

ROLE OF THE WORLD BANK AND IMF IN ISSUING LOANS TO RUSSIA:  
RESPONSIBILITY, TRICKS, CORRUPTION, MAFIA, AND IMPORTANT USE OF LEGAL  
ENFORCEMENT.

by

ELMIRA MAKOVA

(Under the Direction of Fredrick Huszagh)

ABSTRACT

The World Bank and the IMF are among the most important international organizations globally promoting economic stability, growth, free trade, and poverty reduction by financing a wide variety of projects. The policies governing their activities have universal impact. The purpose of this study is to unfold flaws and failures of the multilateral institutions' activities toward financing Russia during a transitional period, leading to dangerous worldwide corruption, money laundering, fraud, and misuse of international funds by the Russian Government. The result of such misuse was increased poverty in Russia, lost belief in the fairness of Governmental institutions, the rule of law and justice, economic crisis, and unbearable national indebtedness. This study will conclude that special measures in the field of legal reform and legal enforcement internationally and within Russia must be continually supported, funded, and broadened by the World Bank and the IMF.

INDEX WORDS: International Law, The International Monetary Fund, The World Bank, Loans, Russia, Mafia, Corruption, Money Laundering, Fraud, Extortion, Legal Reform, Legal Enforcement, Legal Education, Legislation, Judicial Reform, Legislators, Yeltsin, Putin, By-laws, Repatriation of the Embezzled Funds, Transparency, Accountability, Conditionality of Loans

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## DEDICATION

To my Mother, who is an unconditional Dreamer and Believer. To my Father, who has the most beautiful mind. To the incredible person who changed my life and personal outlook about the worth and treasure of precious life, Mimi Sullivan. To Peter Clark, who has the most fantastic heart. And to my Dog Judge Judy, who always managed to interrupt my flow of thoughts in the most distinct and critical moments, by asking me to play with her or take her for a walk, and who loves me with devotion and unconditionally, and who, overall, saved me and made my life more complete and happy. When we care for someone who depends upon us, our hearts become purer and richer. I wish to all of us, children of the Universe, Peace and a World without tears.

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## ABBREVIATIONS

ADR	Alternative Dispute Resolution
ARD/Checchi	Rural Development Institute of land law and policy
ARLI	American Russian Law Institute
CIA	Central Intelligence Agency
HID	Harvard Institute for International Development
IBRD	International Bank for Reconstruction and Development
ICSID	International Center for Settlement of Investment Disputes
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
JSR	Justice Sector Reform
MIGA	Multilateral Investment Guarantee Agency
NGO	Non-Government Organizations
OC	Organized Crime
RFRL	Russian Foundation for Legal Reform
ROC	Russian Organized Crime
SC	Structural Conditionality
TRD	Tranche Release Document
USAID	United States Agency for International Development

## **CHAPTER 1**

### **INTRODUCTION**

#### **1.1. Background**

This thesis was begun in 1999, and was expected to be completed in May of 2000.

Since then, unforeseen life circumstances interrupted the process. The final phase of this author's study is occurring in the fall of 2005.

Many extraordinary things have dramatically changed the face of the world since 1999. In 1999 Mr. Vladimir Putin was not yet the president of Russia. At the same time, Mr. George W. Bush was not yet the President of the United States.

The Towers of the World Trade Center were still a significant standing symbol of New York City. The tragedy of the September 11 victims, the hostages in the Moscow Theater, the massacre of children in Beslan, Chechen-Ingushetia, and the blasts in Spain and London had not yet turned our somewhat peaceful world into dynamite.

During the twentieth century, terrorism was a significant issue, but not yet the dominating force. The war in Iraq had not yet been conceived.

With the turn of the Twenty-first century, not only did the millennium turn, but we, the peoples of the Universe, changed drastically, dramatically and forever.

The hurricanes Wilma, Rita, Katrina, Jeanne, Frances (some of which the writer of this study personally experienced), the devastating tsunami, earthquakes, mudslides, and all the other natural disasters that have recently influenced human well-being and the global economy, are perhaps the dramatic warning signs of Mother Nature.

We walked into the twenty-first century losing one of the most significant values of human life, our sense of security and hope for a safe, peaceful future.

Greed, stinginess, parsimoniousness, tightfistedness, avarice, craving for power, money, gold and black gold (oil), racial, social, political and religious intolerance gave rise to: oil for food<sup>1</sup>, oil for money, workforce for money, oil and money for lives, and the religious outrage of hate-driven terrorists who destabilized a peaceful world.

This study will deal with the above-mentioned tools of exchange: money and its equivalent (in any existing type, shape or form), and the means of legal and judicial enforcement utilized to neutralize currency's devastating effect on humans - rich and poor.

This paper will outline the dynamics of money utilized as a means of violating legal demands, rules, laws, regulations and requirements and the corrupting power of money resourcing from specially organized multilateral financial institutions including but not limited to the World Bank and the International Monetary Fund (IMF). The main goal of these institutions is to fight for peace by fighting against hunger and poverty and by helping to promote negotiation, consensus, free trade and free exchange. The dangers of a corrupted Russian government, officials, financial and banking systems, supplied with the monetary help of the World Bank and the IMF, all pose threats to the safety of the world. One might presume that for the public good there should be a somewhat fair distribution of one of the most

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<sup>1</sup> For a comprehensive analysis of attempt to corrupt Russian Government and Putin's Cabinet, and misuse of the international aid by Saddam Hussein, *see* MAJORITY AND MINORITY STAFFS OF THE PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, 109TH CONG., REPORT ON OIL ALLOCATIONS GRANTED TO THE Russian PRESIDENTIAL COUNCIL (Comm. Print 2005), *available at* [http://hsgac.senate.gov/\\_files/PSIRussianPresidentialCounselReport.pdf](http://hsgac.senate.gov/_files/PSIRussianPresidentialCounselReport.pdf) [hereinafter OIL ALLOCATIONS REPORT].

important tools for rebuilding human lives – money, as well as a very strict accountability for using it and severe punishment for its misuse.

In July 1999, the author of this thesis was a speaker on gender and inequity topics for the Prime Week at the World Bank.

She attended the financial session of the forum as well. She was fortunate enough to be able to question publicly very highly ranked representatives of the World Bank and the International Monetary Fund (IMF) on the following:

- It is well known that World Bank and International Monetary Fund (IMF) issued a significant number of loans of different sizes and amounts to Russia with specific purposes and to complete specific programs. As a citizen of Russia, the author believed that neither the money received from the World Bank nor the money from the IMF was spent in a way or with a purpose that would have helped the Russian economy to recover and be restructured to the good of the people. Thus, the goal of decreasing the poverty level was never reached. Therefore, the author's question was: “Where is the money loaned to the Russian Government, and how might the World Bank and the IMF control where the money went? How was the money spent? What was the final product or result of use of the particular loan amounts?”

The answer from the World Bank and IMF was, “We are having trouble controlling and tracking how the particular country is spending our money and utilizing our help.”

“The problem is that when the Russian Government receives the money, it is mixed with the country’s own money.” (This was the response from the Russian Government under Yeltsin to the World Bank and IMF).

“In addition, we (the World Bank and IMF), have no strong legal means, tools, power, rights, or regulations to demand a report, as check how a particular country and its government is spending money supplied to them by the World Bank and IMF, due to sovereignty issues. ”

What an interesting answer!

If a citizen went to obtain a mortgage loan or business loan to purchase equipment or to start a new line of products, the bank would be in legal and procedural standing to check on how well and properly a person was using the credit received. Moreover, if instead the individual spent the money for vacationing in Hawaii or the Caribbean, the Seychelles Islands or the Maldives, or used the funds for another unintended target, the borrower would be in direct violation of the loan agreement, and would immediately be asked to return the money borrowed.

A simplification perhaps; however, isn't it logical that when millions or sometimes billions of dollars are distributed on an international level to a country by the World Bank and the International Monetary Fund (IMF), stricter procedures and legal requirements and regulations would be in place to track the path and the route of the money loaned? If the money is serving its intended purpose, an accounting should be provided as to how well and properly the goals of the specifically financed program have been achieved by the government of the sovereign country or by authorized subsidies.

Curiously, it appears that the issue of sovereignty is preventing the World Bank and the International Monetary Fund (IMF) from controlling the expenditures of the funds they disburse to a particular country. The World Bank and the IMF officials are admitting that this dilemma still, in 2005, hasn't found its appropriate resolution.

As a Russian citizen in year 1999, the writer of this thesis appeal to the IMF and the World Bank NOT to keep providing funds to the Russian government without a stipulation that it report a plan for achieving goals, and for measuring and reporting on achievement of goals; so that the government would be transparent and accountable for any misuse of funds. It should

be proven beyond reasonable doubt that money is disbursed properly and directly, and that it is used and invested as originally intended.

The IMF and the World Bank briefed the press and public attending that there is a present and ongoing investigation on the use of loans to the Russian Federation from the World Bank and the International Monetary Fund (IMF).

A month and a half after the briefing at the end of August 1999, the news emerged that the Bank of New York was engaged in money-laundering schemes with Russian mobs and officials through a relationship with the Russian affiliate banks. Natasha Gurfinkel Kagalovsky, a Bank of New York executive, resigned in October 1999 under the pressure of a federal investigation into possible money laundering that occurred through accounts at the Bank of New York. The Bank of New York was eager to expand its interests in the Russian market through its affiliate Incombank (which collapsed in October 1998), and was one of the Bank of New York's most profitable customers. In February 2000, Lucy Edwards, another Bank of New York executive, and her husband pleaded guilty to their roles in a money-transfer scheme that washed from \$7 to \$10 billion from Russia through the bank of New York in the period from 1995 until 1999. The Bank of New York cooperated with the investigation and was never criminally charged in connection with this investigation.<sup>2</sup> The scandal with the Bank of New York is serving as an example of money laundering.<sup>3</sup>

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<sup>2</sup> Colleen DeBaise, *Appeals Court Reinstates Embezzlement Suit Vs Bank Of NY*, DOW JONES NEWS SERVICE, Jan. 15, 2002, available at <http://russianlaw.org/dj011502.htm> (last visited Nov. 27, 2005).

<sup>3</sup> *Role of the U.S. Correspondent Banking in International Money Laundering: Hearing Before the Permanent Subcomm. on Investigations of the Comm. on Governmental Affairs*, 107th Cong. 273 (2001) (appendix), available at <http://www.gpo.gov/congress/senate/senate12sh107.html>.

The washed billions could easily include money loaned by the World Bank and the IMF to the Russian Government.<sup>4</sup> Was there a serious misuse of international help to Russia while billions of dollars were flushing away overseas through the Russian banking system the World Bank and IMF were determined to improve? Were mafia, corrupt politicians, and highly ranked officials of Russia in control of international loans, help, aid and assistance? This study will unfold some proven facts. Moreover, extensive investigative research by American legislators launched at the end of the 1990s revealed numerous astonishing facts regarding corruption and the misuse of international funds by Russian officials.<sup>5</sup> The Report entered the public domain around September 2000. In 1999 the author of this work alleged that the schemes regarding the misuse of international money by the Russian government would become matters of public knowledge and concern very soon (X); that drastic and unexpected changes in political power in Russia would happen at the end of 1999 or the beginning of 2000 (Y); and that Russia would march toward a new twenty- first century type of dictatorship (Z)<sup>6</sup>.

As of 2005, sadly, XYZ had happened. Corruption has unfolded; political power smoothly went from Yeltsin to Putin.<sup>7</sup> Putin proved to be a dictator with a democratic face or a new form of democrat with a dictatorial attitude.<sup>8</sup>

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<sup>4</sup> For a comprehensive analysis of the Clinton Administration's actions toward transitioning Russia, see *Russia's Road to Corruption*, Speaker's Advisory Group on Russia, 106<sup>th</sup> Cong. (2000) (presentation by Rep. Christopher Cox, Chairman, House Policy Comm.), available at <http://www.fas.org/news/russia/2000/russia/index.html> (last visited Nov. 27, 2005) [hereinafter *Road to Corruption*].

<sup>5</sup> *Id.*

<sup>6</sup> *Russia's Transition to Democracy and U.S.- Russia Relations: Unfinished Business: Hearing on H.R. 108-54 Before the Subcomm. on Europe of the Comm. on International Relations*, 108th Cong. 1 (2003), available at [http://www.house.gov/international\\_relations/108/89668.PDF](http://www.house.gov/international_relations/108/89668.PDF).

<sup>7</sup> GEORGE W. BRESLAUER, GORBACHEV AND YELTSIN AS LEADERS (2002).

<sup>8</sup> LILLA SHEVTSOVA, PUTIN'S RUSSIA (2003).

As an ordinary person, the author of this study didn't have all resources available to the World Bank and IMF, or the House of Representatives Committee of the United States Senate, or other international institutions and governmental agencies of the United States and Russia to unfold the flaws of the Russian government and the Russian financial market and banking system. However, at the end of the 90s it surfaced that very serious ongoing misuse of international loans by the Russian Government is occurring. On the other hand, internally, the Russian Government used well-concealed lies to the Russian population and proclaimed that the World Bank and IMF are not willing to help the country in times of crisis (1991-1995), while the Government and Mr. Yeltsin personally as President, as well as Mr. Chubais' as an "architect" of privatization, Mr. Chernomyrdin as Prime Minister, and other members of the Cabinet robbed and stole from their own people whom they were sworn to serve.<sup>9</sup>

Some of the most significant reasons for ongoing violations were: a vacuum in legislation with regard to the absence of new laws and regulations, and with regard to members of the legislative branch the ability to understand the urgent necessity of the open market culture and society in a country in transition;<sup>10</sup> the absence of a system of checks and balances; an extreme lack of legal enforcement not only in Russia, but also, as became plain, internationally, and in particular within the World Bank and IMF structure; the lack of readiness of both the World Bank and the IMF to meet the demands of a new era for appropriate changes in their activities and functions, and to address urgent issues. Historically, a weak legal system and powerless

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<sup>9</sup> *Road to Corruption*, *supra* note 4, Executive Summary.

<sup>10</sup> *Id.*

judicial branch in Russia<sup>11</sup> and, therefore, the absence of a system of checks and balances, led to the criminal intent and criminal misuse of international funds, which puts in jeopardy the peaceful existence of an extremely powerful country itself. Russia out of balance can pose direct danger to the rest of the world with its sizeable military, space, defense and nuclear arsenal. Unfortunately, the World Bank and the IMF did not pay enough attention to the Russia's lack of checks and balances, and in 1991-1999 there were not enough special programs developed or financed to help to build, improve, or polish the system of checks and balances in Russia, nor was there adequate financing of programs to conduct substantial and widely scaled legal and judicial reforms reflecting and supporting rapid changes occurring in all walks of newly reforming and transitioning Russian society, governmental entities, financial, banking, commercial and private sectors.<sup>12</sup> The World Bank and The IMF did not place special conditions on the chain of tranches of money to the Russian Federation requiring the government to work rapidly toward improvement of legislation, implementation of legislation, strengthening of the judicial branch or legal enforcement. Those elements did not appear to be priorities for the World Bank and the IMF at the time.

### **1.2. Purpose of the Study**

The present paper will examine how the policies of the World Bank and the International Monetary Fund (IMF) influenced the transition of post-Soviet Russia toward democracy and an open society. The study will discuss how policies have changed over time, how the misuse of international money became possible and how that misuse later unfolded. The study will concentrate on, and will show that ignorance of the rule of law, disregard for legal

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<sup>11</sup> Leon Aron, *Russia Reinvents the Rule of Law*, RUSSIAN OUTLOOK, Mar. 20, 2002, [http://www.aei.org/publications/pubID.13781/pub\\_detail.asp](http://www.aei.org/publications/pubID.13781/pub_detail.asp) (last visited Nov. 27, 2005) [hereinafter RUSSIAN OUTLOOK].

enforcement, and failure to adequately finance relevant legal reform projects diminished what could have been a bright opportunity for Russia to become a full-scale democracy and a full-scale open society. Further, this study will provide some suggestions as to what could have been done, should still be done, and what should be avoided in the future for other countries on the edge of transition from communism (for instance, Cuba, a significant object of an American interest due to geographical location). For countries transitioning to democracy, this study will address what kind of legal measures and financial actions should be taken by the World Bank and the IMF to increase governmental accountability and the accountability of their respective representative entities with regard to use of international money, loans, grants and aid.

