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WESTERN INVESTMENT AND COMMERCIAL CRIME IN THE
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CAPITALISM OR CORRUPTION? CORPORATE STRUCTURE, WESTERN INVESTMENT AND COMMERCIAL CRIME IN THE RUSSIAN FEDERATION

*Scott D. Syfert**

MAYOR: "No man is without sin. It's God's will, and it is no use the free-thinkers arguing about it."

JUDGE: "Well there are sins and sins. I freely admit I take bribes, but what sort of bribes? Borzoi puppies, that's all!"
*- The Government Inspector, Nikolai Gogol (1836)***

I. INTRODUCTION

In a mere six years, the states that once constituted the Soviet Union were transformed from implacable ideological and strategic adversaries of the West into European partners, democracies, and emerging markets. Before our very eyes, the nations that once constituted the gravest threats to the capitalist system set out to remake their political and economic systems in emulation of it.

Educated Western reactions to the democratization of the former Soviet Union has been, to put it charitably, schizophrenic. Depending upon which commentator one chose to listen to, Russia (as the largest and most powerful nation-state to emerge from the rubble of the Soviet Union) was either (a) on the verge of an economic take-off which would result in a

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** NIKOLAI GOGOL, THE GOVERNMENT INSPECTOR 26 (Heinemann Educational Books 1987) (1834).

booming Russian economy, or (b) on the verge of economic catastrophe, which would result in a collapsing Russian state. These were the two poles between which policymakers, corporate attorneys, and opinion-makers in the West oscillated. And, depending upon the expert and time-frame, each contradictory opinion appeared equally plausible.

As a result, Western investment in Russia since *perestroika* has been similarly haphazard and schizophrenic. Large institutional investors and multinational corporations (such as ABB and GE) began operations in Russia, often with success. In the summer of 1997, the Russian stock market was the fastest growing in the world, and Western investment bankers were scrambling to get in; there was, as the headline in *The Economist* put it, "Plenty to Go Round."¹ Today, of course, investors are scrambling to get out and the optimistic market projections of a year ago appear foolish or naive.

What happened? Financial explanations are scattered and uncertain. The schizophrenia that besets Western projections of Russia's future infects the economic post-mortem of the autumn of 1998.

One emerging coherent explanation of Russia's roller-coaster economy since 1991 points to the unbridled corruption of the Russian market, and its nefarious effects on the Russian economy, state and society. The phenomenon of the gangster-state (or of oligarchical capitalism) as an explanation of Russia's economic collapse is now receiving attention from Russia experts worldwide. The impact of Russian corruption, and its effects on Western investment, which is so critical to Russia's economic rejuvenation, is the subject of this Article.

Part II will introduce Western perceptions of Russia's reform and transition: from optimism at the collapse of communism; to pessimism once the economic hardships of reform grew; to the optimism of 1995-1998 once the Russian economy began to expand; and lastly to the current gloom of the banking collapse of August 1998.

Part III will discuss Western investment in the Russian market: the amounts and types of foreign direct investment, the governing corporate law, and the vehicles used for structuring such investments. Part IV will move from the legal aspects of business planning in Russia to the more practical aspects of business in Russia. It will highlight issues Western investors should be conversant with regarding the nature and scope of Russian commercial crime. This section will show how the economic system of the Soviet Union created the conditions necessary for corruption to flourish, and what effects commercial crime is having in Russia and

1. *Russian Finance: Plenty To Go Round*, THE ECONOMIST, Aug. 9, 1997.

beyond. Part V will analyze the legal and political mechanisms currently being employed to contain corruption. Finally, Part VI summarizes some lessons learned by Western businesses coping with the lucrative, but dangerous, Russian marketplace.

II. INVESTING IN RUSSIA: HANG ON FOR THE RIDE

Although investing in Russia in the fall of 1998 appears reckless and dangerous, it was not always so. Just over a year ago, the Russian stock exchange was booming, investors were scrambling to get in, and optimism reigned. In light of the banking and currency crises of September 1998, and the appointment of ex-Soviet apparatchik Yevgeny Primakov to power, bleak pessimism has once again set in regarding Russia's prospects. Yet, it is worth remembering that few things change as frequently, or dramatically, as Russia's prospects.

A. *The Case for Pessimism*

Ever since the formal dissolution of the Soviet Union was orchestrated by the leaders of Russia, Belarus, and Ukraine at Belovezhskaya Pushcha on December 7, 1991,² Western observers have watched and waited anxiously for an authoritarian counter-revolution that would undo the liberal reforms of the last decade, and restore an authoritarian regime. As one expert put it, "a cottage industry of doom-predictors" sprang up with the demise of the Soviet Union.³ Many experienced observers such as Henry Kissinger,⁴ Richard Pipes,⁵ and Zbigniew Brzezinski⁶ shared, in many respects, what became a common and widely-held view. They believed that

2. For a discussion of the negotiations between Russian President Boris Yeltsin, Belarussian President Stanislav Shushkevich, and Ukrainian President Leonid Kravchuk leading up the dissolution of the Soviet State, see DAVID REMNICK, *RESURRECTION: THE STRUGGLE FOR A NEW RUSSIA 19-29* (1997).

