impossible to disassociate the economic development of the successor states from the development of organized crime.

Organized Crime and Economic Development

Pervasive organized crime does not necessarily preclude economic development. Rather, it limits the development of certain legitimate forms of investment and of open markets that benefit a cross-section of the population. The economy becomes dependent on illegitimate rather than legitimate economic activity. Illicit commodities become central ones in the state's participation in international markets. This is probably the greatest risk that threatens the post-Soviet economies. Precedent exists in the economies of Southern Italy and Colombia which are heavily dependent on their illicit commerce in drugs¹⁸. While the post-Soviet economies are

trading in a greater variety of illicit goods than these two societies, the dependence on this illegal commerce is already clear for many in the labor force. Furthermore, many of the successor states are dependent on the foreign currency acquired through this illicit trade.

Concentration of an economy in a limited range of goods and services, either legitimate or illegitimate, places an economy at risk for long term development. Sudden decline in demand or in production may have a catastrophic effect. The decline of the Soviet economy and its replacement in the successor states by organized crime based activity may have a deleterious effect on the future development of these economies. The current sale of illegally appropriated materials and the exploitation of natural resources may lead to large short-term profits. But unless organized crime figures diversify their activities into more sustainable criminality or reinvest their profits domestically, the prospects for future development of the post-Soviet states is not good. Unfortunately, much evidence suggests that much of the profits from this illegal trade is being laundered abroad and is providing no benefits for the domestic economies. Money laundering operations, however, are helping to keep certain of the more advanced former Soviet states solvent¹⁹.

In the former USSR, as elsewhere, the dependence of the state on illegitimate businesses serves as a disincentive to legitimate businesses. Businesses do not enter the market because of extortion threats, but also because they cannot stand the unfair competition. Invested capital lacks security because there is no recourse to a legal system in which the rule of law operates. They can not choose their employees from a free labor market because organized crime creates coercive conditions for the work force.

When organized crime controls much of the economy of a particular area, it may provide, as it has in Sicily and parts of Colombia certain services to the community to ingratiate themselves with the local community. Organized crime groups may pay for the construction of hospitals and schools as a form of insurance against the collaboration of community members with the law enforcement organizations.

Organized crime groups may, therefore, contribute to the infrastructure of their communities but simultaneously may cause significant destruction to the environment. Like other investors concerned exclusively with rapid economic growth, they show no concern for the renewal of natural resources. Economic crime's domination of the economies of the

successor states may prove as devastating for the environment as was the domination by their Communist predecessors. Already organized crime groups are responsible for overfishing of sturgeon for caviar in the Caspian Sea and wholesale harvesting of lumber without concern for reforestation²⁰.

Organized Crime and Protection

The rise of new businesses in many societies has coincided with the need for protection. According to one mafia historian²¹, the need for protection was a crucial element in the rise of organized crime because the emergence of a new entrepreneurial class creates the demand for protection. Therefore, according to this thesis, the need for protection also underlies the rise of Soviet organized crime.

This thesis does clarify some dimensions of the Soviet experience even though the basis of Soviet and post-Soviet organized crime has been fraud rather than entrepreneurship. Furthermore, much of the entrepreneurship that began in the late Soviet period was begun by organized crime members who had their own protection rackets.

Organized Crime and Labor Markets

The collapse of the Soviet economy has resulted in a dramatic decline in legitimate production and increase in effective unemployment. Those still employed by the state sector, the vast majority of the population, are living on salaries near or below the poverty level. Depending on the successor state that one is analyzing, the percentage of individuals officially living below the poverty line ranges between 50 and 95% of the population.

A new class of wealthy is emerging that controls almost all the capital in the society. Depending on the estimates, one to two percent of the population controls most of the resources, many of these having wealth that is significant even in western terms. According to sociological research conducted in Russia, the millionaires are comprised mainly of former members of the Party apparatus and organized crime members²².

Organized crime, one of the few growth sectors in the economy, can attract employees because it can offer jobs, and can pay salaries that are often multiples of what individuals earn

in the state sector. Moreover, the limited employment prospects of many individuals makes them easy targets for the false employment schemes offered by organized crime members.

The feminization of poverty in the post-Soviet period has made many women voluntary and unwilling entrants into prostitution. Some women are recruited because prostitution pays more than any available legitimate employment either in the USSR or abroad. Others are tricked into this work by offers of foreign hotel jobs. The women are threatened with violence and also threats are made against family members in the USSR if they do not comply.

