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Miriam Lansky, Dylan Myles-Primakoff

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The Rise of Kleptocracy

POWER AND PLUNDER IN PUTIN'S RUSSIA

Miriam Lanskoj and Dylan Myles-Primakoff

Miriam Lanskoj is senior director for Russia and Eurasia at the National Endowment for Democracy (NED). She is the author, with Ilyas Akhmadov, of The Chechen Struggle: Independence Won and Lost (2010). Dylan Myles-Primakoff is senior program officer for Russia and Eurasia at the NED.

Since Vladimir Putin rose to power in 1999, the quest to restore the might of the Russian state at home and abroad has been a hallmark of his rule. Yet another such hallmark has been rampant looting by the country's leaders. Thus Russia has figured prominently in recent scholarly discussions about kleptocracies—regimes distinguished by a willingness to prioritize defending their leaders' mechanisms of personal enrichment over other goals of statecraft. In a kleptocracy, then, corruption plays an outsized role in determining policy. But how have the state-building and great-power ambitions of the new Russian elite coexisted with its scramble for self-enrichment? Putin's Russia offers a vivid illustration of how kleptocratic plunder can become not only an end in itself, but also a tool for both consolidating domestic political control and projecting power abroad.

In Russia, circumstances have conspired to provide fertile ground for kleptocracy. The country's long history of feudalism, from which it rapidly transitioned into totalitarianism and then again into oligarchic state capitalism, left little room for a tradition of individual property rights. And the chaotic aftermath of the Soviet Union's collapse paved the way for the rise of an elite with the means and motivation to wield state power for private benefit.

During the 1990s, Russia's political, social, and economic institutions were reeling as they struggled to adapt after the long-ruling Communist Party's fall. Into the resulting power vacuum stepped the remnants of the Soviet security services—one of the few institutions still strong enough to assert its members' economic and political preroga-

tives.¹ Former KGB officers (sometimes called the *siloviki*, or “strongmen”) embedded themselves in government bodies, businesses, and other influential institutions throughout Russia. They used these perches to observe, control, and build their power, often in cooperation with organized-crime networks. Under Russia’s current president, himself a KGB veteran, these efforts have paid off: The network of former KGB officers surrounding Putin has established de facto ownership of the entire Russian economy, with all property rights effectively conditional on the regime’s goodwill.²

Even as the *siloviki* network took shape, emerging Russian elites with newly acquired wealth were developing innovative uses for the international financial system. Since 1991, capital has streamed out of Russia on a breathtaking scale. A recent analysis estimates the total assets held offshore by Russian citizens to be roughly *equal* to the total assets held within Russia.³ The chief cause may be simply that those Russians who have captured large shares of the country’s wealth now wish to keep that wealth secure. Oligarchs can stow their assets in countries whose rule-of-law systems offer greater financial protections, while continuing to enrich themselves in Russia. Yet the Russian government also has been strategically using offshore capital to pursue its international political objectives.

A Strategy of Rule

Today, opaque financial flows and the equally murky ex-KGB network come together in a system of corruption that serves dual purposes. Those at the top follow the imperative of self-enrichment, while also finding in corruption a highly effective political tool. When these two motivations come into tension, self-enrichment will win out, meaning that Russia is indeed a kleptocracy in the terms we set out above. Yet in practice, while illicit enrichment creates myriad inefficiencies and injustices, it rarely comes into conflict with the ruling regime’s quest to tighten its grip. Often the two go together. Russia’s kleptocratic system does, however, decisively shape its rulers’ choice of methods.

Russia’s kleptocracy follows a distinctive foreign policy, with both pragmatic and ideological drivers. While the Putin regime lacks a guiding ideology comparable in scope to communist dogma, one consistent trope it has advanced is that the Western countries have conspired to weaken Russia, which must reclaim its rightful place among the world’s great powers. Lacking the economic and military might that elevated the USSR to superpower status, the Putin regime has sought to give itself a leg up by exploiting the rules of the globalized world order. To this end, it has used corruption internationally both to undermine democratic resolve and principles in established democracies and to bring foreign political and economic elites (particularly in former Soviet states and satellites) under its control.