3. Anders Åslund, *Why the Doomsayers Are Wrong About Russia*, WEEKLY STANDARD, Dec. 29, 1997/Jan. 5, 1998, at 24.

4. See generally Henry Kissinger, *Beware: A Threat Abroad*, NEWSWEEK, June 17, 1996, at 41.

5. See generally Richard Pipes, *Russia's Past, Russia's Future*, COMMENTARY, June 1996, at 35. See also Richard Pipes, *Is Russia Still An Enemy?*, FOREIGN AFFAIRS, Sept./Oct. 1997, at 65.

6. See generally Zbigniew Brzezinski, *Russia: Neither our Partner nor Patient*, WASHINGTON TIMES, Dec. 22, 1995.

Russia's "imperial consciousness" was not dead,⁷ and given time, the forces opposing democracy and reform would gather strength and gradually gain influence in Russian foreign and domestic policy.⁸ The result would be a new, and potentially dangerous, tyranny in Moscow. One noted analyst wrote, in a fairly representative sample of this school: "Russia's alienation from the West . . . could easily contribute to its empire-building tendencies. It may not take too much time or effort to see Russian tanks on the Polish border again. . . ."⁹

Predictions varied as to how this tyranny would occur, or the shape it would take. Some believed that a "Red-Brown" coalition of right-wing nationalists, neo-fascists, and former Communists would take power.¹⁰ Others, such as Nobel Laureate Alexander Solzhenitsyn, believed that democracy was inherently unsuited for Russia after decades of Communist rule, and that democratic institutions would simply collapse, as the Provisional Government had in 1917 before the Bolshevik onslaught.¹¹ Many believed an outright coup led by disgruntled military officers and sympathetic nationalists was the likely outcome.¹² Finally, there were those who believed the cycles of Russian history portended periods of liberal reform, which then failed and were followed by periods of extreme counter-reform and reaction.¹³ These observers believed this pattern would repeat

7. See Stephen Sestanovich, *Geotherapy: Russia's Neuroses, and Ours*, NAT'L INTEREST, Fall 1996, at 4.

8. For one analysis of how right-wing Russian factions would eventually crush liberal reform, see ALEXANDER YANOV, *THE RUSSIAN CHALLENGE & THE YEAR 2000* (Iden Rosenthal, Trans., 1987).

9. Dimiti Simes, *quoted in Åslund, supra* note 3, at 24.

10. See generally WALTER LAQUEUR, *BLACK HUNDRED: THE RISE OF THE EXTREME RIGHT IN RUSSIA* (1993).

11. See ALEXANDER SOLZHENITSYN, *LETTER TO SOVIET LEADERS 52* (Hilary Sternberg, Trans., 1974). In an open letter to the Politburo, Solzhenitsyn wrote that "[a] sudden reintroduction [of parliamentary democracy] would merely be a melancholy repetition of 1917." *Id.*

12. See Vladimir Klimenko, *The Coup Next Time*, MOTHER JONES, Nov./Dec. 1991, at 49.

13. For an explanation of this schemata, see generally YANOV, *supra* note 8. See also Alexander Yanov, *In the Grip of the Adversarial Paradigm*, in *REFORM IN RUSSIA AND THE USSR* 156, 159 (Robert Crummey ed., 1989). In Russia, Yanov wrote,

[T]he *ancien regime* is reestablished regularly, only on a higher military-technological level; where peasant's lands may be taken back from them; where even serfdom, abolished by a reform in 1861, was restored by a counter reform in 1929; and where all the amendments of faulty government practices were perpetually erased by counter amendments — to such an extent that new generations of reformers had to

itself again, spelling the end of the period of liberalism begun under Mikhail Gorbachev. Regardless of the exact scenario envisaged, these various groups shared an underlying premise: Russia is not reformable.¹⁴

Although predictions varied about *how* the reaction would come, there was consensus as to *why* it would come. Generally, the pessimists believed five socio-political factors existed that assured the triumph of the anti-reformist powers.¹⁵ First, they believed that public opinion in Russia generally favored an expansionist foreign policy and was especially inclined to help Russians in the "near abroad."¹⁶ As a result, the pressures of elite and public opinion would force leaders to undertake aggressive actions abroad.¹⁷ Second, there was the perception, "that the Russian elite retains a strong imperial mindset and, in particular, is determined to regain control of the old Soviet Union."¹⁸ Third, it was believed that Russian elite, particularly in leadership, was obsessed with the loss of prestige caused by the collapse of the Soviet Union and the end of the empire.¹⁹ Like France in the late 19th century or Weimar Germany, this *revanchist* attitude would encourage an aggressive foreign policy. Fourth, skeptics believed that Western, especially American, foreign policy coddled Russian leaders, and thus, aggravated the situation.²⁰ Finally, it was widely believed that the Russian economy was faring poorly and that the lack of economic growth would lead to disenchantment with the reform process.²¹ These factors

start the same reforms from scratch decades or even centuries later, only to have them erased by new generations of counter-reformers.

Id. See also Charles H. Fairbanks, *The Nature of the Beast*, NAT'L INTEREST, Spring 1993, at 46, 47 (describing the Soviet system as "an internal combustion engine, with its controlled explosions" which sets up huge stresses which, in turn unleash counter-stresses).

14. Åslund, *supra* note 3, at 24.

15. See Sestanovich, *supra* note 7, at 5.

16. *Id.* "Many influential persons in Russia want to regain not only the empire but the status of superpower." Pipes, *Is Russia Still An Enemy?*, *supra* note 5, at 74.