Chapter II will provide a historic overview of the role and objectives of the World Bank and the International Monetary Fund. Chapter III will highlight recent changes in the overall policy of the World Bank and the International Monetary Fund, and will review operations, objectives and goals, with emphasis on the policies toward the Russian Federation. Chapter IV will link to the comprehensive research and discoveries of the Speaker's Advisory Group on Russia, 106<sup>th</sup> U.S. Congress, *Russia's Road to Corruption*, a presentation by Representative Christopher Cox, Chairman, House of Representatives Policy Committee.<sup>13</sup> This presentation is the result of a superior study of the fundamental flaws of the Clinton administration's policy toward Russia. Chapter V will look inside the criminal activities with regard to corruption, fraud, extortion, money laundering, racketeering and related unlawful executions in the presence of transitioning legislation, legislative process, law drafting, judiciary, law

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<sup>12</sup> *Road to Corruption*, *supra* note 4, Executive Summary.

<sup>13</sup> *Road to Corruption*, *supra* note 4.

enforcement and overall legal enforcement in Russia during its transition from communism toward democracy. Chapter VI will uncover the role of the World Bank and the IMF in funding corruption in Russia, while intending to provide money for the economic reforms.

In conclusion, Chapter VII suggests that not only should Russia be held accountable for the globally spread corruption of its banking system and the system at whole, but also the World Bank and the International Monetary Fund (IMF) and the U.S. should be held accountable for the lack of stewardship and resulting damage, and should improve their ongoing work for better transparency, accountability and conditionality of the loans. Several suggestions to improve the situation, to strengthen legal enforcement and promote the rule of law in the global environment and the Russian Federation will be made, including a proposition for repatriation of embezzled funds from violators.

## **CHAPTER 2**

### **HISTORY, NATURE, AND OBJECTIVES OF THE INTERNATIONAL MONETARY FUND AND THE WORLD BANK**

The International Monetary Fund and World Bank were both chartered as a result of the international negotiations of 45 governments at a conference conducted on July 1-22, 1944 in Bretton Woods, New Hampshire, U.S.A. The goal of the participating countries and founders was to establish a framework for economic cooperation and development that would lead to a more stable and prosperous global economy after the Great Depression and World War II. This charter marks a turning point and a landmark in the changing: world economy, history and global relations.<sup>14</sup> The American scholar Harry Dexter White, who allegedly was a Soviet spy,<sup>15</sup> and the British economist John Maynard Keynes<sup>16</sup>, two brilliant economists of the early twentieth century, were credited with the idea of a voluntary international financial forum such as the International Monetary Fund.

The year 1945 is highlighted in the history of the world, not only as a year of a victory against Nazi Germany, but also as a year when 29 countries explicitly signed the Articles of

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<sup>14</sup> For a comprehensive analysis of the history of the International Monetary Fund (IMF), see MARGARET GARRISTEN DE VRIES, *THE IMF IN A CHANGING WORLD, 1945-85* (1986).

<sup>15</sup> Arnold Beichman, *Guilty as Charged*, HOOVER DIGEST, 1999, available at <http://www.hooverdigest.org/992/beichman.html> (reprinted with permission of the *Weekly Standard*, which first published the article on Dec. 14, 1998).

<sup>16</sup> ROBERT SKIDELSKY, *JOHN MAYNARD KEYNES: 1883-1946: ECONOMIST, PHILOSOPHER, STATESMAN* (2005).

Agreement.<sup>17</sup> of the International Monetary Fund and the International Bank for Reconstruction and Development known as the World Bank. Also in 1945, the United Nations came into existence as well.

The International Monetary Fund initially consisted of about 40 members. Different sources indicate different numbers primarily because some of the members at the beginning stage were unable initially to meet the requirements established and/or didn't sign the Articles of Agreement by the set date of December 31, 1945.<sup>18</sup> As of 2005 the membership reached 184 worldwide.<sup>19</sup>

The IMF is a special financial forum the main purpose of which is to openly discuss the fiscal policies of its members and to avoid severe exchange restrictions on international currencies. IMF membership is open to any government which conducts foreign policy accordingly and accepts the Articles of Agreement and by-laws under which the IMF is run.<sup>20</sup> Each participating government is also required to contribute funds to the operation of the organization. Most funds are put into a special account upon which the organization draws if a member-country needs emergency loans to stabilize its economy. Although voting procedures in place at the IMF are weighted in favor of the largest financial contributors, members reach a consensus before loaning money. Recipient governments are encouraged to restructure their economies to promote free trade, but are under little obligation to follow the measures dictated

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<sup>17</sup> Articles of Agreement of the International Monetary Fund, July 22, 1944, *available at* <http://www.imf.org/external/pubs/ft/aa/aa08.htm> [hereinafter Articles].

<sup>18</sup> *Id.* art. 2, para. 1.

<sup>19</sup> A FACTSHEET: THE IMF AT A GLANCE, INTERNATIONAL MONETARY FUND (2005), <http://www.imf.org/external/np/exr/facts/glance.htm> (last visited Nov. 27, 2005).

<sup>20</sup> *See id.*

by the Fund, which is one of the main reasons leading to the recent failures and heavy criticism of the institution.

In the early stages of its existence the International Monetary Fund was dominated by the United States, which had one-third of the voting power.<sup>21</sup>

Article I of the Articles of Agreement sets out the International Monetary Fund's main responsibilities<sup>22</sup>:

- promoting international monetary cooperation;
- facilitating the expansion and balanced growth of global trade;
- promoting currency exchange stability;
- assisting in the establishment of a multilateral system of payments; and
- making its resources available (under adequate safeguards) to members

experiencing difficulties in repayments.

While the International Monetary Fund promotes international monetary cooperation and provides policy advice and technical assistance with the sole purpose of helping countries build and maintain strong economies, the Fund also makes loans and helps countries devise policy programs to solve balance of payments problems. IMF loans are relatively short-term loans, and funded mainly by the pool of quota contributions provided by its members. This environment is where sufficient financing on affordable terms should be obtained to meet net international payments.

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<sup>21</sup> Rodrigo de Rato, Managing Director, International Monetary Fund, Address at the Circulo de Economía: Globalization and the New Priorities of the IMF (Oct. 20, 2005), <http://www.imf.org/external/np/speeches/2005/102005a.htm> [hereinafter Globalization Address].

To the contrary, the World Bank promotes long-term economic development and poverty reduction by providing technical, financial and organizational support to help countries to reform particular sectors or implement specific projects—for example, building schools and health centers, working on gender issues, urban development, providing water and electricity, fighting disease, protecting the environment, and solving urging problems of cultural improvement and poverty reduction. World Bank assistance is generally long-term, and is funded both by member country contributions and through bond issuance.<sup>23</sup>

In the 60 years of its operations, the IMF has maintained a mainly steady course, while the World Bank has done quite the opposite. When Europe recovered after World War II, the World Bank turned its attention to Latin America and Africa, and later to the Eastern post-Soviet Bloc. With its overriding mission to eliminate poverty worldwide, the World Bank became extensively and heavily involved in a countless number of different projects in countries all over the world.

Two entities, the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), together constitute the World Bank as an International Organization. With other three institutions, the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), and the International Center for Settlement of Investment Disputes (ICSID), all five form the World Bank Group (WBG).<sup>24</sup>

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<sup>22</sup> Articles, *supra* note 17, art. 1.

<sup>23</sup> For a comprehensive overview of the objectives and structure of World Bank Group and World Bank, *see* PAUL MCCLUER, A GUIDE TO THE WORLD BANK (2003).

<sup>24</sup> *Id.*

The main objective of the International Bank for Reconstruction and Development (IBRD) is lending to the governments of middle-income, as well as creditworthy low-income countries. The International Development Association (IDA) provides interest-free loans, which are still called credits, to the governments of the poorest countries in the world. The International Finance Corporation (IFC) lends directly to the private sector of developing countries. The Multilateral Investment Guarantee Agency (MIGA) provides guarantees to investors in developing countries against losses caused by non-commercial risk. The International Center for Settlement of Investment Disputes (ICSID) serves as an arbitrating institution for international investment disputes.<sup>25</sup>

It is recognizable that the initial purpose for establishing the IMF and the World Bank was economic stabilization and growth in the post-World War II era, rather than any other related issues that may appear relevant today. The issues of legal constraints, conditions of loaning money, monitoring and control of fulfillment financed programs, and accountability by the particular government-borrower were taken into consideration but not emphasized enough by the IMF and the World Bank in previous years, indeed not until the new millennium.<sup>26</sup>

Thus, for example, there was and is a principle of conditionality of funds in both institutions. When a country borrows from the IMF or the World Bank, its government makes commitments on economic and financial policies—a requirement known as conditionality.<sup>27</sup>

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<sup>25</sup> WORLD BANK PUBLICATIONS, WORLD BANK GROUP ORGANIZATIONAL DIRECTORY (1993).

<sup>26</sup> THE STRUGGLE FOR ACCOUNTABILITY: THE WORLD BANK, NGOS, AND GRASSROOTS MOVEMENTS (Jonathan A. Fox & L. David Brown eds., (1998).

<sup>27</sup> INTERNATIONAL MONETARY FUND, POLICY DEVELOPMENT AND REVIEW DEPARTMENT, CONDITIONALITY IN FUND-SUPPORTED PROGRAMS, OVERVIEW (2001), <http://www.imf.org/external/np/pdr/cond/2001/eng/overview/index.htm> [hereinafter CONDITIONALITY REPORT].

Conditionality is a way for the IMF and the World Bank to monitor that their loans are being used effectively in resolving the borrower's economic or other difficulties, so that the country will be able to repay promptly and funds can be made available to other members in need. In previous years the IMF and the World Bank didn't emphasize this important aspect of loaning money well enough or did not strongly comply with personally established guidelines. The situation had drastically changed when the World Bank and the IMF became heavily involved with post-Soviet Russia in the early 90s. Relations with the Russian Federation failed the trustworthiness test. Those relationships became one of the most significant examples of the flaws in the policies and procedures within the World Bank and the IMF due to the role, size, military power and historical importance of Russia either as an ally of the United States of America in missile disarmament, oil cooperation and the recently launched war on terrorism, or as an enemy during the Cold War with the U.S., the largest contributor to the World Bank and IMF.<sup>28</sup>

Although in recent years, the IMF and the World Bank obviously have worked very hard to admit the importance and focus and streamline the principle of conditionality,<sup>29</sup> in order to adjust their policies and continue promoting national ownership of strong and effective policies in the member-countries, the principle of conditionality must remain an extremely high priority.

In 1999 and 2000 the World Bank and the International Monetary Fund caused a lot of controversy and were openly and heavily criticized.<sup>30</sup> Activities of both institutions drew large

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<sup>28</sup> *Road to Corruption*, *supra* note 4, Executive Summary.

<sup>29</sup> CONDITIONALITY REPORT, *supra* note 27.

<sup>30</sup> SEBASTIAN MALLABY, *THE WORLD'S BANKER: A STORY OF FAILED STATES, FINANCIAL CRISES, AND THE WEALTH AND POVERTY OF NATIONS*, 480 (2004).

crowds of demonstrators protesting the role the organizations play on the global stage. Activists accused both the World Bank and the IMF of encouraging poverty instead of fighting it, shifting good jobs away from industrialized nations, causing danger to wildlife and dictating austere economic policies to world governments.<sup>31</sup> A lot of projects financed by the World Bank appeared to be less than successful and often harmful instead.<sup>32</sup> The IMF on its part wasted huge amounts of money. Often money loaned by the IMF to support currencies was diverted to support political parties and or laundered (Russia, Argentina).<sup>33</sup> Quite often no strict measures were taken to restructure failing economies, and loans were never repaid.

The World Bank and the IMF took all public criticism in a recent decade very seriously, and began working on restructuring and adjusting to new demands, meeting globalization challenges with constantly improving performances, thus proving the significance, flexibility and overall importance of their work internationally. Despite difficulties, both organizations are globally expanding and all member governments continue to support the IMF and the World Bank as evidenced by their continued contributions.<sup>34</sup>

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<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

### **CHAPTER 3**

#### **THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND – CHANGING POLICIES FOR THE NEW MILLENNIUM**

##### **3.1. Overview of the Most Important Changes in General Policies for the New Millennium. Conditionality, Transparency and Accountability**

Following heavy criticism, the World Bank and the IMF worked intensively to adapt their policies to new demands. In the past few years the World Bank and the IMF have implemented a number of steps in order to right the wrongs of these two multilateral institutions and make their work and policies and procedures more transparent. With transparency the accountability of both multilateral institutions and borrowing countries might be significantly improved to avoid a misuse of international monetary funds in the future.

The World Bank in June of 2002 implemented “The World Bank Policy on Disclosure of Information”<sup>35</sup> to replace an outdated policy published in March 1994.<sup>36</sup> Historical information is publicly made available a year after its issuance.

The Policy stated that the vast majority of information must be publicly available including Articles of Agreement, By-laws of the Bank, the Bank's agreements with the United Nations and with a number of United Nations entities; Guarantee, and Development Credit Agreements, and

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<sup>35</sup> THE WORLD BANK, THE WORLD BANK POLICY ON DISCLOSURE OF INFORMATION (2002) [hereinafter POLICY ON DISCLOSURE], *available at* <http://siteresources.worldbank.org/EXTARCHIVES/Resources/DisclosurePolicy.pdf> (last visited Nov. 27, 2005).

<sup>36</sup> *Id.* at 1.

Draft Agreements prepared for negotiations. Agreements between other parties in relation to Bank-financed projects are also publicly available.<sup>37</sup>

[F]ramework Agreements between the Bank and donors and Administration Agreements between the Bank and donors relating to trust funds, as well as agreements providing for such funds between the Bank and the recipient of such funds, are all publicly available after they have been signed on behalf of the parties to the particular agreement and have entered into effect, and after the parties to such agreements have given their consent to such proposed disclosure.<sup>38</sup>

All money tranches must be presented in the form of a Tranche Release Document (TRD), which will reflect the status of the program being supported under particular operation.<sup>39</sup>

Another substantial achievement of the World Bank was approved on April 13, 2004 by the World Bank's Executive Directors, a new policy framework governing the expenditures that the Bank may or may not finance in investment lending. New Operational Policy and Bank Procedures statements, OP/BP 6.00, "Bank Financing", have been issued, and the Operational Manual revised.

[T]he new policy rests on three guiding principles: (a) that expenditures financed by the Bank need to be productive; (b) that the impact the operations financed have on the country's fiscal sustainability needs to be acceptable; and (c) that acceptable oversight arrangements, including fiduciary oversight arrangements, need to be in place to ensure that loan proceeds are used only for the purposes intended, with due attention to considerations of economy and efficiency.<sup>40</sup>

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<sup>37</sup> *Id.* at 19.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 8.

<sup>40</sup> WORLD BANK, ELIGIBILITY OF EXPENDITURES IN WORLD BANK LENDING: A NEW POLICY FRAMEWORK, <http://www1.worldbank.org/operations/eligibility/documents/March26ExpenditureEligibilityBoardPaper.pdf> (last visited Nov. 28, 2005).

The IMF on its side launched the specially designed “Standards and codes initiative.”<sup>41</sup>

[I]t was a prominent component of the efforts to strengthen the international financial architecture that were initiated in response to the emerging market crises of the 1990s. Noting the need to strengthen financial systems by such means as the adoption of best international standards, in its Communiqué of April 16, 1998, the Interim Committee called on the Fund to work with other concerned institutions and organizations responsible for the development of standards and to consider how best the Fund could assist in the dissemination of such standards to the membership and encourage members to adopt them.<sup>42</sup>

According to its own Department of the Policy Development and Review evaluation as of 2005, it is still questionable how well standards set by the IMF are met six years after adoption.<sup>43</sup>

Although the principle of conditionality in the IMF has existed since the late 80s, its importance rose significantly in the 1990s and emerged in 2000 through evaluation of the results of IMF lending to transitioning post-Soviet countries and other countries with non-market mechanisms.<sup>44</sup> The recognized principle of conditionality transitioned into the principle of Structural Conditionality (SC) with a more developed approach to meet the demands of the new era and the challenges of the new millennium and the tasks set by the United Nations for global poverty reduction. It also recognizes as fact, though indirectly, the increased, globally spread corruption brought on by the emerging countries, not excluding the Russian Federation.

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<sup>41</sup> INTERNATIONAL MONETARY FUND, COMMUNIQUÉ OF THE INTERIM COMMITTEE OF THE BOARD OF GOVERNORS OF THE INTERNATIONAL MONETARY FUND (1998), <http://www.imf.org/external/np/cm/1998/041698a.htm> (last visited Nov. 27, 2005).