Domestically too, the Putin regime has used kleptocratic tactics, in part, to restore certain aspects of the Soviet model. In parallel to their international chase after great-power status, Russia's rulers have tried to banish the chaos of the 1990s at home by reestablishing a considerable degree of Soviet-style control over all aspects of political, economic, and social life. Unwilling or unable to re-create a one-party system backed up by mass repression, the Putin regime has developed a more modern set of authoritarian strategies, with the tactical deployment of corruption perhaps foremost among them.

Sticks and Carrots

In modern Russia, corruption works in two key ways to keep power squarely in the hands of the well-connected. First, favored officials and their allies enjoy great license to steal from the state budget, extort money from private businesses, and even orchestrate the outright seizure of profitable enterprises. Indeed, officials are often essentially forced into participating in corrupt schemes. Property claims and business ventures thus become contingent on the whims of the powerful. Second, as political scientist Alena Ledeneva has explained, this pervasive corruption provides Russia's elites with both a carrot and a stick for use in controlling the officials themselves.⁴ Corrupt acts by bureaucrats, whether willing or reluctant, produce evidence that can later be used selectively to punish anyone who steps out of line.

Thanks to this web of illicit ties and compromising information, a hidden political hierarchy based on personal relationships, money, and informal power supersedes Russia's often hollow formal institutions. The resulting system is fundamentally undemocratic, unjust, and antithetical to good governance. It is, however, an effective means of political control: Kleptocracy ensures that businessmen and officials stay pliable by keeping both in permanent legal jeopardy.

One instructive example is the recent case of former Komi Republic governor Vyacheslav Gaizer. After seven years as the region's finance minister and deputy governor, Gaizer, by then a prominent national leader of the ruling United Russia Party, was appointed governor by President Dmitry Medvedev in 2010 and reappointed by Putin in 2014. But in September 2015, Gaizer and eighteen of his associates (including several members of the regional administration) were arrested on charges of fraud and racketeering. As detailed in opposition activist Ilya Yashin's report "The Criminal Russia Party," the operations of Gaizer's team were essentially indistinguishable from those of a classic mafia group.⁵ For years, the ex-governor's outfit used both violent and political tactics to seize assets and extract bribes from local businesses.

The case against Gaizer was a national scandal, but not because anyone was surprised to see such corruption and criminality in a Russian

regional administration: The situation in Komi was more the rule than the exception. More startling was the national government's de facto admission, implicit in the charges against Gaizer, that an entire region had been run for years (with the blessing of Russia's top leaders) by what was in essence a mafia organization. The crimes in question, after all, had long been well known and reported by local media outlets without any official response. Gaizer's fall was a punishment not for being a criminal, but rather for going too far or otherwise displeasing his political masters.

Another recent corruption case sheds further light on kleptocracy's political dimensions. In November 2016, Russia's then-economy minister Aleksey Ulyukayev was arrested for soliciting a bribe. Making this charge against a cabinet minister even more astonishing was the alleged victim: Igor Sechin, the chief executive of Russia's massive state oil company Rosneft and perhaps the closest political ally of President Putin. As with the Gaizer case, the government's version of events demands considerable suspension of disbelief. As implausible as it is that an entire region could be run for years by an organized-crime operation without the national government's knowledge, it is perhaps even harder to believe that a cabinet minister would demand that one of the most powerful men in Russia personally deliver to him two-million dollars in cash. Nonetheless, the choice of this pretext reflects an environment in which corruption allegations are both a potent weapon and a pointed warning to others.

Moreover, the backstory to the Ulyukayev case involves a far more plausible instance of corruption. In September 2014, one of Russia's richest businessmen, Vladimir Yevtushenkov, was charged with money laundering and placed under house arrest. The Russian government quickly seized Yevtushenkov's controlling share in the highly profitable oil company Bashneft, a stake it kept despite Yevtushenkov's later release. Press reports suggested that the charges against Yevtushenkov were part of a move by Sechin to incorporate Bashneft's assets into Rosneft, then under fiscal stress due to a drop in oil prices. Sechin indeed tried to claim the Bashneft shares, but others in government, including Ulyukayev, opposed the move out of concern that too much of Russia's economy was being concentrated into massive state-owned firms. In October 2016, Rosneft acquired the controlling Bashneft stake. On 15 December 2017, Ulyukayev was sentenced to eight years in prison for allegedly insisting on a bribe to seal his approval of the deal.