17. Sestanovich, *supra* note 7, at 5.

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.* See also Avraham Shama, *Inside Russia's True Economy*, FOREIGN POLICY, Summer 1996, at 111.

Western governments and international assistance organizations that subscribe to this bleak picture believe that they must use their resources to avert Russia's economic meltdown, because such a meltdown might bring untoward sociopolitical changes and even resurrect the 'Evil Empire.' This picture has the sharp resolution only ideology can produce. And it is wrong.

were believed to create a dynamic in Russian politics that would lead to renewed authoritarian rule. For years these views, or variations upon them, have been extremely influential in both foreign policy and international business circles.²² As discussed below, however, the pessimist's case was weakened somewhat in the mid-1990s.²³

Political events undermined the economic reforms of the early 1990's and seemed to buttress the pessimists' case. The political situation was fluid and increasingly violent. Between August 1991 and October 1993, Russia experienced two coup attempts, the first by hard-line Communists against President Mikhail Gorbachev, the second led by right-wing elements of the Soviet Parliament against President Boris Yeltsin.²⁴ In the elections of December 12, 1993, to the Lower House of the Duma, neo-fascist candidate Vladimir Zhirinovskiy's Liberal-Democratic Party received twenty-three percent of the vote, the single largest share of any party.²⁵ Less than one year later, in November 1994, President Yeltsin took the first steps towards the war in Chechnya, a bloody and pointless campaign that would result in the deaths of over 80,000 Chechens and Russian soldiers.²⁶

Simultaneously, despite economic shock therapy begun in January 1992, all economic indicators were bad: the currency was unstable, the standard of living was rapidly deteriorating, and social conditions portended an explosion.²⁷ Given all this, it was not surprising that most Western observers predicted a "gathering storm" over Russia, one that would likely result in authoritarian rule.

B. The Case for Optimism: July 1996 to August 1998

In the mid-1990s a case for optimism regarding Russia's prospects began to be made. After President Yeltsin's defeat of Communist candidate Gennady Zyuganov in the Russian Presidential elections of July 1996, a

Id. at 112.

22. RICHARD LAYARD & JOHN PARKER, *THE COMING RUSSIAN BOOM 2* (1997). "In recent years such pessimism has dominated Western comment on Russia and much of the comment in Russia itself. Yet generally the gloomy forecasts have proved false. Instead there has been progress on most fronts. . . ." *Id.*

23. See Sestanovich, *supra* note 7, at 5-8; Shama, *supra* note 21, at 111-13; LAYARD & PARKER, *supra* note 22, at 3-5.

24. For a discussion of the events leading up to the October coup attempt see REMNICK, *supra* note 2, at 37-83.

25. *Id.* at 89.

26. *Id.* at 261.

27. See Shama, *supra* note 21, at 111-12.

new, more optimistic prognosis of Russia's political and economic future began gradually, if quietly, to take shape.²⁸ There were several reasons for this.

1. The Political Front

First, political developments were hopeful. Russia's political institutions had survived several storms without a reversion to authoritarian rule. The appointments of reformers Boris Nemtsov and Anatoly Chubais as First Deputy Prime Ministers underscored President Yeltsin's commitment to reform, and began a (brief) round of economic liberalization.²⁹ Moreover, despite occasional backsliding by the executive, Russia remained (and remains) a democracy. "[R]eform has made great headway," one expert wrote. "For all the drama of the last few years, Russia has actually proven surprisingly stable."³⁰ Indeed, while many waited for old Russia to reassert itself, other observers believed, "a new, pluralistic Russia has already emerged."³¹ One study noted:

Despite the turmoil, significant progress has already been made toward the consolidation of a post-communist system with distinct channels of power and authority and a means of assuring checks and balances. New groups with their own stakes in this system are becoming more powerful and would resist any leader who might seek to impose radical change. The clock cannot be turned back, because, quite simply, it is broken beyond repair.³²

In contrast to the earlier pessimism of most Western observers, some foresaw a period of relative tranquillity. Rather than a *revanchist* Russia, tormented with imperial ambitions, a sated player appeared to be emerging on the European scene.

28. See *The Battle of Russia's Capitalisms*, *ECONOMIST*, August 9, 1997, at 14. "The past few months have witnessed the most cheery signs yet, since the Soviet empire blew apart six years ago, that Russia could become a normal country. . . ." *Id.* See also Åslund, *supra* note 3, at 24–26.

29. See also Åslund, *supra* note 3, at 24–26.

30. *Id.* at 24.