<sup>42</sup> INTERNATIONAL MONETARY FUND, POLICY DEVELOPMENT AND REVIEW DEPARTMENT, THE STANDARDS AND CODES INITIATIVE—IS IT EFFECTIVE? AND HOW CAN IT BE IMPROVED?: BACKGROUND PAPER (2005), <http://www.imf.org/external/np/pp/eng/2005/070105b.htm> (last visited Nov. 27, 2005).

<sup>43</sup> *Id.* at 33.

<sup>44</sup> INTERNATIONAL MONETARY FUND, EVALUATION OF STRUCTURAL CONDITIONALITY IN IMF-SUPPORTED PROGRAMS: ISSUES PAPER FOR AN EVALUATION BY THE INDEPENDENT EVALUATION OFFICE (IEO) (2005) [hereinafter IMF SC EVALUATION], <http://www.imf.org/External/NP/ieo/2005/sc/051805.pdf> (last visited Nov. 28, 2005).

[T]he use of structural conditions also became important as the IMF increasingly recognized the importance of structural reforms for achieving more sustainable results in the areas of macroeconomic stability and better equipping economies to cope with the effects of adverse external shocks. As a result, policies such as trade reform, price liberalization and privatization became important areas of SC in programs aimed at increasing efficiency and promoting investment and growth. Strengthening the independence of central banks, reducing contingent liabilities emanating from decentralized agencies and state-owned enterprises, and strengthening the regulatory framework of the financial sector are examples of SC geared towards reducing domestic and external financial vulnerabilities.<sup>45</sup>

Those vulnerabilities, left unnamed in the IMF Evaluation of 2005, certainly include flaws in the financial and banking systems and in other features of a free market economy, including laws and regulations in Russia in 1991-2000, widespread corruption, and the extremely dangerous accumulation of debt via the IMF and other lenders.<sup>46</sup>

**[9.] Protect the Russian people from further governmental abuse of IMF lending.**

The Russian government's dangerous accumulation of debt via the International Monetary Fund and other international lenders, and the misapplication of that money through corruption within and without the Russian government, contributed to the total collapse of Russia's economy in 1998. It has also created a heavy burden of debt. The Advisory Group notes that for these reasons many reform-minded Russian officials have strongly advocated an end to further borrowing from the IMF.

The Advisory Group recommends that the United States condition any further support in the IMF of new Russian sovereign borrowing, and through its participation in the IMF Board of Governors work to condition any such lending to Russia (whether for refinancing of existing Russian debt or the extension of any new credit), on the enactment of legal reforms needed to establish a free enterprise economy in Russia, and to stem capital flight and money laundering. Among the other conditions that should be sought are an end to Russian barriers to international trade and cooperation with U.S. and other law enforcement authorities in combating money laundering.

The author of this study is a proud member of the large group of reform-minded citizens of Russia, though not mentioned in the Recommendations chapters of the Speaker's Advisory

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<sup>45</sup> *Id.* at 1.

<sup>46</sup> *Road to Corruption*, *supra* note 4, at Recommendations.

Group on Russia presentation<sup>47</sup> by officials who appealed in July 1999 at the financial session of Prime Week at the World Bank to IMF and World Bank officials to cut the pipeline of money to Russia, and to take measures to decrease the burden of external debt, which is unbearable by the ordinary Russian population, as described in subchapter 1.1. of this thesis.

Around the same time in 2000, when the House of Representatives of the 106th United States Congress became familiar with the discoveries and recommendations of the Speaker's Advisory Group on Russia, the IMF's Managing Director launched the streamlining of the conditionality principle which became the Structural Conditionality (SC) principle.

[L]argely in response to this criticism, in 2000 the Managing Director issued an interim guidance note aimed at streamlining SC in IMF-supported programs. This was followed by the issuance in 2002 of new conditionality guidelines, which stress the need for parsimony and include a test of “criticality” for any variable selected for conditionality. To be included in a program, conditions must be “critical” for the achievement of that program’s objectives. The guidelines also stress the need to seek national ownership of programs.<sup>48</sup>

In addition to The Standards and Codes initiative, The Structural Conditionality Guidelines and The World Bank Policy on Disclosure of Information policy, an external audit has been implemented to audit accounts with the World Bank and the IMF.

Part of the audit process consists of statements covering the project’s final reporting period and is normally completed after the closing date of the loan. The importance of the final audit is of such significance that the Bank sometimes will finance the costs for final audits under loans through an escrow account. If these circumstances exist, the borrower or project entity concludes a contract for the audit prior to closing date. The contract is a lump sum or a fixed price contract, and requires completion of the audit within six months after the end of the fiscal year of the final

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<sup>47</sup> *Road to Corruption*, *supra* note 4.

<sup>48</sup> IMF SC EVALUATION, *supra* note 44, at 2.

disbursement made under the loan. The borrower or project entity opens an escrow account on the terms and conditions that are acceptable to the bank into which the agreed lump sum is deposited by the Bank prior to the closing date or during the four-month extended period for the receipt of the withdrawal applications.

It is important to note that if the Bank does not receive an acceptable audit report by the due date, the borrower will be requested to repay the amount advanced into the escrow account for the audit to the Bank.<sup>49</sup> More important is the fact that despite the external audit requirement there is no sufficient mechanism offered so far for repatriation of embezzled funds of the loans servicing specific programs from the receiving members' countries. Only a mechanism for returning money for audit has been developed by the Bank so far.

Another challenge for the World Bank and the IMF in the last decade of the twentieth century on the verge of a new Millennium was to discover, admit and later adopt an entirely new philosophy of relations with emerging economies. Although the World Bank and the IMF have had some experience with financing legal reforms and judiciary reforms, for instance in the U.S. in 1970-1990, it had never before done so for emerging post-Soviet countries. Therefore at an early stage, in the beginning of the 90s, the World Bank and the IMF initially used the same approach and techniques as before without adjusting to the new demands. Only by the end of the 1990s after a number of significant failures of different projects, the World Bank and the IMF began paying more attention to substantial differences in philosophy of financing and their policy implementation in emerging market economies.

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<sup>49</sup> WORLD BANK, OPERATIONAL MANUAL.

Thus, the development of a massive internal market in private capital has transformed the World Bank's and IMF's relationship with both advanced economies and emerging markets in the period surrounding the early 90s. The United Kingdom and Italy borrowed from the IMF in 1976-1977, the last time that an industrial country sought financial support. With fewer industrial countries needing to borrow money, it freed up some funds that could be allocated for developing or emerging countries.

The emergence of large international capital flows has transformed the IMF and the World Bank relationship with emerging markets. This first began in the 1980s debt crisis, when much of Latin America was affected by reckless borrowing and unwise lending. Turbulence in international capital markets hit Mexico, the major Asian economies; Russia, Turkey, Brazil, and Argentina in the 1990s, and the IMF came to their rescue. The first events happened in conjunction with others, and more recently they were single-country events.<sup>50</sup>

It was widely thought that America held all the cards when it came to controlling the World Bank and the IMF. That is not true, however, because the United States only has about 17% of the total voting power while the IMF's shareholders are 184 member countries. Most IMF decisions reflect a consensus as opposed to a formal vote of the IMF's Executive Board, which is the body that makes the institution's day-to-day decisions. While legally most decisions require only a simple majority of 51%, in practice, almost all the decisions in the IMF get broad support, indicating that if a vote were held, the majority would be much higher.

Some of the most important decisions, such as increasing the size of the IMF's resources or determining changes on borrowings from the Fund, require a 70% or 85% majority. Clearly it is possible for the United States and/or a coalition of industrial countries to veto such decisions. A

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<sup>50</sup> Globalization Address, *supra* note 21.

block of developing countries could also veto decisions because they represent approximately 37% of the voting power in the Executive Board.<sup>51</sup>

Rodrigo de Rato, present Managing Director of the International Monetary Fund, said that the IMF needs to deepen its work on low-income countries.<sup>52</sup> Those countries need macroeconomic policy advice from the Fund and they often need financial support from the Fund. The IMF for its part is trying to be fair in its lending as well as voting by seeking consensus.

Over the past sixty years the IMF has grown from a small fund servicing the purpose of free trade and currency free exchange flow to one that is nearly global in size as well as in objectives. It has strong backers and supports countries throughout the world. So does the World Bank.

Mr. De Rato highlighted in his speech on October 20, 2005 in Barcelona, Spain that the history of IMF is a great one and it will only improve. With the improvement, however, the IMF must learn to adapt, as well as evolve with the changing financial world.

“Like a great city it [IMF] has grown and changed, and matured. My goal is to persuade the members of the institution that we need to manage the process of change, not resist it, and to make the institution ready for the challenges of the next five to ten years, while preserving the strength and flexibility that will allow my successors to manage the Fund’s adaptation over the next 50 years.”<sup>53</sup>

### **3.2. History and Dynamics of Relations with the Soviet Union and Russia**

The Soviet Union applied for membership in the IMF and four organizations of the World Bank Group; the International Bank for Reconstruction and Development, the International

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<sup>51</sup> INTERNATIONAL MONETARY FUND, A FACTSHEET: IMF QUOTAS, <http://www.imf.org/external/np/exr/facts/quotas.htm> (last visited Nov. 27, 2005).

<sup>52</sup> Globalization Address, *supra* note 21.

<sup>53</sup> *Id.*

Finance Corporation, the International Development Association, and the Multilateral Investment Guarantee Agency in July of 1991.

A month later, in August, the World Bank's executive directors approved the creation of a special \$50 million trust fund for technical cooperation in providing technical support for economic reforms in the former Soviet Union.

In November of that same year, the World Bank President Lewis T. Preston paid an official visit to the former Soviet Union and newly independent Russia, and the sides signed an agreement on technical cooperation between the Bank and the Soviet government. Russia was one of the four ex-Soviet republics that agreed to participate in the work of the Bank.

In the fall of 1991 the World Bank opened its temporary office in Moscow. On January 7, 1992 the Russian Federation Government applied for membership in the IMF and the World Bank Group. Russia joined these organizations in June of 1992.

The Bank opened a permanent office in Moscow in early 1993. It currently employs about 70 people, mainly Russian citizens. Showing signs of permanency in the country allowed trust in the Bank to grow. With the Soviet Union in the past, Russia was still growing into what it would become. The presence of the World Bank in the Russian Federation was a positive step for the Bank as well as citizens of Russia. However, it was very controversial.

In June of the same year, 1993, the Bank organized a multilateral meeting in Paris to discuss priority reforms in Russia as well as to coordinate external aid related to them.

The World Bank President Lewis T. Preston at that time paid a three-day visit to the Russian Federation. The focus of the visit was on the energy, financial, social, and agricultural sectors of the Russian economy in addition on Bank's possible assistance in the country's transition to a market economy "While the benefits of rapid economic growth are visible in Russia, economic

growth has been uneven, and poor regions and segments of the population have fallen further behind. Almost 20% of Russia's population lives below the poverty line.”<sup>54</sup>

James D. Wolfensohn, was the President of the World Bank from January 1, 1995 until May 31, 2005. In October of 1995 he made his first visit to Russia and made official visits to the country every year thereafter.<sup>55</sup>

The IMF and the World Bank, using their knowledge, expertise and discretion, were and still are trying their best to help Russia in transition toward a free market economy and an open society, as well as to get Russia out of poverty. While trying to do what was best for the country, the World Bank and the IMF became involuntary accomplices to Russian money laundering, the development of corruption and the blossoming of organized crime. It is imperative to acknowledge that while some international financial institutions such as the IMF and the World Bank are trying to do their best for the country and the global community, the community must be leery of fraud, corruption, money laundering and misuse of international loans and grants.

Today, on the edge of 2006 and after nearly 15 years of perestroika and glasnost, Russia is still in deep indebtedness despite of abundant natural resources and sharply increased prices for crude oil and gas, which are very favorable for the Russian economy.<sup>56</sup> Russia is now a dying country as population size is permanently declining (total deaths by all causes from 1216 per

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<sup>54</sup> THE WORLD BANK, RUSSIAN FEDERATION: TEN THINGS YOU NEVER KNEW ABOUT THE WORLD BANK IN RUSSIA, <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/RUSSIANFEDERATIONEXTN/0,,contentMDK:20251181~menuPK:517710~pagePK:1497618~piPK:217854~theSitePK:305600,00.html> (last visited Nov. 27, 2005).

<sup>55</sup> Globalization Address, *supra* note 21.

<sup>56</sup> See OIL ALLOCATIONS REPORT, *supra* note 1.

every 100,000 citizens in 1992 increased to 1598 deaths per every 100,000 in 2004)<sup>57</sup>, but the poverty level remains the same (average income per capita is lower than US\$90 per month).<sup>58</sup> Russia is still recognized by the global community as an emerging market economy.<sup>59</sup> It is closing the doors to transparency, a free and independent press, journalism and mass-media.<sup>60</sup> Russia is now changing democratic laws previously permitting election of local officials and Governors of Regions by direct vote of the local electorate toward appointment by the President<sup>61</sup> (could you even imagine for a minute that the Governor of Georgia, Florida, New Jersey or any other state would be appointed by the President of the United States?). Today, Russia is undoing privatization of some of the most key formerly privately owned companies, Yukos for example, and turning these companies into state-owned enterprises.<sup>62</sup>

Very legitimate questions are arising: are the reforms working? Is the money loaned to Russia by the World Bank and the IMF serving the intended purposes?

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<sup>57</sup> FEDERAL STATE STATISTIC SERVICE, DEATH RATES BY MAIN CLASSES OF CAUSES OF DEATH, [http://www.gks.ru/bgd/regl/b05\\_12/IssWWW.exe/Stg/d000/05-07.htm](http://www.gks.ru/bgd/regl/b05_12/IssWWW.exe/Stg/d000/05-07.htm) (last visited Nov. 27, 2005).

<sup>58</sup> FEDERAL STATE STATISTIC SERVICE, SUBSISTENCE MINIMUM LEVEL, [http://www.gks.ru/bgd/regl/b05\\_12/IssWWW.exe/Stg/d000/07-13.htm](http://www.gks.ru/bgd/regl/b05_12/IssWWW.exe/Stg/d000/07-13.htm) (last visited Nov. 27, 2005).

<sup>59</sup> INTERNATIONAL MONETARY FUND, RUSSIAN FEDERATION: SELECTED ISSUES (2005), available at <http://www.imf.org/external/pubs/ft/scr/2005/cr05379.pdf> (last visited Nov. 27, 2005).

<sup>60</sup> Joscelyn Jurich, *Evolution of Russia, Ex-Communist Media Examined*, OVERSEAS PRESS CLUB OF AMERICA, available at [http://www.opcofamerica.org/press\\_freedom/articles/110705\\_russiaevolution.php](http://www.opcofamerica.org/press_freedom/articles/110705_russiaevolution.php) (last visited Nov. 27, 2005).

<sup>61</sup> Nikolay Petrov, *Putin's Reforms Are Dangerous for Russia*, THE MOSCOW TIMES, Sept. 15, 2004, available at <http://www.themoscowtimes.com/stories/2004/09/15/006.html>.

<sup>62</sup> See generally Yukos Minority Shareholder Coalition, <http://www.yukosshareholdercoalition.com>.

### **3.3. Overview of the Role of The World Bank and The IMF in Legal Reform in Russia in 1992-2000**

Whatever project the World Bank now undertakes, whether with the aim of economic development, environmental protection or health, one way or another some elements of legal reform will be present. It may be in the form of collaborating with the legislative branch of the country to whom the loan is issued, to amend the laws or to improve them or to draft entirely new legislation with the precise purpose of better achieving goals of the financed project. Moreover, both international financial institutions, the World Bank and the IMF, are now themselves the objects of general or legislative reforms to meet the rapidly changing requirements of today's rapidly changing world trends.