The market in prostitution is just part of the illegal labor market that presently thrives among citizens from the former Soviet Union and Eastern Europe. Organized crime helps numerous males work abroad illegally by providing falsified documents or by smuggling them across frontiers. There they work at below minimal wage, an attractive alternative to the very low pay in the former USSR. Within parts of the former USSR, children have been employed illegally in production by organized crime groups. They work in unregulated conditions at subminimal wages²³.

The control that organized crime seeks to exercise over labor markets may have a negative effect on the development of trade unions independent of state control. At present most former Soviet citizens are still members of the successor unions to those which existed in the Soviet period. An independent trade union movement is growing. Efforts must be made to prevent the infiltration of organized crime groups into these incipient unions. The benefits of this infiltration would be the same as in the United States and other countries -- to gain influence over the labor force, contracts and access to pension funds.

Segments of the labor force are now under the control of the Communist Party rather than that of organized crime groups. The successor states must take precautions to ensure that the collapse of the USSR does not mean the substitution of one form of labor market control for another.

Organized Crime and Foreign Investment

Many foreign investors have chosen not to invest in the former USSR because they legitimately believe that their capital will not be protected. Capital is not protected because of an absence of: (1) clear and permanent legal norms to govern investment; (2) reliable and

honest parties with whom businesses can negotiate; (3) courts which are impartial arbiters of economic disputes; and (4) trustworthy and efficient police or insurance. The operations of organized crime groups exacerbate many of these conditions because many international businesses, despite their willingness to invest in the successor states, cannot conclude a deal because the former Soviet officials, alone or in conjunction with organized crime figures, have appropriated many of the resources once under state control. These new mafiosi prefer to sell a certain amount of the state resources for their own profits rather than open the industry to a multi-national company which might abide by established regulations and limit their gain. In many cases, despite extensive negotiations, organized crime-ex-nomenklatura coalitions have impeded foreign investors who would have created jobs and promoted sound development strategies.

Many foreign investors are impeded by the absence of clearly defined legal norms -- a consequence of the political chaos of the successor states and the influence that organized crime figures have over legislation. Organized crime members have contacts with lawyers and regional officials who will protect the interests of local organized crime groups rather than of foreign investors. The absence of an independent and incorruptible judiciary, a legacy of the Soviet period, means that judges may succumb to the bribes or threats of organized crime personnel. Whereas foreign investors, restricted by company guidelines, may be restricted from interfering in the legal process. Therefore, these businesses cannot compete with the illegal practices of organized crime.

The ill-equipped, corrupt and demoralized police make it necessary for foreign investors to turn to private guard services²⁴. But many of these guard services are run by organized crime groups. The staff of these services include former KGB and militia personnel who may also engage in industrial espionage against businesses, sometimes at the behest of their employers.

The pervasiveness of organized crime inhibits foreign investment in several more direct ways. Many pay significant protection money to limit threats from organized crime groups. Violence and extensive property damage have been inflicted on businesses which failed to make payments. Businessmen often need to travel with bodyguard-chauffeurs. Several foreign businessmen have died mysteriously during business trips to different parts of the former

Soviet Union and many others have been robbed and deprived of computers and other advanced technology. Businesses operating in Moscow and other major cities have appealed to foreign police to assist them because of the precarious situation within the former USSR. There are reports that the assistance of the German criminal police, the FBI as well as other international police organizations has been requested when foreign investors have felt themselves subjected to extortion schemes and other threats. Several of them have been murdered by individuals associated with organized crime.

Capital in most of the successor states is at greater risk than in other countries. The former Soviet Union, therefore, cannot compete with many other countries for legitimate capital investment. Foreign investment, as in the former East Germany and other parts of Eastern Europe, does come from foreign organized crime groups. They have the protection mechanisms and the willingness to take the risks in the hostile environment. While mafia investment may be more a phenomenon in Eastern Europe than the former Soviet Union, emigre Soviet organized crime figures are repatriating capital to establish businesses. Even for them the investment climate may not be secure because corrupt officials in conjunction with law enforcement personnel may connive to acquire their newly established businesses.

Organized Crime and Regional Development

Organized crime often develops in areas that are relatively underdeveloped economically in relation to others in the region. For example, in Italy, the regions with the greatest concentrations of organized crime are Sicily, Campania, Calabria, Puglia, areas which are underdeveloped in relation to the economies in the north. Yet those engaged in organized crime activity require proximity of individuals with superior skills in technology, communications and more international business skills. Therefore, links have developed between the organized crime groups of the South and the more economically advanced economy of the North of Italy. A similar relationship exists in both Latin America and Asia. Chinese in Hong Kong and Macao control the organized crime that exists in the less developed economies of Asia. Colombians market and process the drugs which are produced in the less developed Latin American countries of Bolivia, Peru and Ecuador.