31. Angela Stent & Lilia Shevtsova, *Russia's Election: No Turning Back*, *FOREIGN POLICY*, Summer 1996, at 92.

32. *Id.*

2. The Economic Front

Economically, there was growing consensus that Russia had passed through the worst of its transition, and was on the verge of a economic "take off" similar to the period of dynamism which the economies of Southeast Asia experienced in the 1980s. Many economic indicators suggested this scenario was possible. Russia, the optimists pointed out, has one of the world's premier educational systems, a well-educated workforce, and a potential market of millions;³³ Russia is the world's leading producer of many natural resources, including natural gas and nickel; Russia produces more oil, steel, platinum, diamonds, and other minerals on a per capita basis than the United States.³⁴

Other economic indicators were similarly promising.³⁵ Inflation was dramatically reduced from 2500 percent a year in 1992 to 130 percent in 1995.³⁶ Prices were being set by a freely, if imperfectly functioning, market. Expenditure on the military fell from approximately twenty-five percent of GDP under the Soviet economy, to approximately three percent in 1997.³⁷ Simultaneously, but little commented upon, was the fact that privatization had proceeded faster in Russia (at the time) than any other country in Eastern Europe.³⁸ ("[Currently,] more than [seventy] percent of [Russian] GDP is produced in the private sector."³⁹)

With these statistics in mind, the pendulum of educated opinion swung from bleak pessimism to cautious optimism — and in many cases all the way to outright bullishness. "Russia is likely to experience growth averaging at least [four] percent a year for a decade or more," one study predicted. "In living standards Russia by 2020 may well have outstripped countries like Poland, Hungary, Brazil, and Mexico, with China far behind."⁴⁰ One investment guide recommended, "now is the most convenient time to penetrate and get settled into the Russian market, while competitors are still few and the market's chaotic state allows such high return on the risk."⁴¹

33. See LAYARD & PARKER, *supra* note 22, at 124.

34. *Id.* at 124–25.

35. See Jonathan Thatcher, *Reformist Russia Starts to Glitter for Investors*, REUTERS, March 10, 1997, available in LEXIS.

36. See LAYARD & PARKER, *supra* note 22, at 141.

37. See Åslund, *supra* note 3, at 24–25.

38. See LAYARD & PARKER, *supra* note 22, at 125.

39. Åslund, *supra* note 3, at 24.

40. LAYARD & PARKER, *supra* note 22, at 148.

41. TANKRED G. GOLENPOLSKY, ROBERT M. JOHNSTONE & VLADIMIR A. KASHIN, DOING

Many believed Russia was on the verge of an economic *chudo*, or “miracle.”⁴² “The social cost of the transition has been great, but the new Russia has a market economy based on private property and an elected, if imperfect, government,”⁴³ wrote one observer.

C. *The Reckoning — August 1998*

Then came August 1998. On August 17, the Russian ruble was devalued, eventually plummeting almost seventy percent. Simultaneously, the government stopped payments on its short-term debt, unleashing a currency and financial crisis that appeared (and may yet) result in the collapse of social order and democracy in Russia.⁴⁴ A bank run developed as worried citizens sought desperately to withdraw their savings. As a result of the collapse of the ruble, virtually all of Russia’s private banks, which had borrowed heavily from the West, became financially insolvent.⁴⁵

One source predicted that Russian banks owed a total of \$30 billion to foreign creditors, while Russian corporations owed an additional \$25 billion.⁴⁶ Conglomerates such as Inkombank, SBS-Agro and Rossisky-Kredit each owed millions; SBS-Agro’s indebtedness alone was reported to total over \$1 billion.⁴⁷ Western stock markets, fearing the Russian turmoil’s impact on German and other Western lenders with exposure to the unfolding crisis, fell startlingly.

To make matters worse, the Russian government appeared to be totally impotent to stop the growing panic. President Yeltsin appointed Victor Chernomyrdin and later Yevgeny Primakov, both anti-reformist Soviet era hangovers, to rescue the country.⁴⁸ By late September 1998, inflation was up sixty-seven percent from the previous month, and many predicted hyperinflation would set in by year’s end.⁴⁹ The economy as a whole was

BUSINESS IN RUSSIA 53 (Linda Pinkham ed., 2d ed. 1996).

42. See DANIEL YERGIN & THANE GUSTAFSON, *RUSSIA 2010 & WHAT IT MEANS FOR THE WORLD* 160–61 (1993).

43. Åslund, *supra* note 3, at 25.

44. See Patricia Kranz, ‘*The Oligarchs have overplayed their hand*,’ *BUS. WK.*, Sept. 21, 1998, at 48. See also Daniel Yergin and Thane Gustafson, *Don’t Write Off Russia — Yet*, *FORTUNE*, Sept. 28, 1998 at. 99.

45. See Kranz, *supra* note 44, at 48.

46. *Id.*

47. *Id.*

48. See *Russia. Steady as She Drifts*, *ECONOMIST*, Sept. 26, 1998, at 52.

49. See Greg Myre, *Russian Inflation up 67 Percent since August; expected to worsen*,

predicted to contract by five to six percent in 1999, and appeared on the brink of total collapse.⁵⁰ Although there is (as yet) no social unrest or anti-democracy movement, the worst fears of the pessimists appear to be coming true.

D. Russian Commercial Crime

What caused the collapse? Explanations are uncertain, but one theme predominates: the prevalence and danger of commercial crime.⁵¹ Harvard economist Marshall Goldman estimated that eighty percent of businesses in Russia are controlled by criminal syndicates.⁵² Even if this is over estimated, and as one expert thinks "the [criminal] picture is improving, contrary to most reporting,"⁵³ the problem remains. Indeed, many see the proliferation of commercial crime, and the criminalization of Russia's political and social life, as the greatest threat to Russia's participation in the global economy, and even to its long-term stability. Many analysts and investors have concluded that Russia is a lawless market-place, and therefore risk overrides all possible reward. As one business guide bluntly noted: "To survive in Russia, any private businessperson either Russian or foreign, must continuously break the law."⁵⁴ The criminalization of Russia's commercial life explains in large part the country's recent economic experience.