Legal and judicial reform may include, but are not limited to: amending a country's laws to improve the business environment and improve the investment climate, harmonizing laws for internal consistency, adapting law to contemporary conditions, or solving the problem of finding means of legal enforcement of existing as well as new laws and regulations. It is imperative for any country's economic growth to have an effective legal system which promotes development by protecting persons' rights and their property, allowing peaceful and civilized (as opposed to racketeering, extortion, corruption, money laundering and violent) resolution of disputes, facilitating economic exchange, and letting citizens hold their government accountable.<sup>63</sup>

Since the role of the IMF is to provide short-term and very specialized financial assistance to fix monetary, budgetary and currency exchange problems in the borrower-country, the IMF didn't emphasize any legal reform issues with Russia, or momentarily scrutinize the existing

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<sup>63</sup> For more information, *see generally* THE WORLD BANK GROUP, LEGAL INSTITUTIONS OF THE MARKET ECONOMY, <http://www1.worldbank.org/publicsector/legal/index.cfm>.

legal environment since Russia joined the IMF in 1992. Obviously that was a very shortsighted policy. In such unique circumstances as Russia faced after the collapse of communism, it was very reckless of anyone to rely on the country's existing laws. Here the World Bank stepped in, although the initiative itself did not come from the World Bank. From the collapse of the Soviet Union in 1991 until 1996, the World Bank was not involved in financing any legal projects or reforms in Russia. The Russian legal reform project by the World Bank began in 1996 following a request from the Russian Government.<sup>64</sup>

This clearly indicates that the IMF and the World Bank, while financing numerous projects to one of the most powerful countries in transition in the world, did not pay much-needed attention to reform of the legal climate in Russia. The analogy is to allowing powerful, speedy cars and big trucks on the streets of New York City with all the traffic lights off, no stop signs or other traffic signs, and in addition allowing traffic in both directions on all the streets and avenues. The same dangerous lack of internal regulations existed in the link among the World Bank, the IMF and Russia. Huge amounts of money had been allocated to the country where there was no economically and commercially workable civil legal system, or the existing legal system never in its history served the ideology and purposes of an open market society.

While facing this new dilemma, it must be recognized that for about two decades the World Bank was working on different legal projects in many countries.<sup>65</sup> Some of them failed, some

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<sup>64</sup> For a detailed analysis of the legal reform project financed by the World Bank in Russia, *see* Monika Borbely et al., Project Report on the Role of Foreign Aid for Legal Reform Programs in the Russian Federation, Woodrow Wilson School of Public and International Affairs, Princeton University (Jan.1999), *available at* <http://www1.worldbank.org/publicsector/legal/projectreport.pdf> (last visited Nov. 27, 2005) [hereinafter Princeton Project Report].

<sup>65</sup> *See id.* at 58.

had reasonable support. However, the legal project in Russia appeared to be one of the largest (the Bank committed US\$58 million), as well as one of the most unusual and difficult for international donors.<sup>66</sup>

Acknowledging the importance of sound judicial systems to good governance and economic growth all over the world, the World Bank and several other donor organizations have funded judicial reform projects in more than two dozen developing countries and transition economies during the last two decades. Yet little is still known about the actual effect of judicial reform on economic performance or even about what elements constitute a sound reform project.<sup>67</sup>

Thus extensive experience and the less-than-successful results of judicial reform initiatives in such countries as Bangladesh, India, and Argentina<sup>68</sup> should have served as warning signs to the World Bank to provide more reasonable safeguards for itself in its activities with the Russian Federation in 1996.

Indeed, there are numerous points on which the World Bank should be heavily criticized in regard to the legal reforms in Russia. However, the scale of the reforms and initiatives launched by the World Bank in Russia as the unique field of their implementation is enormous.

The main objectives of the project launched in Russia by the World Bank in 1996 include: improving the quality of drafting of economic laws; improving the classification and codification of legislation to increase access to legal information; improving legal education through new

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<sup>66</sup> *Id.* at 59.

<sup>67</sup> Richard E. Messick, *Judicial Reform and Economic Development: A Survey of the Issues*, 14 WORLD BANK RES. OBSERVER 117, 117-36 (1999), available at <http://www.worldbank.org/research/journals/wbro/obsfeb99/pdf/article6.pdf>. (last visited Nov. 14, 2005)

<sup>68</sup> Richard E. Messick, *International Support for Civil Justice Reform in Developing and Transition Countries: An Overview and Evaluation* (2000), available at <http://www1.worldbank.org/publicsector/legal/donorsupported.doc> (last visited Nov. 27, 2005).

books, teaching materials, and teacher training, especially in economic law fields; and training of judges in the courts of general jurisdiction and arbitration courts.<sup>69</sup>

Indeed, a huge number of other closely related issues were left out, not ignored but underestimated. One example is legal empowerment or legal enforcement. Legal education and training of lawyers and judges would not work without powerful, widespread education of the population, mass media coverage, community workshops, and enhancement of police and other law enforcement. Without effective mechanisms of legal enforcement covering all aspects of legal and judicial reforms, etc., each and every good governing law will become worthless. On the other hand Russian cultural and historical ignorance toward the rule of law was obvious and hard not to acknowledge at the beginning of the 90s, as there was no law under the Soviet Union in its civilized meaning as it exists in an open market society.

To implement its legal reform project in Russia, the World Bank decided to act via a specially created non-governmental organization, the Russian Foundation for Legal Reform (RFLR).<sup>70</sup> This non-governmental organization RFLR was founded in Russia in April 1996 in accordance with the President of the Russian Federation's Decree No.81 of 22.02.1996. The founders were the Administration of the President of the Russian Federation, the Ministry of Finance, the Ministry of Justice, the Federal Commission on Securities and the Stock Market of the Russian Federation Federal Government, and the Russian Academy of Science.<sup>71</sup> The initial

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<sup>69</sup> Princeton Project Report, *supra* note 64, at 20.

<sup>70</sup> *Id.*

<sup>71</sup> FAR EAST CENTER OF ECONOMIC EDUCATION, RUSSIAN FOUNDATION FOR LEGAL REFORM, <http://www.fecee.vladivostok.ru/FECEE/rflr.htm> (last visited Nov. 27, 2005).

existence of this organization was solely based on the loan from the World Bank requested by the Russian government, which, indeed was expected to be repaid, and had changed over time.<sup>72</sup>

The World Bank itself believed that the Russian government had the full intention of repaying the loan, and thought that by borrowing versus receiving money in the form of a grant or aid, the government would be more interested in participating fully to achieve the designated goals of legal and judiciary reforms.

A summary of the World Bank legal reform project in Russia is presented in Table 1.<sup>73</sup>

Indeed, the legal reform project in Russia became a challenge for the World Bank: the size of the country, political instability and uncertainties accompanying the transitioning economy, the rush for any countable results to prove the success of reforms due to the political issue of President Boris Yeltsin's coming re-election campaign in 1996,<sup>74</sup> all might be seen as flaws in the World Bank's policy implementation.

Not surprisingly, only 20% of all money directed toward legal reform in Russia from the World Bank was disbursed and utilized between launching the project in 1996 and reporting in 1999.<sup>75</sup> The graphic description of disbursement is presented in Figure 1.

It was expected that the remaining 80% of funding must be disbursed by the end of the four-year project.

It has been noted that by acting through RFLR, a Russian-created and Russian-based organization, the World Bank achieved a goal of direct representation of the interests of Russian

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<sup>72</sup> Princeton Project Report, *supra* note 64, at 62.

<sup>73</sup> *Id.* at 60. *See infra* Table 1.

<sup>74</sup> *Id.* at 66-67.

<sup>75</sup> *Id.* at 20, 68-69. *See infra* Figure 1.

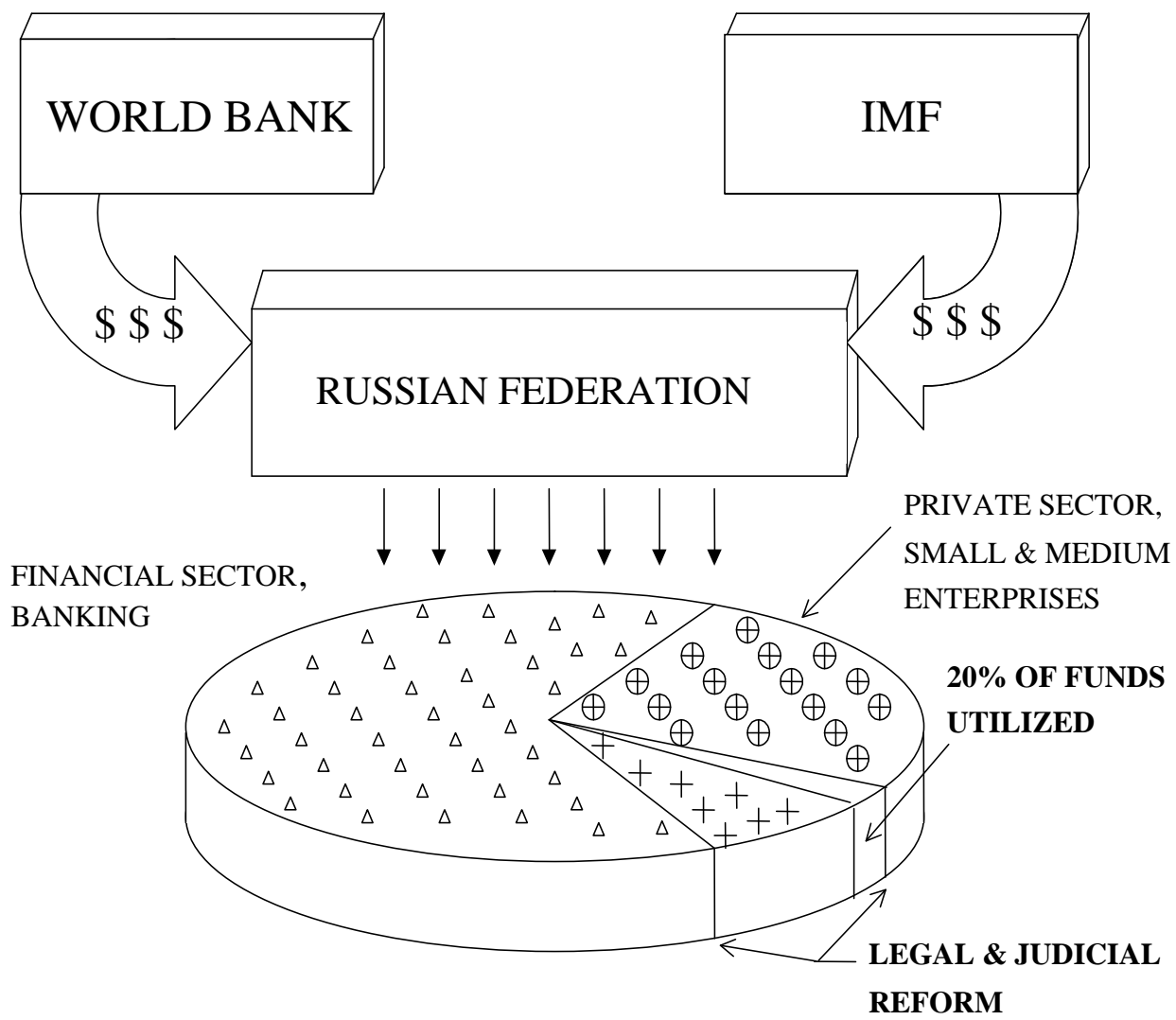
citizens and the Russian government in moving forward legal reform in Russia.<sup>76</sup> However, the direct link of RFLR to the Russian government on the other hand increased the influence of the World Bank on the Russian government via legal means. In this case, if the Russian government did misuse and misplace part of the international aid and loan from the World Bank, it is certainly as much the fault of the World Bank as of the Russian Government. And it should be a duty of the World Bank, as well as an urgent agenda priority, to develop mechanisms for repatriation of embezzled funds, perhaps through improvement in the World Bank's by-laws and internal regulations.

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<sup>76</sup> *Id.* at 71-72.

**Table 1: Summary of the World Bank Project Description in Russia, May 1996.**

<b>Project Name</b>	<b>Description</b>	<b>Budget (US\$ million)</b>
Legislative Drafting	<ul style="list-style-type: none"> <li>• Improve the quality of drafting of economic laws, decrees and regulations;</li> <li>• Assist the Government of Russia in analyzing federal/regional and federal interagency coordination in drafting laws and regulations;</li> <li>• On a pilot basis, to improve legislative drafting at the regional level.</li> </ul>	<b>20.0</b>
Legal Information	<ul style="list-style-type: none"> <li>• Designing the appropriate classification of legislation and identifying the appropriate method of codifying Russian legislation;</li> <li>• Determining the appropriate scope and framework, as well as levels of public investment in the systems for collection, organization and dissemination of legal information.</li> </ul>	<b>24.8</b>
Legal Education	<ul style="list-style-type: none"> <li>• Introduce innovative teaching methods and materials, increase exchange between legal academia and practice and improve teacher training;</li> <li>• Improve public awareness and understanding of the role of law in a market economy.</li> </ul>	<b>20.0</b>
Judicial Reform	<ul style="list-style-type: none"> <li>• Improve the quality of judicial training;</li> <li>• Assist in analyzing impediments of effective court administration and case management;</li> <li>• Assist the development of consensus for necessary structural reform;</li> <li>• Promote the development of Alternative Dispute resolution (ADR)</li> </ul>	<b>10.4</b>
Other	<ul style="list-style-type: none"> <li>• Other priority activities, agreed upon between the Borrower and the World Bank</li> </ul>	<b>3.0</b>



**Fig. 1. Disbursement of International Funds from the World Bank and the International Monetary Fund to the Russian Federation in 1996-1999.**

## **CHAPTER 4**

### **THE ROLE OF THE U.S. IN THE LINK OF THE WORLD BANK, THE INTERNATIONAL MONETARY FUND AND RUSSIA**

The United States of America since the date of creation of the International Monetary Fund (IMF) and the World Bank in 1945 was and still is the most powerful contributor to their monetary funding. It was previously mentioned that the U.S. has had one-third of the voting power. Today the U.S. holds 17 percent of the voting power. Based on the charters<sup>77</sup> of those international financial institutions, the largest donor has the most voting power. Although, decisions are made based on a consensus of all members, the largest contributor to a certain extent is capable of influencing the final decision of the Board of Directors of the IMF or the Executive Board of the World Bank. This influence may lead to the decisions and actions performed by the World Bank and the IMF, which later would be recognized not only by the specific country, but also by the international community and even by the institutions themselves as flaws or even failures in policies, laws and economic achievements.

Thus, in 2000, when Russia was on its way to electing a new president, the Speaker of the House of Representatives of the 106th U.S. Congress launched a wide and deep investigation to assess the results of the U.S. policy toward Russia during the Yeltsin years. The result of this effort produced the most comprehensive, honest and detailed report on the U.S. policy flaws with regard to Russia ever. Six committees of the House of Representatives became involved in this investigation and assessment.<sup>78</sup>

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<sup>77</sup> Articles, *supra* note 17.

<sup>78</sup> *Road to Corruption*, *supra* note 4.

“The Speaker's Advisory Group on Russia comprises the Chairmen of the Committees on Armed Services, Appropriations, Banking, Intelligence, and International Relations, as well as the House Vice Chairman of the Joint Economic Committee, and additional members of the House leadership and the committees of jurisdiction.”<sup>79</sup>

The results of the investigation completed by September 2000 thoroughly describe a huge number of flaws and failures of the U.S. Administration toward transitioning Russia. They also reveal what kind of damage had been done through the U.S. policy toward Russia as a trading partner and influential nuclear counterpart, leading to a world more threatened by Russian weakness than strength.<sup>80</sup>

[R]eport begins with a summary of the historic events that led to the collapse of the Soviet Union in December 1991 and a description of the conditions in Russia during the last year of the Bush administration and at the commencement of the Clinton administration. It assesses the task ahead for Russia in moving from a century of state control to a free enterprise democracy, and compares that agenda with the actual policies pursued by the Clinton administration from 1993 to the present. The manifold failures of both Russian and U.S. government policy are surveyed: the early corruption of the non-market "privatization" to insiders; the spread of organized crime; the eventual complete collapse of the Russian economy in 1998; the rise of weapons proliferation as a means of generating hard currency; and the increasing estrangement of Russia from the United States, essentially reversing the trends that existed in 1992.<sup>81</sup>

The U.S. is, indeed, the largest donor to the IMF and the World Bank. Without its pressure and in particular that of Vice President Al Gore, the World Bank and the IMF would not be in a position to give as much money to Russia as they did during the Clinton Administration. The report revealed that Vice President Al Gore insisted and pressured the World Bank and the IMF

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<sup>79</sup> *Id.* at Introduction.