The Bashneft saga was an unusually high-profile instance of a phenomenon that menaces all owners of Russian businesses, large and small: *reiderstvo* (or "raiding"), the practice of corrupt officials and business interests conspiring to seize commercial assets through tactics such as the falsification of documents, lawsuits, and judicial orders.⁶ In the most notorious case, the Russian state in 2003 seized the oil com-

pany Yukos from businessman Mikhail Khodorkovsky, who was imprisoned on charges of a range of financial crimes. As with Bashneft, the bulk of Yukos's assets ended up under the control of Sechin's Rosneft.

In many cases, *reiderstvo* is practiced for straightforward economic reasons—a corrupt official or businessman sees a profitable company, and simply decides to take it.⁷ This appears to have been largely the cause of Yevtushenkov's woes. But as the Khodorkovsky case shows, "raids" on private business can also have decidedly political motives. In the early years of Putin's presidency, Khodorkovsky was unusual among Russia's oligarchs in taking an interest in social and political reform. In 2001 he launched the Open Russia initiative (the first of two by the name) to strengthen civil society. The primary purpose of Khodorkovsky's imprisonment was to send a message to his fellow oligarchs that their participation in opposition politics was unacceptable. The seizure and distribution of his assets was merely a side benefit for those involved.

The practices deployed against Yevtushenkov and Khodorkovsky occur at all levels of Russian society, with profound political and economic consequences. Local authorities can arrest compromised rivals and expropriate the businesses of any local entrepreneurs who might dare to support these officials' opponents or to fund any independent political activity. At the same time, the ease with which rapacious officials can seize successful businesses has accelerated the concentration of Russia's economic resources in a small number of hands. In this way, Russia's kleptocracy is a self-sustaining system that closes down the possibilities for reform from within.

Beyond Russia's Borders

The political and economic logic of kleptocracy inevitably spills over beyond Russia's borders. To launder and store its illicit riches, the Russian elite depends on open markets, foreign legal protections, and relations with other states—especially wealthy ones (such as the United Kingdom and the United States) into whose large luxury real-estate markets it can sink vast wealth with anonymity. One might expect that this would motivate Russia to maintain stable foreign relations and behave as a traditional great power. In some cases—as in the international dealings of the mammoth state-owned gas monopoly Gazprom, or in Moscow's relations with elites in other post-Soviet states—efforts to strengthen Russia's political influence and to bolster its financial flows are indeed intertwined. Here, kleptocracy supplies additional means to ends it largely shares with traditional great-power politics.

Yet revelations of the theft at the system's core, which could intensify both international sanctions and domestic discontent, pose a constant threat to Putin and his circle. As a result, fear may propel them into

reckless behavior. To avert perceived threats to the kleptocratic system, Russia's elites are willing to risk losing access to the markets that have been absorbing their ill-gotten gains. In these cases, they resort to extreme measures more characteristic of rogue states or nonstate actors than of traditional great powers.

Revelations of the theft at the system's core pose a constant threat to Putin and his circle. As a result, fear may propel them into reckless behavior.

Gazprom's dealings in Europe demonstrate how the Russian state uses its control of economic resources to advance conventional great-power interests alongside those more particular to kleptocracy. Two major pipeline projects, the already operational Nord Stream 1 and the planned Nord Stream 2, stand at the intersection of

monopoly power, crony capitalism, and foreign-policy opportunism. The aim of both pipelines is to carry gas under the Baltic Sea to Germany, bypassing Ukraine as well as several other Central or Eastern European states (including EU members). By reducing the leverage of these states vis-à-vis Moscow, the pipelines further Russia's traditional quest to divide Europe and gain dominance in its eastern half. The Nord Stream initiatives—whose Swiss incorporation allows them to avoid EU jurisdiction—also threaten to weaken the EU by generating conflicts of interest (former German chancellor Gerhard Schröder was tapped to chair the Nord Stream shareholders' committee) and sparking political squabbles pitting states imperiled by the initiative against those that stand to gain. In a protest to the European Commission, eight EU members expressed alarm at the “potentially destabilising geopolitical consequences” of Nord Stream 2.⁸