III. RUSSIAN BUSINESS CRIME & WESTERN INVESTMENT

A. Western Investment

Simply put, investing in Russia, while potentially rewarding, has never been for the faint hearted. Although the law governing legal entities has developed considerably since 1991, the unenforceability of contracts, inadequate law enforcement, inchoate mechanisms for conflict resolution, and, most importantly, the criminalization of business, have scared all but the bravest — or most reckless — Western investors. The prevalence of

ASSOCIATED PRESS, Sept. 24, 1998, *available in* LEXIS.

50. *Id.*

51. See generally STEPHEN HANDELMAN, *COMRADE CRIMINAL* (1995).

52. See Dmitry Radyshesky, *The New Klondike Myth is Dispelled*, in *DOING BUSINESS IN RUSSIA* 22 (Linda Pinkham, 2d ed., 1995).

53. Åslund, *supra* note 3, at 25.

54. GOLENPOLSKY, *supra* note 41, at 53.

crime has predictably chilled the economy. As the American Chamber of Commerce in Russia put it shortly after the contract killing of American businessman Paul Tatum, “[o]ne can hardly expect an investment boom in a country where commercial disputes are settled through force of arms and investment risk includes the very life of the investor.”⁵⁵

Nevertheless, Western investment in Russia, until recently, has continued apace. By 1993, there were 12,000 registered enterprises with foreign involvement in Russia, with the United States registering the greatest number of joint ventures.⁵⁶ Although the sum of foreign investments and the number of enterprises with foreign participation has grown, “this growth was accompanied by a decline in the amount of the average foreign share in the charter capital of enterprises with foreign participation from [seventy-five to eighty] percent in mid-1993 to [thirty-five to thirty-six] percent in early 1994.”⁵⁷ Thus far, the great bulk of joint ventures between Westerners and Russians involved Western investment in the service sector,⁵⁸ including the production of consumer goods and services, such as clothing, fast-food, and furniture.⁵⁹ Of the 12,294 joint ventures with Western partners registered as of January 1, 1994, production of consumer goods accounted for 35.5 percent of all foreign investment.⁶⁰ Investment in basic industries — oil and gas, chemicals, metallurgy, timber, and the like — accounted for 32.2 percent.⁶¹ Business services, such as accounting, have (until very recently) also prospered, with all the “Big Four” accounting firms providing local financial and consulting services.⁶²

Investment banking had also begun to boom prior to 1998. By August 1997, the *Moscow Times* stock index was six times higher in dollar terms than eighteen months earlier, with the total value of Russian shares over \$100 billion.⁶³ Renaissance Capital, Creditanstalt of Austria, and Belgium’s Banque Bruxelles Lambert had already entered the market through

55. Michael Lelyveld, *Russian Leadership Hangs in a Delicate Balance*, J. COM., Nov. 6, 1996, at 2A.

56. See GOLENPOLSKY, *supra* note 41, at 48.

57. *Id.* at 61.

58. *Id.* at 63.

59. See generally U.S. Dept. of Commerce, *1997 Russian Country Commercial Guide*, July 30, 1996 (visited Nov. 6, 1998) <<http://www.itaiep.doc.gov/bisnis/country/rucg.html>>.

60. See GOLENPOLSKY, *supra* note 41, at 63.

61. *Id.*

62. See LAYARD & PARKER, *supra* note 22, at 144.

63. See *Russian Finance: Plenty to Go Round*, *supra* note 1, at 62.

acquisition, and Merrill Lynch and Goldman Sachs were expected to open a Moscow office by the end of 1997.⁶⁴

Overall, owing to the uncertainty of the business climate, the vast number of joint ventures with foreign investors has typically involved minor investments. Nonetheless, many major investors in a variety of fields, including Siemens,⁶⁵ Proctor & Gamble,⁶⁶ Credit Swiss First Boston Ltd.,⁶⁷ G.E.,⁶⁸ and Westinghouse,⁶⁹ have taken the plunge. Until very recently, many experts believed this wave of investment would be the first of several waves that would result in Western investment patterns similar to those found in Taiwan, South Korea, or China.⁷⁰

1. Foreign Direct Investment

Foreign Direct Investment (FDI) in Russia has outpaced investment in the other nations of the former Soviet Union (with the exception of the Baltic countries).⁷¹ And yet, due to political instability, inflation, and other problems associated with new markets, Western investment in Russia has been less than in the Eastern European nations, and far less than in emerging Asian markets.⁷² According to the U.S. Department of Commerce, "total foreign direct investment in Russia [by 1997] amounted to \$10 per person, compared with \$200 and \$100 in neighboring Poland and

64. *Id.* at 62-63. "Creditanstalt of Austria formed a joint venture with Grant, a broker . . . [while] Banque Bruxelles Lambert acquired an interest in United City Bank." *Id.*

65. Siemens has been a major investor in the Russian power sector. In October 1995, "Siemens (Germany) won a DM 200 million contract to build a gas powered steam turbine plant in the Siberian city of Omsk." *Power & Energy: Russia*, BUS. E. EUR., Oct. 9, 1995, available in LEXIS. Siemens also acquired minority interests in two St. Petersburg companies: a ten percent stake in Leningradsky Metallichesky Zavod/LMZ, a turbine maker, as well as a twenty percent stake in Elektrosila, a generator producer. *Id.*