<sup>80</sup> *Id.* at Recommendations.

to continue issuing loans even as the circumstances made clear that Russia was on the edge of default. Creation of the Gore-Talbot-Summers troika<sup>82</sup> vested authority for the development and execution of American policy toward Russia in an elite and uniquely insular policy-making group without accountability to the normal checks and balances within the executive branch.<sup>83</sup>

In the past decade Russian organized crime's threat to the world has become universally acknowledged. A report recently completed by the Center for Strategic and International Studies quotes FBI Director Louis French summarizing the importance of these concerns by "Stat[ing] bluntly that the ROC (Russian Organized Crime) is the greatest long-term threat to the security of the United States". The study concluded that "the impact of ROC on the future stability of democratic Russia is the key threat for the United States". A second serious threat is the transnational activities of ROC in Cyprus, the Caribbean Islands, and other offshore banking centers the world over.<sup>84</sup>

Another threat is represented by the corrupt individuals not only in Russia but in the U.S. Thus, Arthur Christy, former U.S. Attorney, is a key figure in the Bank of New York scandal being employed by the Russian Incombank as a lawyer who helped the bank in money laundering schemes.<sup>85</sup>

The Clinton administration ensured that billions in Western economic assistance to Russia would amount to more temporizing. The trio's focus was on micromanagement of the Russian economy instead of the legal fundamentals that would permit individuals to start their own

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<sup>81</sup> *Id.* at Executive Summary.

<sup>82</sup> *Id.* at ch. 4.

<sup>83</sup> *Id.*

<sup>84</sup> RUSSIAN LAW INSTITUTE, U.S. LAWYERS HIRED AS SPIN DOCTORS FOR RUSSIAN MOBS, <http://www.russianlaw.org/004.htm> and <http://www.russianlaw.org/crisis.htm> (last visited Nov. 28, 2005) [hereinafter U.S. LAWYERS FOR RUSSIAN MOBS].

<sup>85</sup> *Id.*

businesses, grow a competitive market, and create a tax base, thus dooming their ‘privatization’ efforts to failure.<sup>86</sup>

With massive lending and aid to plug the gap in the Russian central government’s operating budget, the funds were exposed to theft and fraud. The amount of loans from the U.S., the World Bank and the European Bank for Reconstruction and Development added to Russia’s enormously growing foreign debt, which continued to burden the central government’s operating budget and weigh down the nation’s economic prospects, as presented in Table 2.<sup>87</sup>

New policies of the World Bank and the IMF in the new millennium requiring pure transparency of information allow anyone to locate, not only on paper in highly specialized publications, but also over the World Wide Web the easily accessed, high-level information, thus increasing the accountability of the multilateral institutions and sovereign governments. For instance, it is easy now to find out through widely accessible sources that the most significant amount of hard currency funds equaling US\$4.6 billion was disbursed to the Russian Federation by the IMF in 1998; as much as US\$3,594,250,000 in 1995 and US\$2,687,861,200 in 1996 respectively. From 2000 until 2005 no extra loans were issued. However, some restructuring has been made.<sup>88</sup>

The overwhelming bulk of the money disbursed as a loan to the Russian Federation was hidden offshore by the Russian Government, corrupt officials and politicians, mainly in banks on the Channel Islands (UK territory) and Virgin Islands (U.S. territory), and also in Cyprus

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<sup>86</sup> *Road to Corruption, supra* note 4.

<sup>87</sup> *Id.* at. ch. 4, *See* U.S. Financial Aid to Russia (2000) from IMF Summary of Disbursement and payments. FY 1999 Annual Report (January 2000). *See also infra* Table 2.

<sup>88</sup> *See* INTERNATIONAL MONETARY FUND, RUSSIAN FEDERATION: TRANSACTIONS WITH THE FUND FROM MAY 01, 1984 TO OCTOBER 31, 2005, <http://www.imf.org/external/country/RUS/index.htm> [hereinafter IMF TRANSACTIONS].

(Independent) while Russia suffered from the vacuum of appropriate legislature, a weak judiciary, and corrupted law enforcement.

At the turn of the millennium neither the World Bank nor the IMF was fully exercising its influence by seeking the support and collaboration of other institutional members to develop and improve institutional internal rules, by-laws and procedures for lending.

While the American public was entertained by the scandal of President Clinton and Ms. Monica Lewinsky, the so-called 'Troika' (Gore-Talbot-Summers) was working very hard to create future explicit dangers for that public by giving birth to the Russian mobster and monster, corrupted from the very top to the very bottom, from the Government and legislators down into the streets. In this long ladder so many did not hesitate to sell tons of nuclear materials overseas, top military and technological secrets and even parts of ballistic missiles, tanks and submarines, at times just to provide food and minimum necessities for families and children, rather than to put billions of dollars into offshore banks accounts.

The findings of the Speakers' Advisory Group on Russia are astonishing and deserve to be reviewed again after the 5<sup>th</sup> anniversary of the presentation.<sup>89</sup> The conclusions clearly reveal the present and prospective threat to the U.S. security, requiring continuing close and direct attention from the U.S. President to policy toward Russia. Unfortunately, the present Administration is again unable to pay adequate attention on the necessary scale to these matters of mutual interest. President George W. Bush began his first term by becoming immediately preoccupied, in a manner which has become continuous, with numerous entirely different issues: the war on terrorism, the war in Iraq, the chain of unfortunate hurricanes, Social Security Reform and Enron and other corporate scandals which have shaken America. The President's attention is divided and he does not have the time to allot to Russia's strife. Once again, the U.S. is missing out on a

crucial time for relations with Russia. The U.S. is about to lose another golden opportunity to solidify relations between the U.S. and Russia, especially with the prospective election of a new president of Russia. The only saving grace is that President George W. Bush and President Vladimir Putin have somehow a personal sympathy toward each other, perhaps as the biggest holders of petroleum assets and as members of an oil fraternity, Bush from Texas, Putin from Russia, rich with oil as well.

Before 2000 70% of Russians held a favorable view of the U.S.; only 37% hold such views today. More than 80% of Russians polled by the U.S. government in 2000 thought that the U.S. was seeking to weaken Russia, while a staggering 85% believed that the U.S. sought world domination.<sup>90</sup>

Although the Russians' view of America has declined, it was still wavering back when President Clinton was in office. CIA officials had described the information concerning Chernomyrdin that was provided to Vice President Al Gore as "more detailed and conclusive than allegations of bribery and insider dealing that have been made in the Russian media and elsewhere." Yet, when asked in 2000, whether or not Chernomyrdin is corrupted, Gore replied, "I have no idea."<sup>91</sup>

There was a seriously negative consequence to Russia's battle against organized crime, corruption, wrongful privatization, and money laundering, along with the Clinton administration's failed economic strategy for Russia and its tight embrace of corrupt officials including the aforementioned Chernomyrdin, as well as Chubise'.<sup>92</sup>

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<sup>89</sup> *Road to Corruption*, *supra* note 4.

<sup>90</sup> *Id.* at Executive Summary.

<sup>91</sup> *Id.* at ch. 4.

<sup>92</sup> *Id.*

Russian Organized Crime (ROC) became responsible not only for grisly mayhem and violence in all walks of society including politicians (Galina Starovoitova, a former member of Parliament of very rare reputation, very well respected by the electorate, she became a threat to a male dominated environment in the Russian governmental hierarchy and was shot to death by a hit man on November 20, 1998), journalists (Vladislav Listiev, a very well-recognized journalist, was shot by a hit man on March 3, 1995), but also for ordinary street gangsters who could kill just for fun or to extort a hundred dollars. ROC also took on functions as diverse as enforcing contracts and court judgments, providing personal security and channeling bribes from corrupt officials for scarce resources.<sup>93</sup>

Because of the failure to focus full attention on replacing Communism from the very beginning of perestroika with the basic legal elements of the free enterprise system, conditions allowed organized crime, corruption, violence, and money laundering to flourish. Without the essentials such as legislated protections for private property, a modern commercial code and honest, efficient and speedy courts to enforce property rights, the 'privatization' of government entities in Russia predictably resulted in chaos.<sup>94</sup>

It is understandable that it was practically impossible for America to be able to reach out to Russia as an ally on all issues, but if legislators, lawyers, the judiciary and the general public were educated with western values of strong law, the power of legal knowledge would help significantly to prevent trouble, and it would help the U.S. in the future regardless of who comes to power after Putin. Putin is not going for an unconstitutional third term, as he stated recently in October 2005. He will be reelected in 2008. Until 2008 the U.S. must pay extremely serious

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<sup>93</sup> Vagiph Guseinov, *Ot Yeltsina k...? Chronika Tainoi Bor'bi* [From Yeltsin to...? The Chronicle of hidden fight] (1999) (Russ.).

<sup>94</sup> *Road to Corruption*, *supra* note 4.

attention to relations with Russia in order not to lose a second time within a decade the golden chance to turn Russia into an open society once and for all<sup>95</sup>.

Russia is still in the throes of organized crime, and the recovery has not happened yet:

Top Russian public officials openly acknowledge the problem of the organized crime takeover of the Russian economy.<sup>96</sup>

Former Russian Minister of Internal Security Kulikov admitted that he saw no solution to the problem of mafia control over the Russian banks except the re-nationalization of privately owned banks. In 1994, Russian Tax Police officer Major Gromov told the Conference of the Financial Crime Enforcement Network that “almost all Russian banks are corrupt.” Yeltsin himself called his own country “the biggest mafia state in the world, the super power of crime that is devastating the state from top to bottom.”<sup>97</sup>

What sets the Russian mafia apart from others is its unique sophistication and understanding of the system and its ability to manipulate it via the use of the U.S. power brokers such as “political” law firms, major accounting firms, commercial and investment banks, political lobbyists and prominent public relations figures.<sup>98</sup>

The Clinton administration, by its own admission, said that it gave insufficient attention and priority to Russian money laundering. The Bank of New York scandal mentioned above, which involved the laundering of as much as \$10 billion total, is a clear example. The Bank of New York scandal is directly related to Inkombank’s dirty operations. Inkombank was one of Russia’s top ten banks, and has been the focus of media attention in 1998-2000. It is believed to be linked

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<sup>95</sup> *Id.*

<sup>96</sup> See U.S. LAWYERS FOR RUSSIAN MOBS, *supra* note 84.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

to Russian and international organized crime syndicates not only in the United States but in Australia and a number of other countries also.<sup>99</sup>

The source goes on to say that the report concluded that “via use of various bookkeeping machinations” attempts were made to conceal losses amounting to 998.2 billion rubles (approximately \$200 million in US funds), and retained earnings were also inflated by 1.35 rubles (\$250 million in US funds). The report concluded that Inkombank was virtually insolvent largely due to bad loans to ‘questionable entities.’ Read: Russian mafia within the country.<sup>100</sup>

It is obvious that while the US was trying to help Russia out, in some ways it hurt it as well. With its well-meaning loans and help, it also aided in the organized crime and external debt of the Russian nation. The Clinton Administration was somewhat aloof when it came to admitting how much it knew about how the money was being used. Spokespersons put a spin on it to make it appear as though there was no threat to the U.S..<sup>101</sup>

The Bush Administration has been worse, because worse than doing something improperly is doing nothing. Bush’s attention now lies elsewhere, as he is focused on the war in Iraq, the hurricanes, and the possibility of his vice president being indicted on a CIA leak.

The Report concluded that U.S. - Russia relations must be the biggest priority of the President.<sup>102</sup> It is imperative that Mr. George W. Bush’s Administration emphasize this aspect of its external policy and use its power at the World Bank and the International Monetary Fund (IMF) to promote broad financial assistance to Russia, not only in economic and financial issues but also in much greater measure for strengthening the power of the legal system and legal enforcement in Russia to build a solid base for a democratic future of its ally in a war on terror.

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<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> *See Road to Corruption, supra* note 4.

<sup>102</sup> *Id.*

Lending practices that have improved greatly within last few years and the transparency, conditionality and accountability principles governing the World Bank's and the International Monetary Fund's (IMF) daily activities could be very well used to achieve the aim and to satisfy the U.S. as well as global interest in a strong market- and democracy-oriented Russia with a stable legal system.

It is imperative by all means to help Russian citizens to understand that the U.S. being the most well-developed democracy on the globe was not seeking to weaken Russia. To the contrary, the U.S. was capable of recognizing its own flaws and admitting failures in its own policy for dealing with the corrupted Russian Government and the increasing debt of the Russian nation to the international community. It was able honestly to assess all the negatives and to make crucial steps toward correcting wrongdoings not only in U.S. policy but also in its influence on the policy of the World Bank and the IMF. The legislative branch of the U.S. fulfilled its commitment, and the irrational lending to Russia was interrupted in 2000. See Table 3.<sup>103</sup>

Such transparent accountability of the American Government and its legislative branch in particular is not yet achievable in Russia, while the country is leaning toward strong Presidential power versus American Federalism with its historically tested system of check and balances.

This chapter will not be concluded properly without mentioning that besides loans from the World Bank and the IMF, the U.S. and a number of American donors made a significant contribution to the establishment and development of legal and judicial reforms in Russia. The U.S. Agency for International Development (USAID) is funded by the U.S. Congress, and it has been one of the most important donors and supporters of legal reform in Russia.<sup>104</sup> However the majority of its grants and contracts are going directly to American firms and non-government

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<sup>103</sup> See IMF TRANSACTIONS, *supra* note 88. See also *infra* Table 3.

<sup>104</sup> Princeton Project Report, *supra* note 64.

organizations (NGOs).<sup>105</sup> The Agency recognizes that while only 10 years ago the modern legal system in Russia was virtually non-existent, the framework of the modern judiciary is largely in place today.<sup>106</sup> The list of intermediate U.S. contractors includes:

- ARLI - the American Russian Law Institute Inc., a not-for-profit organization;<sup>107</sup>
- HID - Harvard Institute for International Development, which itself while using US\$30 million from USAID to consult to Russians on privatization, tax and legal issues became involved in the corruption scandal related to oil money and is now being sued by the American Government;<sup>108</sup>
- ARD/Checchi- Rural Development Institute, an Institute of land law and policy, also financed by USAID , and who provided Russia policy and legal advice on land privatization and land market development from 1994 to 1999;<sup>109</sup>
- ABA/CEELI – American Bar Association/Central and Eastern Europe Law Institute, which is conducting a number of seminars and clinics not only for lawyers but also for social advocates all over Russia;<sup>110</sup>
- Chemonics - Chemonics International Inc. is a partner of USAID, and is globally recognized for promoting advanced initiatives in different sectors of International development. The company has its office in Moscow as of 2005, conducts various

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<sup>105</sup> *Id.* at 55.

<sup>106</sup> See USAID, DATA SHEET (2005), <http://www.usaid.gov/policy/budget/cbj2005/ee/pdf/118-0221.pdf>.

<sup>107</sup> See American Russian Law Institute, <http://www.russianlaw.org/> (last visited Nov. 28, 2005).

<sup>108</sup> See University Diary, <http://margaretsoltan.phenominet.com/2004/06/this-heres-big-ol-ruski-oil-platform.html> (last visited Nov. 28, 2005).

<sup>109</sup> See RURAL DEVELOPMENT INSTITUTE, MARKET DEVELOPMENT, [http://www.rdiland.org/CONSULTING/Consulting\\_topic\\_Market.html](http://www.rdiland.org/CONSULTING/Consulting_topic_Market.html) (last visited Nov 28, 2005).

<sup>110</sup> See American Bar Association, <http://www.abanet.org/ceeli/countries/russia/home.html> (last visited Nov. 28, 2005).

development projects and promotes the rule of law and other free market initiatives.<sup>111</sup>

The list of other famous donors includes but is not limited to: the Carnegie Foundation, the Ford Foundation, Freedom Support Act and the Soros Foundation (Open Society Institute).

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<sup>111</sup> See USAID, [http://www.usaid.ru/en/main/activity/index.shtml?activity\\_id=644](http://www.usaid.ru/en/main/activity/index.shtml?activity_id=644) and <http://www.chemonics.com/> (last visited Nov. 28, 2005).

**Table 2: U.S. Financial Aid to Russia – 1992-1999.**

	in millions
U.S. Commercial Financing and Insurance (Export-Import Bank, OPIC, USDA)	\$8,890
Non-FREEDOM Support Act Funds'	\$3,960
International Monetary Fund	\$3,830
FREEDOM Support Act	\$2,260
World Bank	\$1,050
European Bank for Reconstruction and Development	\$ 306
<b>TOTAL</b>	<b>\$20,290</b>

Sources: IMF Summary of Disbursements and Repayments: Russian Federation, World Bank Country Brief, EBRD Activities in Russia, Dept. of State U.S. Government Assistance to and Cooperative Activities with the New Independent States of the Former Soviet Union: FY 1999 Annual Report (January 2000).