A similar economic relationship seems to be developing between the less economically developed parts of the former Soviet Union and the more industrialized regions closer to Western Europe. The basis for this relationship already existed in the Soviet period when massive fraud was perpetrated in the cotton industry by the so-called Central Asian "mafia." By falsifying production figures, Party leaders in cahoots with collective farm chairmen and key justice officials received large payments from the central government for cotton that was not grown. Pay-offs to key figures in Moscow, such as Brezhnev's son-in-law, the Deputy Minister of Interior, secured their immunity from prosecution²⁵.

The illegal economic ties between the Asian and the Russian Republics have resurfaced with the collapse of the former Soviet Union. Members of the Asian mafias, prosecuted by justice officials from Moscow in the final years of the Soviet period, were released from prison almost immediately after the dissolution of the USSR. Their release showed the autonomy of the newly independent countries from Moscow's policies. Yet they also revealed the continuity in the links between Party officials and the illegal apparatus. These reemerged organized crime groups are responsible for new forms of criminality not linked to state production. Chief among these is drug production, already rising in the final Soviet period, and an active arms trade to the numerous Asian countries with ethnic disturbances.

Illicit trade has risen because Moscow's subsidies to the Asian republics declined along with the Soviet state. Furthermore, as now independent countries, they need foreign currency to act as sovereign countries abroad. But Russia's appropriation of the resources of the former Soviet state left these countries in a much more disadvantaged position than they had known in the Soviet period.

In the early post-Soviet period both Kyrgyzstan and Kazakhstan contemplated legalizing the cultivation of drugs. But bowing to international pressure and the threat of curtailment of foreign assistance, these countries subsequently outlawed drug production²⁶.

Yet a significant drug market is developing between the drug producers of Central Asia and the more sophisticated organized crime groups in Moscow. The lowest paying work of production is done in the areas of least development with great rates of unemployment and underemployment. For this reason, ethnic minorities are associated with drug production²⁷. Little attention is given to the technicians who process the drugs in Russia or serve as couriers

to the west. Those who launder the money from Russia and the Baltic states are dependent on the labor supply of the less developed regions of Asia.

The emergent drug trafficking from the former Soviet Union resembles the Latin American situation in several important ways. Drug production occurs in highly undeveloped areas with no alternative sources of income by populations with a tradition of drug cultivation and consumption. Processing of drugs is done in neighboring regions where there is a higher level of education and technology. The goods are then marketed in the most advanced countries. The profits made by these sales are then laundered in the countries where the drugs are sold or in others with advanced banking systems. The chain that runs from the poorest parts of Latin America through Colombia into Mexico and then the United States to the off-shore banking in the Bahamas is being replicated in the former USSR. The primary target of this illicit trade is the marginalized and unemployed youth of Eastern and Western Europe rather than the United States.

The problems of severe underdevelopment in many newly independent Asian countries suggest that illicit commerce from these countries will develop further as organized crime groups become more entrenched and the states cannot offer alternative employment or sources of foreign currency. The weakly developed law enforcement systems in these societies and the lack of cross-border protections suggests that there will be great growth in organized crime activities in these less developed regions.

Organized Crime and Privatization

The post-Soviet economy is being privatized by the distribution of vouchers to citizens, auctions and special formulae developed for individual large companies. Organized crime has exploited all the different privatization methods to secure a disproportionate share of the assets of the Soviet state. In Russia as well as in some of the other successor states, privatization has proceeded most rapidly in the area of small businesses. Many of these have been sold at auctions where organized crime figures have limited the participation of ordinary citizens. Organized crime members possessing large amounts of rubles have, therefore, been able to legally acquire without much competition a significant share of the service sector -- food stores, restaurants and other businesses serving consumers. Their control of this market may

mean that citizens will pay higher prices in the marketplace than if a fair and competitive market operated in the consumer sector. For example, prices in Palermo markets, dominated by organized crime, are as high as in other parts of the country even though the products sold are raised in nearby Sicilian farms²⁸. Once the central planners in Moscow fixed prices. Competition may still not exist in the post-central planning period because organized crime will now fix prices. Central planning once made goods unavailable; now they will be equally inaccessible because of costs.