66. See GOLENPOLSKY, *supra* note 41, at 14. Proctor & Gamble owns a fourteen percent stake in Novomoskovskbythim. *Id.*

67. *Id.* Credit Swiss First Boston Ltd. is the leading Western investor in the Russian securities market. *Id.*

68. See *Power & Energy: Russia*, BUS. EAS. E., Feb. 20, 1995, available in LEXIS. G.E. Power Systems, a division of G.E., acquired a seventy percent stake in a joint venture with Kirovsky Zavod, a St. Petersburg based firm, to produce gas turbines. *Id.*

69. *Id.*

70. See generally LAYARD & PARKER, *supra* note 22.

71. See generally U.S. Dept. of Commerce, *Business in the Newly Independent States (BISNIS)*, *Russia: Economic and Trade Overview* (last updated March 1, 1997) <<http://www.itaiep.doc.gov/bisnis/country/rusecon.htm>> [hereinafter "BISNIS"].

72. *Id.*

Lithuania [respectively].⁷³ In 1995, half of FDI was concentrated in four sectors: trade (17.1 percent), finance (14.3 percent), food (10.1 percent), and fuel (9.3 percent).⁷⁴ The power sector has seen high profile deals involving, among others, *Électricité de France*⁷⁵ and Asea Brown Boveri (ABB). In March 1996, ABB, a \$25 billion Swedish-Swiss conglomerate,⁷⁶ won two contracts worth approximately \$100 million from Omskenergo, the Omsk energy utility producer, to supply equipment to power the Omsk HPP-3 power plant in Western Siberia.⁷⁷ Following FDI in the fuel sector were investments in the metalworking and machine building sector, the forestry sector, and chemicals.⁷⁸

2. Amount of Foreign Direct Investment

Estimates of FDI in Russia vary widely, due to “company confidentiality and the relative lack of definitive means of establishing actual cash inflows.”⁷⁹ Nonetheless, until August 1998, FDI in Russia was expanding rapidly. According to the Russian State Committee on Statistics (GOSKOMSTAT), FDI in 1993 totaled \$2.9 billion, with ninety percent of the capital in direct investments.⁸⁰ Unofficial U.S. Department of Commerce estimates were lower, but predicted FDI of \$290 million in 1992 (with no corresponding portfolio investment), \$1.36 billion in 1993 (with a corresponding \$300 million in portfolio investment), \$1.3 billion in 1994 (with a corresponding \$2.5 billion in portfolio investment), and \$1.5 billion

73. *Id.*

74. *Id.* In the previous two years, the fuel industry held a much more dominant role in the investment environment (accounting forty-four percent of total foreign investment in 1994). The ascendancy of investment in other industry areas can be interpreted as a positive sign of an economy that is becoming more diversified, and less reliant on the extraction of natural resources. *Id.*

75. See *Power & Energy: Slovakia*, BUS. E. EUR., Jan. 8, 1996. “Slovakia: Electricite de France (France) has signed an agreement with Slovenske Elekrarne, the state-owned utility company, to provide technical and support services to complete the first two units at the embattled Mochovce nuclear power plant.” *Id.* See *Power & Energy: Lithuania*, BUS. E. EUR., Jan. 29, 1996 (discussing an agreement between Electricite de France and Lithuania to conduct a feasibility study to sell electricity to Western Europe).

76. See generally ROSABETH MOSS KANTER, *WORLD CLASS: THRIVING LOCALLY IN THE GLOBAL ECONOMY* 47–48 (1997).

77. See Ian Rodger, *ABB Wins Russian Power Deal*, FIN. TIMES, Mar. 14, 1996, at 3, available in LEXIS.

78. See BISIS, *supra* note 71.

79. *Id.*

80. See GOLENPOLSKY, *supra* note 41, at 59–60.

in both FDI and portfolio investment in 1995.⁸¹ By 1996, GOSKOMSTAT estimated the total volume of accumulated foreign direct investment in the Russian Federation at just over \$7 billion.⁸² Looking at the Commonwealth of Independent States (CIS) as a whole, the total was between \$10 and \$11 billion.⁸³

Investors have been primarily Western, and of those, predominantly European. The five leading sources of investment in Russia, as of July 1, 1993, were the aggregate East European nations (14.5 percent), the United States (10.6 percent), Finland (9 percent), Germany (8.3 percent), and Italy (7.8 percent).⁸⁴ The largest single investor, in cumulative dollars, has been the United States.⁸⁵ The Russian Ministry of the Economy estimated in March 1996 that in 1995 the U.S. accounted for 29.1 percent of new total investment (\$812.9 million), Switzerland 15 percent (\$419.8 million), and finally Germany 10.5 percent (\$293 million).⁸⁶

B. Governing Law Regarding Western Investment In Russia

Structuring investments in Russia is still complex and unsettled. Corporate law regulating Western investment is found in several different instruments. The most recent instrument is the Russian Civil Code. Part One of the Civil Code was adopted by the Russian State Duma on October 1994.⁸⁷ Part Two was adopted in December 1995⁸⁸ and signed by President Yeltsin on January 26, 1996. Prior to adoption of the entire Civil Code on January 1, 1995, the creation, function, and dissolution of corporate entities in Russia was governed by three separate pieces of legislation: the Law on Enterprises,⁸⁹ the Law on Joint Stock Companies, put into force by the

81. See BISNIS, *supra* note 71.

82. See GOLENPOLSKY, *supra* note 41, at 60.

83. *Id.*

84. *Id.*

85. See BISNIS, *supra* note 71.

86. *Id.*

87. Federal Law on the Introduction Into Operation of Part One of the Civil Code of the Russian Federation, *Sobr. Zakonod. RF*, 1994, No.32 [weekly] Art. No. 3302, *reprinted and translated in WILLIAM E. BUTLER, CIVIL CODE OF THE RUSSIAN FEDERATION* 504 (1997).