**Table 3: Russian Federation: Transactions with the IMF from May 1992 to September 30, 2005.**

YEAR	DISBURSEMENTS	REPURCHASES	CHARGES PAID
2005	0	2,293,770,240	18,064,962
2004	0	1,117,424,465	75,829,729
2003	0	1,356,065,590	100,706,947
2002	0	1,147,587,215	161,637,500
2001	0	<b>2,997,937,522</b>	398,106,279
2000	0	<b>2,189,497,343</b>	523,542,056
1999	471,429,000	<b>3,101,138,750</b>	528,469,919
1998	<b>4,600,000,000</b>	673,921,875	528,876,040
1997	<b>1,467,252,800</b>	359,500,000	423,093,268
1996	<b>2,587,861,200</b>	359,500,000	323,567,770
1995	<b>3,594,250,000</b>	0	193,954,079
1994	1,078,275,000	0	122,264,400
1993	1,078,275,000	0	56,082,833
1992	719,000,000	0	0

## **CHAPTER 5**

### **THE RUSSIAN STUDY: CORRUPTION, MAFIA, AND IMPORTANT USE OF LEGAL ENFORCEMENT VIA JUDICIAL AND LEGAL REFORM CHALLENGES**

#### **5.1. Corruption**

Corruption is defined in the Black's Law Dictionary.<sup>112</sup>

Though corruption or its consistent criminal counterparts in the form of bribery and extortion did exist in Soviet Russia as well as long before communism, in the Tzar's Russia, the legal definition of corruption didn't exist in Russian law and could not be found in the Russian Law Dictionary<sup>113</sup> as it is in the American Black's Law Dictionary.

The first officially recognized definition of this legal term in Russia emerged only in 1997, although, the word itself was widely known and used. Today corruption is recognized all over the world as one of the most widespread, hard-to-fight aspects of criminal conduct. Today corruption in Russia is a fairly normal part of everyday activities, business operations and practices. It is, indeed, a heavy burden on the trustworthiness of the country and its governance not only in the eyes of the world community, but also for the Russian population itself.

The World Bank defines corruption as the abuse of public power or public office for private gain:

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<sup>112</sup> Under this definition, corruption is an act done with intent to give some advantage inconsistent with official duty and the rights of others. It is also defined as the act of an official or fiduciary person who unlawfully and wrongfully uses his station or character to procure some benefit for himself or for another person, contrary to duty and the rights of others. BLACK'S LAW DICTIONARY 345 (6th ed.1990).

<sup>113</sup> Uriditecheskiy Entsiklopediteskiy Slovar' [Encyclopedias Law Dictionary] (A. Y. Sucharev et al.ed., Soviet Ensiclopedia, 2d ed. 1987) (Russ.) (1984).

[w]hat is abuse of public power? The term ‘public power’ relates to the exercise of government functions. Their abuse can be imputable to two different perpetrators. The first one is the person who holds public office and exercises government functions. The abuse can be the deed of this public official without anybody else’s participation. The other perpetrator can be a person who seeks to influence by inappropriate means the exercise of government functions that he himself does not have. In this case, corruption is collusive behavior. As a consequence, the abuse of public power comprises both configurations. Private gain in this context is the change of the sound balance between public and private interests (common good) during the decision making process in favor of particular interests. As a consequence, neither the processes nor the outcomes are equitable.<sup>114</sup>

Surprisingly, while the world is searching for measures to fight corruption and Russian corruption in particular, Russia itself does not have a law on corruption. The legal database of Russia has dramatically expanded since 1991 with many positive outcomes for the market economy and the freedoms of an open society; however the fact remains –that the State Duma did not adopt any specialized laws in its fight with corruption, notwithstanding that President Putin is promising to fight corruption.

The first draft of the Federal Law “O bor'be s korruptsiei” (Law on the Fight against Corruption) was introduced to the Duma on February 15, 1996. The State Duma adopted the law, but president Yeltsin vetoed it. When the law was introduced to the Duma a second time, the Duma canceled that session of its agenda.<sup>115</sup>

In total, the Duma made seven attempts to introduce and adopt this legislative draft.<sup>116</sup>

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<sup>114</sup> KLAUS DECKER ET AL., LAW OR JUSTICE: BUILDING EQUITABLE LEGAL INSTITUTIONS 6, [http://siteresources.worldbank.org/INTWDR2006/Resources/477383-1118673432908/Law\\_or\\_Justice\\_Building\\_Equitable\\_Legal\\_Institutions.pdf](http://siteresources.worldbank.org/INTWDR2006/Resources/477383-1118673432908/Law_or_Justice_Building_Equitable_Legal_Institutions.pdf) (last visited Nov. 30, 2005) [hereinafter LAW OR JUSTICE].

<sup>115</sup> Ckandal.info, *Kto napomnit Presidentu pro Korruptsiu?* [Who will Remind the President About Corruption?], Aug. 8, 2005 (Russ.), <http://www.ckandal.info/main.html?news=1864> (last visited Nov. 30, 2005).

<sup>116</sup> *Id.*

Much later another legal draft called “O protivodeistvii corruptsii” (About resistance to corruption) was not turned down by the Duma, and was adopted in its first draft, i.e., in its first reading by the chamber of the Russian Parliament on November 20, 2002. Since that time no more attempts to adopt and enact it into a law have been made. Around April of 2005, President Putin called for this draft’s adoption by the Duma. However, legislators decided to initiate the drafting of an entirely different document from scratch rather than amend and improve the initial project and move forward. How long it will take professionals to draft legislation on the fight with corruption in Russia, adopt it and achieve the President’s ratification remains unknown.<sup>117</sup>

It is important to take into consideration that progressively oriented and concerned citizens of Russia have noticed that there are two entirely parallel lines of thought in Russia. One is a strong stance by legislators and government to prevent any and all attempts to design a legislative framework for fighting corruption, whereas another line is that widespread corruption has become pandemic and requires immediate measures.<sup>118</sup>

On the other hand, Some Russians argue that by simply enacting numerous laws and regulations and presidential decrees on the fight with corruption would not be sufficient to achieve a total victory in the combat with evil as a phenomenon. This group asserts that in the overall war with corruption only the strongest will win. Ironically, that means the State and Federal governments, which are overwhelmingly corrupted themselves.<sup>119</sup>

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<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> Kompania, *Pchelinaiya okchota. V totalnoi bor'be s korrupsiei pobezdaet silneishii*. [*Bees Hunt. In a Total War on Corruption, Only the Strongest Will Win*], Jan. 26, 2004 (Russ.), [http://www.compromat.ru/main/ne\\_rossiya/pchelin.htm](http://www.compromat.ru/main/ne_rossiya/pchelin.htm).

The evidence supporting this argument, first and foremost, is based on unproved assertion which government has not rebutted: that former Prime–Minister Michael Kas'ianov was an accomplice to and permitted suspicious financial transactions related to the Russian external debt.<sup>120</sup>

The fact, that accusations were not rebutted by the government once again confirms that Russia today is still too far away from openness, transparency and accountability of its government to its own citizens.

The second piece of evidence supporting the argument is an assertion concerning the worth of adopting legislations to fight corruption on the ground in Russia. The group believes that simply adopting laws and regulations combating corruption will only once again give the power to a few, and to the same decision-making bureaucrats in the government. The example used is the historically well-known war on corruption launched in the U.S. in the 1970s, when the mandate to fight corruption in the government was given to the U.S. Ministry of Justice. That is where the article derives its headline from.<sup>121</sup> However, the authors are making the same mistake international donors did, but in the opposite direction. They are applying Russian reality to the American soul.<sup>122</sup> They sadly have no sense that it is possible to establish transparency in the Russian Parliament and government as it exists in the U.S. Congress. The idea to build a base for launching parliamentary investigations as has long been done in the U.S. now is in the Russian air. Just recently in this year of 2005, president Putin publicly mentioned it would be

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<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

<sup>122</sup> *See id.*

beneficial to launch a campaign for establishing an institute of parliamentary hearings. Today the group of legislators is already drafting the law.<sup>123</sup>

However, the law on corruption is still in question.

Indeed, such lack of sense of the possibility of transparency in the Russian government is not at all the fault of the author of the article, but just an unfortunate lack of information and a lack of broad exchange between journalists and the ordinary people of Russia and America.

Nevertheless, Putin's call for parliamentary investigations sounds very ironic but timely in view of the oil for food scandal and the oil allocations granted to the Russian Presidential Council.<sup>124</sup> The pro-Kremlin Unity Party known as the United Russia Party received the largest oil allocations from Iraqi Saddam Hussein because it was the governing party and the party of the President. The Russian Presidential Council also received a significant amount of oil allocations under the management of Alexander Stalevich Voloshin, who was appointed to that position initially by Yeltsin and stayed on with Putin. He reportedly assisted Putin to rise to power. Mr. Voloshin is recognized as the most powerful man in Russia after Putin, and is a guide for those who needed things to be “fixed” in the Kremlin.<sup>125</sup>

With all this said, indeed this concern of the Russian people does not sound surprising, and must not be disregarded, but to the contrary, taken into full consideration. Indeed, there are ways to decrease the adverse effects of corruption in Russia, and fight it with success while taking into consideration the very unique and special corrupt political and economic environment. In those

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<sup>123</sup> *See id.*

<sup>124</sup> OIL ALLOCATIONS REPORT, *supra* note 1.

<sup>125</sup> *Id.* at 2-3.

circumstances, the experience derived from the old days of the U.S. in the 1970s<sup>126</sup> will never hurt. Tactics and tools of combating corruption that now exist in the U.S. would only be beneficial to all concerned Russians. The Russian people are incredibly smart and well-educated, and if they put their mind to it, they will prevail in the war on corruption. However, it takes courage and a very strong will, and they, indeed, will need continuous support from the U.S. and the international community.

The recent August 2005 public opinion poll of the Russian population revealed a result not at all surprising to a native of Russia and quite astonishing for a foreigner. To the question which profession or occupation in Russia is the most criminal one, the answer is:<sup>127</sup>

The Second Runner-up is the so-called mafia under whose umbrella are united bandits, hit men, killers, thieves, racketeers, gangsters and money launderers;

The First Runner-up is ministers and highly ranked governmental officials and legislators; and

The winner is traffic control police officers (highway patrol) within law enforcement (police) officers, and abbreviated in Russian as GIBDD (Gosudarstvennaya Inspektsiya po Bezopasnosti Doroznogo Dvizheniya) [Government's Inspection for Road and Traffic Safety or Highway Patrol], called Gibbons<sup>128</sup> for a reason.

The First Runner-up beat the Second Runner-up by 30%.<sup>129</sup>

The graphic description of the public opinion poll is presented in Figure 2.

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<sup>126</sup> See Kompania, *supra* note 119.

<sup>127</sup> Ckandal.info, *supra* note 115.

<sup>128</sup> Steve Rosenberg, *The Scourge of Moscow's Roads*, <http://news.bbc.co.uk/2/low/europe/1420666.stm> (last visited Dec. 1, 2005).

<sup>129</sup> See *supra* note 115. See *infra* Figure 2.

Information on corruption practices is available through an independent entity “Transparency International – Russia”<sup>130</sup> launched as a project in December 1999 and supported financially by the Soros Foundation. At the conference held in Moscow, Russia on July 2005 the investigation's results, Diagnostica Rossiiskoy Korruptsii 2001-2005 [The Diagnostic of Russian Corruption 2001-2005], were announced. This is a very deep comprehensive statistical report and analysis completed by talented and honest Russian scientists, mathematicians and sociologists and available in Russian only. In Table 4 through Table 9 some of the data gathered is presented, translated by the author of this thesis.<sup>131</sup>

Table 4 represents the opinion of Russian citizens in respect to the spread of corruption during President Yeltsin’s and President Putin’s administrative terms. Thus public opinion shows that in 2001 58% of respondents believed that Yeltsin's administration was highly corrupted. Nothing has changed over the past few years and in 2005 on average 57.8% of Russian citizens still believe that Yeltsin's administration was deeply corrupted. To the contrary, in 2001 after one year of President Putin’s first term only 14.3% of respondents anticipated that Putin's administration would be corrupt. Today, in 2005, 43.1% of respondents believe that Putin's administration is highly corrupted. This represents a 201.4% increase among ordinary people in respect to the number of respondents. Accordingly, in 2001 only 11% of businessmen thought Putin's administration is corrupted. Today, in 2005, 37.6% of respondents from business circles are clear about the depth of corruption in President Putin’s administration, which represents an increase of 241.8%.

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<sup>130</sup> <http://www.transparency.org.ru/PARTNERS/index.asp>

<sup>131</sup> IT-Russia, Vo skol'ko raz uvelitchilas korruptsiya za chetire goda: Result'ati novogo issledovania Fonda INDEM [ How much has Corruption Increased in the last 4 Years: The Results of new study of the INDEM Fund], Jul. 20, 2005 (Russ.), [http://www.indem.ru/corrupt/2005diag\\_press.htm](http://www.indem.ru/corrupt/2005diag_press.htm), See *infra* Table 4. – Table 9.

Nonetheless, understanding of the process of corruption among people has drastically improved. Table 5 presents data confirming that today more people understand corruption as a negative social phenomenon. Among ordinary people, this advanced understanding improved from 38.3% in 2001 to 52.6% in 2005, and among business people from 50.6% in 2001 up to 61.3% in 2005.

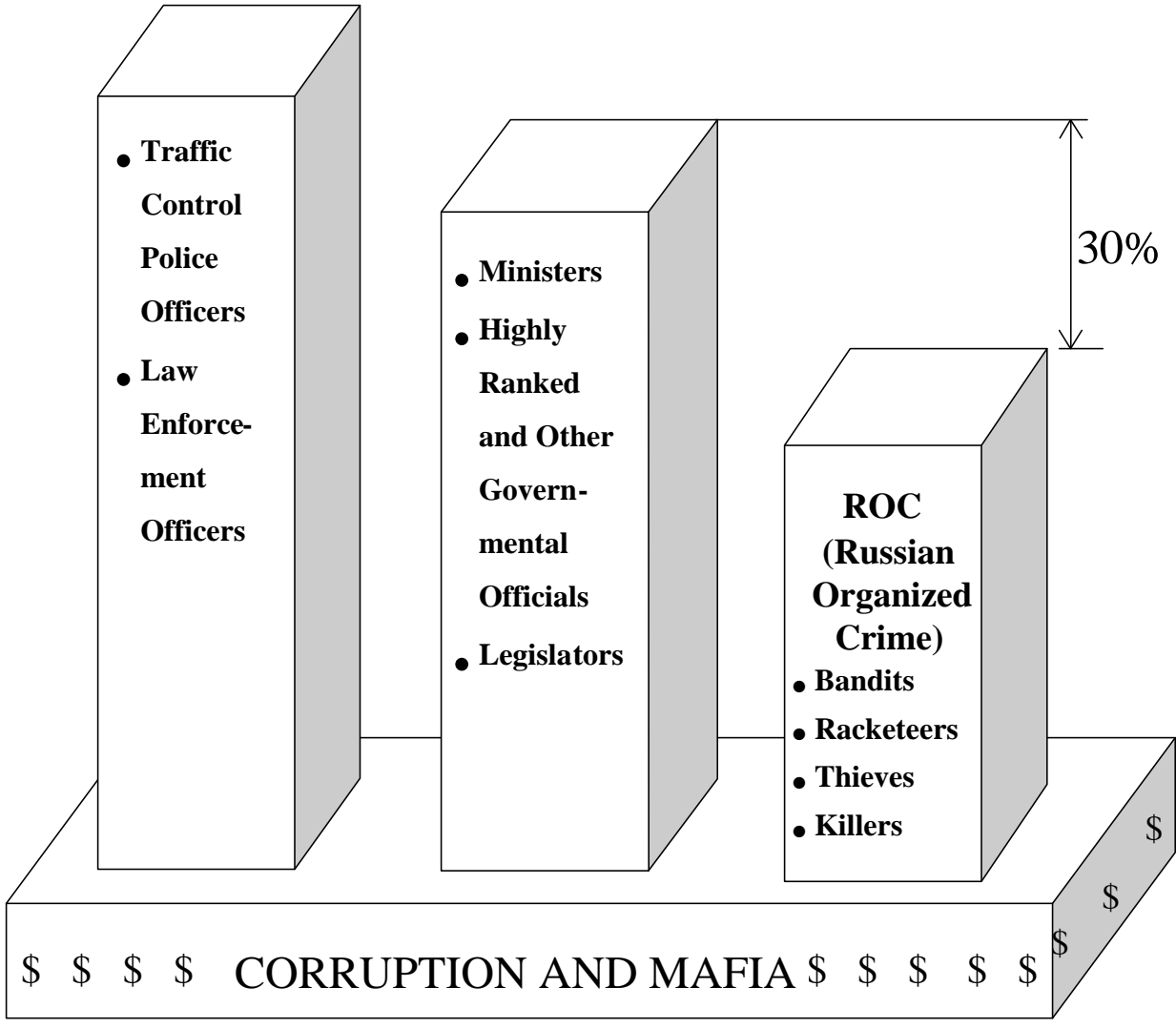
Table 6 reflects another phenomenon – reasons for bribe-giving have shifted over the past few years. If in 2001 bribes were given more often at to the initiative of a giver, in 2005 givers were not so comfortable or willing to give a bribe to the official. To the extreme, bribe takers became more persistent and pushier, demanding bribes from business people and ordinary citizens.