The funds that the pipelines will generate represent not only a means of renewing the Putin regime's depleted treasury, but also a potential source of rents. Completion of Nord Stream 2 would be a boon for Gazprom, which has majority ownership of Nord Stream. Currently chaired by Victor Zubkov, a former Russian prime minister and close associate of Putin, Gazprom is struggling with U.S. sanctions, as well as with an EU antimonopoly investigation and prohibition on raising capital. The CEO of Nord Stream 2, longtime Putin associate and former Stasi agent Matthias Warnig, is another figure who represents Russia's interwoven webs of economic and political influence.⁹

In post-Soviet states, corruption constitutes one of Russia's most important levers of influence. The outstanding example was Moscow's relationship with former Ukrainian president Victor Yanukovich, who effectively functioned as a Russian proxy until the 2014 EuroMaidan Revolution. After trying and failing to suppress these mass protests, which were motivated in large part by outrage over corruption, Yanukovich fled both his office and the country (tellingly heading to Russia).

Before his fall, Yanukovich had benefited from a corrupt scheme that depended on Gazprom providing gas at a substantial discount to an intermediary company owned by Ukrainian oligarch Dmitry Firtash. The company then resold it to Ukrainian customers at far higher prices, with much of the profit going to finance Yanukovich's political campaigns. While the grotesque images of Yanukovich's gold and marble palaces, car collection, and private zoo may have resonated most with the public, his ledgers also detail the spending of US\$2 billion over five years on unofficial cash payments to politicians, media representatives, and foreign consultants. This points to a political system driven by bribery.¹⁰

The case of Ukraine also highlights the more erratic side of Russia's kleptocratic foreign policy. The Kremlin saw an existential threat in Ukraine's 2014 "Revolution of Dignity," which had the potential not only to cement the country's place in Europe and outside Russia's grasp, but also to set an example for Russia's own civil society. Moscow reacted by annexing Crimea and starting a war, now more than three years old, that has ravaged the eastern Ukrainian provinces of Donetsk and Luhansk. This response has provoked costly European and U.S. sanctions on Russian companies and officials. It has also deeply antagonized Ukrainians, likely reducing Russia's long-term chances of influencing elite factions in Ukraine. Confronted with a popular grassroots movement in a neighboring state that challenged kleptocracy itself, however, the Kremlin eschewed these long-term geopolitical calculations. Instead, it behaved in a manner that reflected its roots in the organized-crime syndicates of the 1990s: Like a gangster, it sought to signal its lack of restraint.

Alexander Litvinenko, a former Federal Security Service (FSB) officer who turned against the agency and migrated to London in 2001, used a different term for kleptocracy. He called Russia a "mafia state." In two politically explosive publications, Litvinenko described the KGB's transformation into a mafia organization and alleged that the FSB (a KGB successor agency) had organized a series of explosions in Russian apartment buildings in 1999, helping to spark the Second Chechen War and cement Putin's rise to power.¹¹ He also began to cooperate with Spanish prosecutor José Grinda, who was investigating St. Petersburg mafia bosses with alleged money-laundering operations in Spain. Litvinenko was scheduled to travel to Madrid for an in-person meeting with Grinda in November 2006.

A week before his trip, Litvinenko was poisoned on U.K. soil with polonium, a rare radioactive isotope. Following a painful hospital stay, he died on November 23. A lengthy U.K. investigation found that two KGB veterans, Andrei Lugovoi and Dmitri Kovtun, had carried out the murder. The inquiry concluded that they probably had done so under the direction of the FSB, and most likely with the approval of Putin and FSB director Nikolai Patrushev.¹² Perhaps unsurprisingly, Russia

has refused to turn the alleged assassins over to the United Kingdom, and in 2007 Lugovoi secured a seat in the State Duma. To silence a loose-lipped defector, Moscow proved willing to risk a crisis in Anglo-Russian relations. The timing suggests that defending kleptocracy was a priority: Litvinenko's prior sensitive accusations notwithstanding, he was killed only as he started to cooperate in exposing the regime's financial crimes.