88. Federal Law on the Introduction Into Operation of Part Two of the Civil Code of the Russian Federation, *Sobr. Zakonod. RF*, 1996, No. 5 [weekly], Art. No. 411, *reprinted and translated in BUTLER, supra* note 87, at 509.

89. See RSFSR: Law on Enterprises and Entrepreneurship, *enacted in Dec. 25, 1990, reprinted in ECONOMIC LAW OF RUSSIA, available in LEXIS.*

RSFSR Council of Ministers Decree 601,⁹⁰ and the Foreign Investment Law.⁹¹ The Civil Code does not supplant these earlier instruments, though it does seek to clarify their provisions.⁹² If conflict arises between the Civil Code and previously existing legislation, the Civil Code will prevail.⁹³ In addition, both the Federal Assembly and the President may issue legal decrees under the Constitution, which may impact business.⁹⁴ Overall, experts believe that Russian corporate law has largely stabilized, and barring radical political change, will continue to do so.⁹⁵

C. Structuring Investments in Russia

Generally, FDI in Russia is structured in one of three ways under existing Russian corporate law.

1. Portfolio Investment

First, foreign investors may purchase enterprises outright through state-sponsored privatization.⁹⁶ Investors may participate as primary or secondary purchasers of securities, thus obtaining equity interests.⁹⁷ Foreign portfolio investment is increasingly used by individuals and corporations for short-term returns.⁹⁸ "Portfolio investment equities are traded on several markets, with foreigners owning as much as [forty] percent of Russian companies' publicly-traded equities."⁹⁹ In certain sensitive sectors, such as oil or gas, mandatory investigations of foreign investors are required, while in other areas, investment may be denied altogether.

90. See Jonathan Russin, Aleksander Podolsky & John Knab, *Forming a Russian Company*, March 1, 1996 (visited Oct. 27, 1998) <<http://www.itaiep.doc.gov/bisnis/country/russin.html>>.

91. See RFSFR: Law on Foreign Investments, enacted on July 4, 1991, reprinted in 31 I.L.M. 397 (1992).

92. See GOLENPOLSKY, *supra* note 41, at 98.

93. See Russin, *supra* note 90.

94. See GOLENPOLSKY, *supra* note 41, at 96.

95. *Id.* at 98.

96. *Id.*

97. *Id.*

98. BISNIS, *supra* note 71.

99. *Id.*

The 1997 surge in the Russian stock market enticed several large institutional investors into the Russian market.¹⁰⁰ Renaissance Capital announced plans in July 1997, to merge with MFK, the investment banking arm of a diversified Russian conglomerate whose leader is Uneximbank, Russia's largest private bank.¹⁰¹ The merged bank will be called MFK-Renaissance, and will have equity of \$200 million and gross assets of \$2 billion.¹⁰² Given the recent troubles, however, banking initiatives are suspended, and share prices have plummeted.

2. Representative Offices

A second vehicle for investment is for a Western investor to open an independent, representative office of a foreign corporation. Article 55 of the Civil Code provides (vaguely) that corporations may establish "representations and branches."¹⁰³ The representative office is an "individual subdivision" of an existing corporation and may be used as a point of contact, or liaison office between the foreign investor and a Russian enterprise.¹⁰⁴ A representative office may be either accredited or unaccredited.¹⁰⁵ "An accredited office can market and sign contracts, but cannot engage in taxable commercial activities."¹⁰⁶ A non-accredited office is in most respects identical to the accredited office, except that it may not issue invitations to foreigners to visit the office, which is necessary to receive visas.¹⁰⁷ Representative offices allow a business to keep its options open and establish contacts before committing FDI.¹⁰⁸

100. See *Russian Finance: Plenty to Go Round*, *supra* note 1, at 62-63.

101. *Id.* at 63.

102. *Id.*

103. Civil Code of the Russian Federation (Part I), art. 55, *Sobr. Zakonod. RF*, 1994, No. 32 [weekly] Art. No. 3301, *reprinted and translated in BUTLER*, *supra* note 87, at 29.

104. See PRICE WATERHOUSE, *DOING BUSINESS IN THE RUSSIAN FEDERATION*, Jan. 1, 1994, at 59.

105. See U.S. Embassy, Moscow, *Working With Russian Business Partners* (Feb. 7, 1996) (visited Oct. 27, 1998) <<http://www.itaiep.doc.gov/bisnis/country/rupartnr.html>>.