Table 7 uncovers the decreased intensity of corruption over the period 2001 to 2005, or rather the decreased number of bribe-giving events. However, with the decreased number of events, the size of bribes has increased drastically. The average bribe amount grew from US\$10,200 to US\$1,358,000 in 2005. The size of the market where corruption is widespread has increased from USD 33.5 billion in 2001 to USD 316 billion in 2005.

With all the negatives said, there are only a very insignificant number of positive improvements presented in Table 8. Number of events in which a bribe was requested by an official decreased slightly from 2001 to 2005 in certain areas of business cohabitation. For instance, fiscal authorities and tax authorities obviously became less corrupt than before. In 2001 the number of events in which a bribe was requested was 19%, and in 2005 it is only 12.2%. All other authorities are showing the same tendency for slowly progressing improvement as well, excluding law enforcement. Here a slight increase in bribe demand is obvious.

Table 9 contains characteristics of corruption in daily life of Russia versus the business environment as presented in Table 8. The trend is obvious: corruption is spreading, and the risks of finding oneself in the situation of being forced to give a bribe are increasing. However, the willingness of the average citizen to give a bribe has diminished.

Corruption has an evil face and is very difficult to fight. Public judicial proceedings and their expansive representation in mass media could help the legislative process in the combat against corruption.



**Fig. 2. Russian Federation, Results of Public Opinion Poll, August 2005.**

**Table 4. Public Answer to the Question: “When Do You Believe that Corruption, Bribe-Taking, Embezzlement of Governmental and Public Funds, Special-Interest Protectionism, and the Godfather Patronage System Were Most Widespread in Russia?”**

Variations of responses suggested	Ordinary citizens			Businessmen		
	2001	2005	Δ	2001	2005	Δ
During the presidency of <b>Boris Yeltsin</b>	58.0	57.8	-0.3	57.3	53.8	-6.1
At the present time under the presidency of <b>Vladimir Putin</b>	14.3	<b>43.1</b>	<b>201.4</b>	11.0	<b>37.6</b>	<b>241.8</b>

**Table 5. Understanding of Corruption as Social Phenomena by Russians.**

Level of understanding of corruption processes	Ordinary citizens		Businessmen	
	2001	2005	2001	2005
	%	%	%	%
Advanced and Systemic level of understanding	38.3	52.6	50.6	61.3
Ordinary level of understanding	41.9	39.8	36.5	33.6
Absence of understanding	19.8	7.5	12.8	5.1

**Table 6. Reasons for Offering Bribes.**

<b>Responses variations</b>	<b>2001, %</b>	<b>2005, %</b>
A Bureaucrat insisted on bribe (gave a hint, created circumstances)	17.4	25,1
Bribe giver knew in advance this matter could not be solved without a bribe giving	57.2	54.2
A Bureaucrat did not insist on bribe , but bribe giver decided it could secure resolution of an issue	20.3	18.3
Not sure or refused to answer	5.1	2.4

**Table 7. Characteristics and Dynamics of Corruption in Business Practices of Russia, 2005.**  
(positive number reflects increase in the activity)

<b>Characterized as</b>	<b>2001</b>	<b>2005</b>	<b>Δ</b>
Intensity of corruption (average amount of bribes given)	2.248	1.795	-20.2
Average size of a bribe (in US\$K)	10.2	135.8	1231.4
Yearly combined bribe size (in US\$K)	22.9	243.75	964.4
Size of the market (in US\$ billions)	33.5	316	843.3
Size of the apartment which could be purchased using one average bribe (sq. meters)	30	209	596.7
Ratio of volume of business corruption to gross Revenue of Federal Budget	0.66	2.66	303.0

**Table 8. Percentile Representation of the Last Occurrence of Business People's Experience in Regard to Communication with Authorities Involved in Corruption Practices. Based on Type of Authority.**

<b>Response variations</b>	<b>2001 %</b>	<b>2005 %</b>
Non fiscal control, Supervising Authority	39.5	38.9
Fiscal, Taxes Collecting Authorities	19	12.2
Licensing Authorities	19	16.4
Customs Control Authorities	4.2	1.2
Law Enforcement Authorities	10.5	11.8
Other	3.3	3
Not sure or refused to answer	4.5	16.5

**Table 9. Corrupt Practices in Daily Life in Russia. Dynamics of Corrupt Practices in Daily Life in National Market.**

<b>Charctersistics of Corruption</b>	<b>2001</b>	<b>2005</b>
Spread of Corruption (%)	50.4	54.9
Corruption's Risks (%)	25.7	35.0
Demand for Corruption (preparedness to give a bribe, %)	74.7	53.2
Intensity of Corruption (average number of bribes given per year per giver)	1.19	0.882
Average size of a bribe in rubles (US\$1=29.845 Ruble)	1,817	2,780
Proportion of an average bribe to the minimum poverty level	1.21	1.17 in 2004
Average Yearly contribution of one bribe giver in rubles (US\$1=29.845 Ruble)	2,162	2,452
Yearly Volume of Corrupt Practices in Daily Life (billions of US Dollars)	2.825	3.014

## **5.2. Mafia**

The mafia is a phenomenon of Russian reality and still remains an enigma to the world despite of everything written about it.

From one person's criminal activity (like Jesse James<sup>132</sup> and John Dillinger,<sup>133</sup> for example) or a small group of thieves or killers, it progressed to become big, well-organized groups of individuals carrying out criminal intent and united under an umbrella of criminal organizations, often with a structure like a real corporation. Those groups could be organized and coordinated not only on the national scale of a particular country, but often internationally.

The presence of an organizational structure led these groups to be called organized crime (OC). Not necessarily as family-based as the Italian mafia'; the Russian mafia is protected by corrupt politicians and law enforcement officers, the legal advice of law practitioners and flaws in the legal and economic environment of the country.<sup>134</sup>

The days when money derived only from such activities as gambling, prostitution, and the illicit use of narcotics are long gone. The new Russian mafia specializes in oil, nuclear materials, military and defense arms equipment, the sale of defense secrets, tanks, aircraft and submarines, and the more peaceful but equally profitable and competitive sugar, coffee, cotton and liquor trades, as well as gold, steel and aluminum are also among the mafia's interest. Anything which can bring important or lesser sums of money is the focal point of the mafia's routine activities.

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<sup>132</sup> T. J. STILES , JESSE JAMES: LAST REBEL OF THE CIVIL WAR (2002).

<sup>133</sup> For more information, *see generally* DARY MATERA, JOHN DILLINGER: THE LIFE AND DEATH OF AMERICA'S FIRST CELEBRITY CRIMINAL (2004).

<sup>134</sup> *See* U.S. LAWYERS FOR RUSSIAN MOBS, *supra* note 84.

During the Cold War the Russian mafia used its connections in the Communist Party to establish a vast black market network. In the power vacuum that followed the fall of communism, the brutal group became even wealthier, more influential, and more successful. The meaning of the word mafia had dramatically changed over the years in Russia.<sup>135</sup>

If in Soviet times the qualification to become a mafia boss was the honor to be a Vor V Zakone (meaning thief at law, on the model of Attorney at law) or a hit killer, who had little property and was valued by the length of time he had served in a prison or Gulag, then in post-Soviet times the mafia became very diversified.<sup>136</sup> Among thieves and Vor V Zakone, the more intelligent people who did not have prior criminal records became familiar faces. Officers and soldiers who served in Afghanistan or elsewhere and even members of the GRU (Gosudarstvennoe razvedivatelnoe Upravlenie, Army intelligence) or the KGB (now known as the FSB) intelligence fill the ranks of the army of mafia and OC groups.<sup>137</sup> Educated, smart, diversified, pervasive, prepared for a fight and hard times, these soldiers made OC especially dangerous. At some point it became prestigious to belong to a mafia group. Many youngsters were curious about it, looking for easy ways to get rich and be 'recognized' by alike.

Members of the Russian Mafia often lead outwardly respectable lives and maintain a variety of legitimate businesses as a front, or cover, for their criminal activities.

The scale of involvement of population in criminal activities was absolutely astonishing.

In 1992 it was determined that as many as 1,684 criminal groups were located in Moscow and its suburbs. However, only 11 of those were qualified by the courts as criminal groups

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<sup>135</sup> *Id.*

<sup>136</sup> Valeriy Karishev, *Istoria Russkoi Mafii 1995-2003 Bol'shiaya Krisha* [*The History of Russian Mafia 1995-2003 The Big Roof*] (2004) (Russ.).

<sup>137</sup> *Id.*

equaling the definition of bandits. The reason was that judges were afraid of consequences. In 1993 in Moscow alone, 352 groups were liquidated by law enforcement. Nevertheless, it didn't help to release the tension of the criminal burden in the Capital of Russia. New soldiers came to replace the old ones. No one wanted to work in factories or bake bread, and the government did not pay salaries. Department store shelves were empty. Normal food was only in dreams. The solution could have come then, if the economic situation had been normalized and civilized. Criminals would then have left racketeering of legal businesses and would have had to return back to their standard mafia practices of narcotics, prostitution and gambling.<sup>138</sup>

In 1997 organized crime (OC) was recognized as the first priority for problem-solving. According to the statistics about 16,000 criminal groups of different sizes plus 60,000 individuals closely related to them were operating just in Moscow and its suburbs.<sup>139</sup>

The average perception is that mafia or OC is a group of sporty-looking young men with very short hair, visiting the gym on a regular basis and sometimes with nice, quiet families or very intelligent, law-abiding parents very much of the old school. However, in the mid-1990s it became clear, though no one wanted to admit it, that the mafia emerged as a new phenomenon with a new and entirely different face. A new type of mafia has surfaced – a white-collar mafia, practicing financial and banking crime, privatization crime, computer crime and a long list of other kinds. According to CIA information, about ten of the largest and most influential Russian banks participated on a wide scale in unlawful and criminal activities, money transfers and

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<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

money laundering. About 30-40% of GDP (natsionalnogo valovogo producta) was produced exclusively on the black market.<sup>140</sup> The mobster emerged.

One of the figures of the Russian mafia with international roots was a mobster originating in Russia with the nickname 'Yaponchik', a famous Vor V Zakone, who arrived in the U.S. in 1992 as a crew member of a cinema group and stayed. He planted his roots in Brooklyn, New York and continued to preside over as one of the most recognized mobs ever. However he was a mob in the old style with his personal “Code of Honor”. It took hard work, but when he was caught by the FBI, imprisoned and finally extradited to Russia, the event was announced as one of the most significant successes of the FBI’s work in combating international organized crime.<sup>141</sup>

### **5.3. Judicial and Legal Reform Challenges**

The legal system of the Soviet Union is famous for centralism, protection of interests of the States' super power versus rights, interests and needs of the private individuals who form that sovereign State and who unite under its jurisdiction, and whom they call “my Motherland” whether born in Russia or through adopting its citizenship. For those who were born and raised an the open society and free market economy, it is practically impossible to comprehend the depth of damage done to the human mind by 70 years of the communist regime and brainwashing with socialist ideas under the Soviet regime. Normal values of human well-being and recognition of basic human rights were distorted to the point of not acknowledging them at all.

There was a very famous slogan during Soviet times: “Ran’she dumai or Rodine, a potom o sebe”. The literal translation is: First, think about the interests of the State, and then after that

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<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

about your personal interests. This can be interpreted as: “Dear Citizen, it is not about your rights and interests that the Federal Government pledged to recognize and protect, it’s only about the interest of the Federal Government, and if any room is left then, maybe, perhaps, it is about some of your interests. But we will see how it turns out, no promises, and, indeed, only in case we decide to think at all about your interests.”

That is the environment people in the Soviet Union used to live in, from 1917 until Gorbachev's perestroika began.

One of the most significant achievements of perestroika was not in fact the building of the road to economic freedom, stability and a free market environment. The most substantial achievement of perestroika was the recognition of human rights, interests and needs. Recognized human rights include but are not limited to the right and protections of ownership, the right to move freely and to choose freely one’s new residence or motherland, the freedom to exchange, sell or buy real estate, the right to a fair court hearing, freedom of religion, and so on.

In order to protect human rights, the historically proven system of checks and balances, the independent judiciary, a strong legal environment, an independent legislative branch and a system of legal enforcement with a strong law enforcement division within the legal system versus the police state system must exist.

The architectural development of this bright-featured house of recognized and valued human rights under the umbrella of equal justice for all takes time and money. First, the projected aim must be set, whether a two-bedroom house in Beverly Hills or the palace of Versailles. Then the architectural draft must be drawn, the basement cemented, communication systems (gas pipeline, water, sewer, cables, drainage) provided, walls erected, heating and cooling systems installed, ventilation system or chimneys cleaned, roofing covered and sealed,

windows for lights, air and new ideas arranged...And when construction seems to be over, the interior design will be another challenge to meet.

Thus the legal system. In Russia after the post-Soviet era, the old system is not serving new demands, and a lot of hard work must be performed. For this work to be successful, plans must be developed and mutually accepted by the participants, financing must be obtained and the work must begin as scheduled.

However, a range of difficulties have delayed the constituting of parts of the project, as the complexity of the task as a whole is enormous.

At the beginning of perestroika, when it became obvious that the existing legal system had no capacity to meet the new requirements of a changing society, plans for a legal revolution were conceived.

The breakthrough occurred in July 1991 when a new law was passed in the legislature and the Constitutional Court of the Russian Federation was born.<sup>142</sup> In October, later in the very same year, legislators approved The Concept of Judicial Reform, a very revolutionary document.<sup>143</sup> Then in 1993 the new Constitution of independent Russia was drafted and enacted.<sup>144</sup> On October 21, 1994 the first Part of the Civil Code of the Russian Federation was adopted by the Duma, a chamber of the Federal Parliament, and on December 22, 1995 the second Part of the Civil Code of the Russian Federation.<sup>145</sup> In large measure, the analogy between the U.S. Commercial Code and the Civil Code of the Russian Federation could be drawn. The enacting of this most significant, comprehensive and literally revolutionary law providing legal cornerstones

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<sup>142</sup> For more information, *see generally* Peter H. Solomon, Law and Courts in Post-Soviet Russia, paper presented Dec. 3, 1999 at the Paul H. Nitze School of Advanced International Studies, Johns Hopkins University, Washington, D.C., at 2.

<sup>143</sup> RUSSIAN OUTLOOK, *supra* note 11.

<sup>144</sup> *Id.*

<sup>145</sup> Grazhdanskii Kodeks RF [GK] [Civil Code] (Russ.).

not only for commercial purposes, but everyday life in respect to rights and types of ownership including real estate and land; contracts; legal forms of business entities; remedies including but not limited to restitution, repossession, fines, penalties; intellectual property rights; tangible and intangible property rights, and so much more. The significance of its impact on Russian society when the law came into existence is impossible to overestimate.