A voucher system was initiated to provide all Russian citizens the opportunity to acquire the assets of the Soviet state. Based on the Czech model, all citizens received supposedly untransferable vouchers to prevent their acquisition by organized crime members and other wealthy citizens. Organized crime has managed to sabotage the process in several ways. First, more vouchers were printed than were authorized. Second, organized crime members illegally acquired vouchers from economically desperate Russian citizens. Third, vouchers have been illegally reused by organized crime figures. Having access to more than their share of vouchers, organized crime has been able to acquire a disproportionate share of the businesses and the shares of larger private enterprises.

Individuals in charge of many of the large Soviet companies have managed to privatize the resources of these enterprises or the properties associated with them at ridiculously low prices. This has been done without allowing ordinary citizens a chance to compete. For example, the apartments and dachas owned by large enterprises have been bought at prices that are a mere fraction of their value on the open market. Yet the even larger scale criminality has been to sell state property under their control as if it were their own. This includes minerals and lumber.

The privatization of apartments, particularly in such choice locales as Moscow, has given ample opportunity to organized crime for enrichment. As is the case in cities in Eastern Europe, tenants of choice Moscow real estate have been murdered for their apartments.

Organized Crime and the Economic Resources of the State

Organized crime impedes legitimate economic development and strikes at the weak economy of the post-Soviet states. Much of the commerce of organized crime is in the export

of strategic raw materials. Many of these materials are illegally appropriated from the former Soviet state and include such items as military equipment, minerals, and nuclear materials. In fact, the trade of organized crime is so diverse that it includes almost any former state property which can be sold for a profit. Sometimes those offering to sell the material abroad actually have access to it. But in most proposed sales of nuclear materials, for example, organized crime groups are trying to defraud western businessmen who know that such materials can be acquired from the former USSR at highly attractive prices.

Organized crime groups are selling former state resources to different markets reflecting their increasingly sophisticated strategies. For example, most mineral shipments are destined for European markets. Mineral shipments out of the Baltic port of Tallinn are so significant that the freighting charges are a major source of currency for the Estonian government²⁹. Many of the weapons that have been stolen or bought from soldiers at military bases are bought by nationalist groups engaged in ethnic conflict in many of the successor states³⁰. The Caucasus as well as parts of Central Asia are important markets for small scale military materials. Larger scale military equipment is being sold to Arab countries and other nations in the third world. These sales by organized crime groups need to be differentiated from the official government sales of weapons.

Various schemes have been detected in both the United States and Western Europe to launder large amounts of rubles abroad. These operations, which have been executed for the last several years, are often committed by former KGB personnel who have the foreign contacts, language skills and knowledge to operate abroad effectively³¹. These former security personnel have established their own organized crime groups that specialize in laundering money through foreign banks.

Former Party and military officials, as well as employees of mines and military-industrial complexes, are also exporting state resources for personal profit. The individuals acquiring these materials are often not members of traditional organized groups, but the shipment and export of these materials is often done in conjunction with recognized organized crime figures.

The theft of these strategic items deprives the post-Soviet states of important sources of revenue that are needed to develop the economy. Not all the items presently sold abroad could

be legitimately marketed by the successor states, but many of the minerals and military equipment could be sold in Europe and to third world countries. The profits that are obtained from the illegal sale of these items is often not repatriated to the country but is instead deposited in foreign bank accounts. Therefore, the state is suffering from a dual loss -- the loss of materials as well as the problem of capital flight.

Organized Crime and Capital Flight

The problem of capital flight is one of the most serious economic problems facing the post-Soviet states. The amount of money being exported is estimated at between 4 and 15 billion dollars in 1992³². The extent of capital that is leaving the country is of such proportions that it recalls the experience of Latin America during the so-called "lost decade" of the 1980s. At that time so much money left Latin America, that these countries were deprived of the revenues that they needed for their economic development. The post-Soviet states are suffering the same consequences as Latin America during the previous decade, they are losing the capital needed to rebuild their depleted infrastructures.

Many of the successor states prefer to close their eyes to many organized crime activities because their economies benefit from these transactions. For example, officials in Latvia do not inquire into the large foreign currency exchange market in Riga, (much of it the consequence of organized crime activity) because the proceeds from this exchange are necessary to keep the Latvian currency afloat. In the past year, the free-standing Latvian currency has been one of the few to rise significantly against the ruble. Riga's sophisticated financial services can be compared to the off-shore banking provided in the Bahamas.