Despite Litvinenko's untimely passing, Grinda's investigation succeeded in producing damning evidence of extensive connections between Russian elites and the mafia bosses passing their money through Spain. An indictment in the case was issued in 2015. Using intercepted telephone conversations between known mafia figures and high-level Russian officials, Grinda found that the mafia "is integrated into Russia's police structures." The officials mentioned as having ties to the mafiosi included former prime minister and current Gazprom chief Zubkov, Investigative Committee chairman Alexander Bastrykin, and top drug enforcer Nikolai Aulov; the latter had spoken to the crime boss at the center of Grinda's case 78 times in about eighteen months.¹³ The case is slated for trial in February 2018, and a Spanish judge has issued an arrest warrant for twelve Russian citizens, including Aulov and Vladislav Reznik, the former chairman of the Duma's finance committee.¹⁴

Facing the Backlash

Kleptocracy puts enormous resources at the Russian government's disposal, enabling Moscow to coopt foreign business and political elites. Yet with Western societies waking up to the security threat stemming from Russia's kleptocracy, it also makes the regime vulnerable to international sanctions. In August 2017, a near-unanimous act of the U.S. Congress codified and amplified the sanctions (including visa bans, asset freezes, and prohibitions on business activities and technology transfers) already in place against certain Russian companies and individuals due to Moscow's aggression in Ukraine and cyber-interference in the 2016 U.S. presidential election. The act calls specific attention to the fight against corruption. It tasks three U.S. government agencies with compiling a report that will detail the holdings, involvement in corruption, and relationships to President Putin of significant individuals in Russia; the U.S. economy's exposure to "Russian politically exposed persons and parastatal entities" (with particular attention to "the banking, securities, insurance, and real estate sectors"); and the possible results of further sanctions.¹⁵ This requirement for a systematic analysis of Russia's kleptocracy demonstrates a new understanding of the threat, as well as bipartisan political resolve to address it.

When kleptocracy took hold in the 2000s, Russia's economy was

growing, oil prices were soaring, and the rising middle class was grateful to Putin. Maintaining this system during the current economic downturn is proving more difficult. It is no coincidence that the most significant opposition political movement in Russia today centers on an anticorruption message. Activist Alexei Navalny, persevering through spells of imprisonment, has galvanized a protest movement that in March and June 2016 drew tens of thousands of people, most of them young, to take to the streets against kleptocracy. The tech-savvy team at Navalny's Foundation Against Corruption produces documentaries unmasking high-level corruption, which have drawn tens of millions of views on YouTube. Despite frequent arrests and attempts at intimidation, Navalny's backers have also organized a national campaign for Russia's March 2018 presidential election, with offices in more than a hundred cities and towns. As of this writing, the authorities are refusing to register Navalny on the technical grounds that he has a criminal conviction (on trumped-up fraud charges). But Navalny and his team have defined the presidential contest to such an extent that an election without them will be an unmistakably empty ritual. And the emerging network of young activists will persist in fighting corruption long after the election is over.

Russia's rulers also face growing social and economic discontent. The country's economy is struggling, with bankruptcies in the third quarter of 2017 nearing record numbers. Economic, social, and labor protests—which occur throughout the country, but especially in major urban areas in the central regions—are also growing more frequent. The majority are sparked by local grievances such as salary arrears, housing-construction scams that defraud would-be homeowners, and ecological damage.¹⁶ A few campaigns, such as the recurring protests by long-haul truckers against new taxes imposed in late 2015, have been coordinated and national in scope. Permeating these protests has been outrage at the grave injustice of a system in which the nation's wealth goes abroad to support the lavish lifestyles of a small minority, while the vast majority face a diminished quality of life and reduced salaries, pensions, and social services.

Domestic and international scrutiny of kleptocracy is the most serious challenge that Putin's system currently faces. During Putin's first two terms as president, his administration was able to harness kleptocratic structures and tactics to project Russian power and influence on a global scale. But since Putin's 2012 return to the presidency, maintaining this system amid swelling domestic criticism has necessitated greater levels of repression, and the shrinking economy has brought about increasingly visible divisions within the Russian elite. Internationally, kleptocracy now portends financial and political isolation. The longer Russia remains in thrall to corruption, the more isolated, poor, and authoritarian it is likely to become.

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