Between 1995 and 2000, both politics and the economy impeded further legal revolution. However, both the passage of new laws and the implementation of those adopted in 1991-1995 suffered not only from the "cold civil war" between the pro-reform president and a parliament dominated at that time by the reactionary hard-line Left, which voted down or blocked laws submitted by the Kremlin, but also from actions of local authorities and law enforcement entities. Society was operating without further enhancing and clarifying existing and newly enacted legislation. Thus it took about two years and a plethora of by-laws for many provisions of the Civil Code to be adopted, accepted, recognized and used not only by the general public but by local officials including law enforcement officers and government officials in districts, cities, regions and republics. Not only the Civil Code went through a troubled recognition and acceptance, but a post-Soviet Criminal Code<sup>146</sup> as well, and several key provisions of the Constitution—most conspicuously court-sanctioned arrests search, and seizure - could not be put into effect for a long time.<sup>147</sup>

Taking advantage of the infighting in the Center and the Kremlin's limited economic power, many regions continuously violated both: the Constitution and Federal laws. Thus Moscow's very popular and powerful mayor and bright pro-reformist Mr. Luzkov ignored the rulings of the

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<sup>146</sup> Ugolovnyi Kodeks [UK] [Criminal Code] (Russ.).

<sup>147</sup> RUSSIAN OUTLOOK, *supra* note 11.

Constitutional Court and continued for a very long time to restrict the right of residence under the guise of registration<sup>148</sup> in the city of Moscow.

Legal implementation and enforcement also suffered tremendously from a lack of funding as Russia coped with the legacy of the Soviet economic collapse, an empty treasury, enormous subsidies to money-losing enterprises, and the absence of a modern tax system, which had to be created from scratch. The shortage of means precluded raising meager judicial salaries, appointing the thousands of new judges needed to exercise court review of the procuracy's (like district attorneys') actions, and enforcing the constitutional right to a jury trial or to defense counsel immediately after arrest and before questioning.<sup>149</sup>

To address such deficiencies, in December 2001 the Russian parliament passed, and President Vladimir Putin signed, four laws critical of the legal revolution: two laws dealing with judges' qualifications, appointment procedures, retirement age, and administrative, civil, and criminal liability; a law on compliance with decisions of the Constitutional Court; and, most importantly, a law that put into effect the post-Soviet Criminal-Procedural Code.<sup>150</sup>

The legislative package was the product of almost two years of work by a group of progressive jurists.

Another crucial step in legal enforcement was the amendment made to the Law concerning the Constitutional Court. This amendment requires all executive branches within two months to abolish a law or regulation found by the Constitutional Court to be unconstitutional. The executive branch includes but is not limited to districts, regional authorities of different levels up to the head of the region or republic him/herself and the president of Russia.

Noncompliance could result in the dismissal of the executive.

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<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

The refusal of a local legislature to pass necessary laws could lead to its dissolution.<sup>151</sup>

Among the most ingrained defects of the Russian judiciary since perestroika were: wide exposure to the influence of corrupt individuals, criminals and officials; bribing and intimidation of lawyers, attorneys, judges, prosecutors and investigators; low salaries and long delays in their deliveries from the government; unavailability of legal information, which when available was often very confusing; weekly, sometimes daily changes in legal codes, laws, and regulations to the point of making them almost impossible to track; huge contradictions among regional and federal laws and regulations, as well as presidential decrees;<sup>152</sup> insufficient education and training; extremely poor computerization and absence of other necessary equipment, furniture and supplies; not enough databases or network connection, and ramshackle buildings where courts preside.

A lot has been done by 2005 to improve the situation. Nonetheless, without the capacity to implement and to enforce laws, regulations, reforms, initiatives, improvements are blunted. The impression Russia leaves over the years of legal reform efforts is that there is no rush for legal empowerment.

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<sup>150</sup> *Id.*

<sup>151</sup> Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation], [Federal'nyi konstitutsionnyi zakon, "O vnesenii izmeneniy I dopolneniy v federal'nyi konstitutsionnyi zakon 'O konstitutsionnom sude Rossiyskoy Federatsii'" (The federal constitutional law, On the introduction of changes and amendments to the federal constitutional law "On the Constitutional Court of the Russian Federation")] 2001, No12, Item1191, <http://www.akdi.ru/gd/proekt> (last visited Jan. 30, 2002).

<sup>152</sup> Princeton Project Report, *supra* note 64.

## **CHAPTER 6**

### **THE ROLE OF THE WORLD BANK AND THE IMF IN LEGAL REFORM IN RUSSIA. PROSPECTIVE OUTLOOK**

Although as of 2000 the IMF was no longer financing the Russian Federation, the external debt had been restructured.<sup>153</sup> Moreover, many projects on legal reform in Russia financed by the World Bank prior to 2000 are not so financed any more, some projects came to an end, and some just simply do not exist for unknown reasons. For instance, the Russian Foundation for Legal Reform (RFLR),<sup>154</sup> which was responsible for distribution of the World Bank loan to Russia aimed at legal reform, does not support its own website since 2002, and it is almost impossible to find any other links or news to track its transformation, if any. Indeed, its effectiveness was already questioned in 1999.

Was it widespread corruption in Russia, the presence of mafia in all walks of society, financial scandals, continuing economic and legal instability<sup>155</sup>, lack of cultural understanding of the Russian soul and culture in the 1990s, overall overconfidence in the superiority of foreign institutions, weak internal policy on accountability and poor understanding of causal links between legal and economic reforms in the transitioning society, overwhelming ignorance of political realities on the ground<sup>156</sup> and overconfidence in one leader (Yeltsin)<sup>157</sup> that made the World Bank vulnerable to failure in Russian legal reform, revealing the need for drastic changes? Hence it remains true that the World Bank in Russia sadly repeated its previous mistakes in its

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<sup>153</sup> See IMF TRANSACTIONS, *supra* note 88; see also *infra* Table 3.

<sup>154</sup> Princeton Project Report, *supra* note 64, at 20.

<sup>155</sup> *Road to Corruption*, *supra* note 4.

<sup>156</sup> Princeton Project Report, *supra* note 64, at 18.

<sup>157</sup> *Road to Corruption*, *supra* note 4.

legal reform projects in other sovereign countries in the mid-1970s.<sup>158</sup> This is a disappointment of a great magnitude.

Nevertheless,

[R]ecognition of the ancillary role of foreign aid might have been one of the most important strengths of the World Bank's approach. By cooperating closely with the Russian government, and by adopting a Russian implementation agency, the World Bank avoided the pitfall, common to many legal reform projects in Russia, of relying too much on Western models, Western thinking and Western experts.<sup>159</sup>

It remains questionable why the World Bank cut financing of legal reform in Russia so drastically. Was it due to their own failures or the change of power on December 31, 1999 from Yeltsin to Putin; or, perhaps, due to the critique by the international community and the obvious necessity to revise their own policies on lending; or the continued pressure from the U.S after the 2000 Senate hearings?<sup>160</sup>

While the answer would serve the purpose of satisfying a curious mind, the facts remain: since 2000 the World Bank and the IMF have undertaken many efforts to improve their own by-laws and regulations. Principles of transparency, conditionality and accountability were introduced and further enhanced. Substantial work in different fields with legal involvement has been conducted all over the world. Numerous conferences on this subject matter have been held, issues addressed, analytical papers produced, and public discussions generated.

If in previous years the World Bank and the IMF didn't strongly emphasize the importance of legal reform and legal enforcement, nowadays it has become an issue of the greatest

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<sup>158</sup> Princeton Project Report, *supra* note 64, at 18.

<sup>159</sup> *Id.* at 72.

<sup>160</sup> *Road to Corruption*, *supra* note 4.

significance. “It is now widely accepted that the ‘rule of law’ is key to sustainable development.”<sup>161</sup>

The World Bank admits that the meaning of ‘rule of law’ has yet to be more deeply identified in its entirety. Therefore in today’s approach it is divided into an idealistic model and a real model in its entirety. In different countries ‘rule of law’ carries different layers of meaning and definitely different approaches to building and establishing it sufficiently.

[W]ithin an idealized ‘rule of law’ system, equitable legal and regulatory institutions operate as safeguards against abuses of state and non-state power while well-functioning regulatory frameworks are crucial for the effective delivery of public services. A ‘rule of law’ system is generally characterized by multiple arms of government - the executive, legislative and judiciary - with each branch holding the others accountable through differing ‘checks and balances’. The separation of powers principle aims to combat the dangers of investing state power in one person or group. The judicial branch, in particular, exists to protect citizens against the arbitrary or inequitable use of political or economic power. Further, predictable and fair ‘rules of the game’ and secure legal rights are seen as the basis for an effectively functioning society.<sup>162</sup>

Further the World Bank acknowledges that the building of equitable, accessible legal institutions should be priority number one for enhancing economic growth and development, as well as the millennium goal of poverty reduction. The inequitable legal institutions and subverted courts on the other hand allow a financially or politically strong elite to prevail in any court case brought against them.<sup>163</sup> “The absence of effective sanctions may also mean that those in positions of power pursue socially harmful acts that are in their self-interest.”<sup>164</sup> The main reason

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<sup>161</sup> KLAUS DECKER ET AL., LAW OR JUSTICE: BUILDING EQUITABLE LEGAL INSTITUTIONS, [http://siteresources.worldbank.org/INTWDR2006/Resources/477383-1118673432908/Law\\_or\\_Justice\\_Building\\_Equitable\\_Legal\\_Institutions.pdf](http://siteresources.worldbank.org/INTWDR2006/Resources/477383-1118673432908/Law_or_Justice_Building_Equitable_Legal_Institutions.pdf) (last visited Nov. 30, 2005) [hereinafter LAW OR JUSTICE].

<sup>162</sup> *Id.* at 6.

<sup>163</sup> *Id.* at 7.

<sup>164</sup> For a discussion of the causal relationship between inequality and injustice, see EDWARD GLAESER ET AL., THE INJUSTICE OF INEQUALITY (2002),

for such ignorance is that those individuals recognize that legal, political, and regulatory systems will not hold them accountable.

The World Bank also is clear in its understanding of:

[t]he rise of oligarchs in transition countries, who managed to manipulate politicians and shape institutions to advance their own privilege and extract rents from the state at the expense of the social interest. The unbridled capture of economic gains in these countries also led to a substantial breakdown in law and order.<sup>165</sup>

It is imperative that both multilateral institutions, the World Bank and the IMF, continue to work toward such important issues as legal reform and legal enforcement via Justice Sector Reform (JSR)<sup>166</sup> while seeking consensus with member countries. They must do this through their own means to continue positive practices of protecting the interests of the general public whom individuals in the government represent, but not always with the required devotion, honor and dignity needed to promote good governance all over the Globe.

The agenda of continuing funding of legal reform and legal enforcement through the legislative branch, the judicial branch, other government bodies, presidential power, law enforcement, tax enforcement agencies, the setting of legal standards and ways of limiting the power of the state versus the power of the private sector, and via broad legal education of the general public of Russia must again become again a focal point of the World Bank and the IMF activities. Furthermore, the IMF could reconsider today's' strict policy on lending to Russia and

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<http://post.economics.harvard.edu/faculty/shleifer/papers/inequalityWP.pdf>.

<sup>165</sup> LAW OR JUSTICE, *supra* note 161, at 8. For a full list of related studies and research papers, *see* J. Hellman, G. Jones, and D. Kaufmann, World Bank Institute, [www.worldbank.org/wbi/governance/wp-governance.html](http://www.worldbank.org/wbi/governance/wp-governance.html) (last visited Nov. 28, 2005).

<sup>166</sup> *Id.*

by strictly applying the principle of conditionality could require the Russian government to take responsibility and accountability for its actions, to develop the necessary plans to implement and enforce the rule of law in the Russian Federation by balancing domestic interests with internationally recognized practices and principles.

## **CHAPTER 7**

### **CONCLUSIONS AND REMARKS**

The adverse lending policy of the IMF and the World Bank to Russia in transition in the middle of the 1990s brought enormous debt to the Russian nation due to the huge misuse of international loans. Nevertheless, not only must the Russian government be blamed for the misuse of money given to it from the World Bank and the International Monetary Fund (IMF) leading to widespread and sophisticated corruption, global money laundering, extortion, racketeering, poverty; political, economic and military instability, and the failure of a large number of internationally financed programs in Russia. Proportional responsibility must be undertaken by the World Bank and the International Monetary Fund (IMF) themselves, as well as the U.S.

To repair the damage incurred all parties should have to negotiate appropriate measures based on mutual interest and consensus.

Notwithstanding other important and urgent issues and tasks that the global community and multilateral organizations such as the United Nations, the IMF and the World Bank are facing, two major actions could be considered as a goodwill option and a necessary step for their better performance for the global good.

In addition to developing rule of law programs via Justice Sector Reform (JSR) to strengthen the legislative process, judiciary, legal implementation, and law enforcement all over the world (1), there is also a need to initiate an inside project between the two multilateral institutions, the World Bank and the International Monetary Fund (IMF), in order to develop

inside by-laws and regulations meeting the rapidly changing needs of globalization. Since the time of the Bretton Woods charter, so much has changed, thus there is a role for the World Bank and the IMF. Part of the named project may include provisions to create better mechanisms of tracking by the World Bank and the IMF to follow how money lent by them is spent by each country, and the first guinea pig would be the Russian Federation. Such by-laws and regulations will, hopefully, find the support of concerned members who make up the vast majority of the World Bank and the International Monetary Fund (IMF).

It would be particularly helpful to Russia if the World Bank and the International Monetary Fund (IMF) would not only help with developing programs and financing targeting improvements in the legislation progress, law drafting and public discussions for better support of the open society and the open market economy, and but also in keeping and supporting legal databases, improving judiciary, law enforcement, and most importantly, launching and financing the broad and very expansive process of legal education of the peoples of Russia.

For a very long time the population of Russia was ignorant toward the law in the totalitarian communist era. There was no national culture of respect toward the law; there was no trust in law, and the weakest experience of the law was legal enforcement and legal implementation. The Russian people still barely believe that justice could be fairly served, could prevail, and could be accessible for all.

The peoples of Russia are still having problems adjusting to the new leadership. Even nowadays after nearly 15 years of perestroika the judicial branch is still not strong and speedy enough; quite often courts are corrupted; therefore, people do not feel free and comfortable enough to go to the courts and address their issues and concerns, as they do in America.

Trust is a very delicate and important issue. The Russians lost a lot of trust in Russia through the Yeltsin government, its corruption and his connections with mafia rule. Trust is easily lost, but incredibly hard to restore. Russia needs to restore the nation's trust in itself.

Another interesting aspect of implementing rule of law is in the development and introduction of class action lawsuits like those in America. The money stolen by the Yeltsin administration from all Russian citizens after the fall of the Soviet Union in Michael Gorbachev's presidency is a good example, as the government of Russia became very rich within days in 1991 leaving the vast majority of the Russian people without life savings. The same is applicable to the default of August of 1998, and the government never answered their own people's enquiry concerning the default caused directly by the overwhelming outstanding debt of Russia to the World Bank and the International Monetary Fund (IMF). Class action legal practices must be broadly introduced to Russian lawyers, consumer advocates and the general public.

Another opportunity is more deeply developed and powerfully implemented consumer's protection laws.

The next way to improve and strengthen the legal system and legal enforcement is by widening and broadening the exchange among judges as well as regular lawyers from different branches and practices of law, and different geographical regions (local municipal courts and local chapters lawyers especially), and also through law study abroad, having law students study a semester in an American law school (although funding would have to be made more widely available and accessible), and through summer schools or internships in the courts and law firms being made bigger, broader, and more extensive to get the best and the hardest work out of those studying law.

The funds from the World Bank and explicit support of the International Monetary Fund may be and should be widely available to fulfill such important tasks.

Another serious aspect to consider is creating a mechanism for repatriation of the embezzled funds, as well as publicity and transparency of those precedents for the global community. This way the peoples of the Universe will be able to reestablish their confidence in justice and fairness and accountability of their governments. Not only the American taxpayers who assume a tradition of responsibility and accountability, but the taxpayers of other countries including Russia would feel more secure knowing that each and every government or business entity may be held accountable for misusing international funds. Indeed, a very complex issue of jurisdiction will rise, concerning laws applicable and ways to implement such a provisions. However, only about one hundred years ago people could not even dream of flying, and only about two decades ago the world was introduced to the computer, and just ten years ago the internet. Today we can not even imagine world without airplanes, computers and World Wide Web. Thus with the World Bank and the International Monetary Fund. The multinational campaign could be discussed and launched to develop new specialized international institution for economic disputes resolution alike but servicing different purpose then the International Center for Settlement of Investment Disputes (ICSID) of the World Bank Group, it also could be a specialized structure, department or institution within existing ICSID. This new creation would help to solve disputes between peoples of nation and their governments in regards to the suspected or possible misuse of international funds.

In the changing world, the IMF and the World Bank need have no fear of changing either.

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