The alliance of former members of the Party elite with members of organized crime is necessary to successfully acquire and export state resources. Members of both the former nomenklatura and organized crime figures have the international contacts to launder funds and invest them abroad. Many have developed ties with earlier emigrant groups who have bases of operations in Germany, the United States and Israel. Former Soviet citizens, in residence abroad for already ten to twenty years, can provide current organized crime figures from the successor states with the financial and legal expertise that they need to successfully implement and manage their operations.

The capital flight comes not only from the export of strategic raw materials. Other sources of the funds that are exported are equally damaging to the future economic development of the post-Soviet states. For example, the appropriation and export of foreign aid assistance, the illegal privatization of the resources of the state and large scale financial frauds all deprive the successor states of resources needed for future economic growth.

German officials contend that at least 70% of the foreign aid distributed never reached its intended recipients. This experience in the distribution of foreign aid is certainly not unique to the USSR. In many parts of the world, the food intended for disaster victims often instead winds up on the black markets. In these black markets, items are sold for sums that would exceed the resources of the victims but would be accessible to the middle class.

In the former Soviet states, the situation is different. These black marketeers are as short-sighted as those engaging in extortion. The organized crime figures who intervened in the distribution of foreign aid went for immediate profits rather than the long term maintenance of black markets. The amount of foreign aid that was diverted and the excessive prices that were charged for the diverted goods had two consequences. First, it limited the assistance that was provided, depriving impoverished and ill citizens of sorely needed aid. Second, it led to new delivery strategies in which armed guards would escort shipments to intended destinations such as old age homes and orphanages.

The approach of the Soviet and post-Soviet organized crime figures may be explained by the fact that many did not intend to stay in the former USSR. They imagined their future life abroad, in international organized crime. Therefore, it was in their best interests to maximize profits which would be rapidly expatriated. Not all proceeds from diverted foreign aid were transferred abroad. Some stayed within the former USSR to build dachas for local officials.

Money exported abroad comes from several other important sources. These include: the massive financial frauds committed on the territory of the former USSR and on post-Soviet military bases, the pay-offs to post-Soviet officials to receive contracts, and illegal privatization to members of the nomenklatura and organized crime figures.

The financial frauds which are committed often link operations on Soviet territory with individuals abroad. Some of these frauds have costs not only for the post-Soviet states but also

for foreign governments. For example in Germany, complex financial schemes are developed to exploit the subsidies that the German government is to provide post-Soviet military troops.

Soviet personnel on a military base in Germany provide an extensive paper trail documenting the delivery of needed food supplies. This scheme, developed in conjunction with organized crime figures currently in residence in Germany, would require German payments of millions of dollars for the delivery of goods that were never in fact delivered to the base. The Soviet personnel would be deprived of food supplies and the German government would pay huge amounts for non-existent supplies.

Long-Term Consequences

Organized crime's domination of the economies of many of the successor states will determine many aspects of the post-socialist transition in the coming decades. It will not necessarily impede economic growth because, as the Italian experience has shown, high rates of growth are possible even with organized crime penetration into the central state. But it will preclude certain forms of development. Illegitimate commerce may predominate at the cost of legitimate business funded by foreign investment. Environmental damage, such as was perpetrated in the Soviet period, may continue because organized crime entrepreneurs are more concerned with short-term profits than long term consequences.

A very unequal pattern of economic development may occur because organized crime thrives when there are great variations in economic development. Residents in areas with high rates of unemployment, and little prospect of development or investment, may accept the employment offered by organized crime or may cultivate illicit crops like drugs because they have limited economic alternatives. Therefore, the future development of labor markets and their organization will be determined to a significant degree by the evolution of organized crime groups. Free labor markets may not emerge because the coercion of organized crime groups may supplant that of the Communist Party. Formation of free labor unions may be inhibited, or they may be taken over by criminal elements.

The major economic threats from the present organized crime structures are the exportation of much needed capital and the depletion of the resources of the former Soviet Union. If too much capital is sent abroad there will not be the funds needed to develop the

economy. Furthermore, the organized crime groups are depriving successor states of natural resources that they will need for the subsequent development of their economies. These threats may not be as great as they first seem because foreign organized crime groups are investing capital in many former Soviet states. Furthermore, organized crime groups, aware of the limited resources of the former Soviet state are diversifying their illicit activities.

The most critical question concerns the future evolution of these illicit economic entrepreneurs. Will they remain like the mafia and Camorra and persist in their illegal activities at the expense of their home communities and international markets, or will they develop like the robber barons of the United States in the past century, who developed into the major philanthropists of American society? The answer may be premature but some unique post-Soviet variant will develop because the organized crime which has emerged is strongly affected by the socialist state which preceded it.

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