106. *Id.*

107. *Id.*

108. See GOLENPOLSKY, *supra* note 41, at 100.

3. Registered Joint Ventures

A third way of investing, and the most common, is through a joint venture. Generally, a joint venture is similar to a partnership, and may be structured in a variety of ways.¹⁰⁹ Western firms may incorporate a new entity under Russian law or invest in an existing Russian entity. In the Russian context, it is common for the Western investor to provide the necessary capital, while the Russian partner may provide a low-cost, under-used manufacturing facility, or, in the case of marketing Western goods, local knowledge and access to a wide market.¹¹⁰ Many Western corporations, including Mars, Pepsi, Coca-Cola, Caterpillar, and Deutschetelekom have invested in Russia through joint ventures.¹¹¹ As experts point out, “[m]ost Western companies that have started up in Russia have as their prime objective supplying the potentially huge domestic market, and they want to do so from inside Russia, because costs are low (wages around \$100 a month) and most imports are taxed.”¹¹²

4. Legal entities for joint ventures.

The Russian Civil Code provides for four legal entities. Investors can establish or invest in general partnerships (*tovarishchestvo na vere*), limited partnerships, (*kommanditnoe tovarishchestvo*) and limited responsibility societies¹¹³ (similar to American LLCs, or German *GmbHs*).¹¹⁴ However, the most common form, and thus the most appealing to any Western investor looking to register an enterprise in Russia, is the non-publicly traded or “closed” Joint Stock corporations. This is often structured by way of a joint venture between a Western investor and an existing Russian organization.¹¹⁵

The closed Joint Stock Company (“JSC”) is similar to a Western corporation. It may issue shares, limit liability for shareholders, and the

109. See RALPH H. FOLSOM & MICHAEL W. GORDON, INTERNATIONAL BUSINESS TRANSACTIONS 541–42 (1995).

110. See LAYARD & PARKER, *supra* note 22, at 144.

111. *Id.*

112. *Id.*

113. See GOLENPOLSKY, *supra* note 41, at 101.

114. See OECD, INVESTMENT GUIDE FOR THE RUSSIAN FEDERATION 89 (1996) [hereinafter “OECD GUIDE”].

115. See PRICE WATERHOUSE, *supra* note 104, at 62.

like.¹¹⁶ A closed JSC has a limited number of shareholders and restricts registration and transferability of shares in accordance with the articles of incorporation.¹¹⁷ The Law on Foreign Investment, as well as Article 98 of Part One of the Civil Code (with parallel provisions) delineates the procedure for forming a closed JSC.¹¹⁸ Registration with State Agencies,¹¹⁹ capitalization rules,¹²⁰ and disclosure requirements must be met as well.¹²¹ Specific registration requirements exist for joint ventures involving foreigners.¹²²

IV. RUSSIAN BUSINESS CRIME

A. *The Post-Soviet Russian Economy*

Even before the current economic crisis, Russia was generally regarded as the "Wild West" of the modern global economy. Economic liberalization made a few extraordinarily wealthy, while others, especially the elderly and those on fixed incomes, have seen their savings evaporate and their standard of living fall precipitously under the free-market reforms

116. Civil Code of the Russian Federation (Part I), art. 96 § 1, *reprinted and translated in BUTLER, supra* note 87, at 55. "Participants in the joint-stock company (shareholders) shall not be liable for its obligations and bear the risk of losses connected with the activity of the society within the limits of the value of the stocks belonging to them." *Id.*

117. *See* OECD GUIDE, *supra* note 115, at 90.

118. Civil Code of the Russian Federation (Part I), art. 98, *reprinted and translated in BUTLER, supra* note 87, at 56. *See* PRICE WATERHOUSE, *supra* note 104, at 63-64 (describing the various and complex steps necessary to forming a JSC).

119. *See generally* PRICE WATERHOUSE, *supra* note 104, at 60-63.

120. *Id.* at 63. As of 1994, minimum capitalization for a closed JSC was 10,000 rubles and 100,000 rubles for an open JSC. *Id.*

121. *Id.* at 63-64. JSCs are required to make available for inspection accounts, reports, and other information contained in the founding documents, and other accounting requirements may be required in addition by the Ministry of Finance. *Id.*

122. *See Working With Russian Business Partners, supra* note 105. Closed JSCs are not only the easiest for foreign investors to employ, should they choose the registered enterprise as their vehicle for penetrating the Russian market, but they are also the legal entity most misused for commercial crime. Of commercial crimes committed in the private sector in 1995, the majority were perpetrated in or with JSCs. *See* Larisa Kislinskaya, *7,000 Economic Crimes Committed in Moscow in 1995*, ITAR-TASS, Jan. 24, 1996, *available in* LEXIS. "The Department of Economic Crimes has prepared law suits against almost 8,000 people" in 1995. *Id.* Roughly 17 percent of these crimes were committed in the banking and financial sphere, and 3.5 percent were committed involving foreign investment activities. *Id.*

spearheaded by Yegor Gaidar in 1991.¹²³ The collapse of Soviet central planning brought prosperity, destitution, and uncertainty. State institutions, such as schools and hospitals, experienced a loss of subsidies and found state infrastructure and services in dramatic decline.¹²⁴ The drop in life expectancies, especially for men, dramatically represents the frightening disintegration of post-Soviet Russia's economic and social life. In 1987, life expectancy peaked for Russian men at sixty-five years. By 1993, it had fallen to fifty-nine years.¹²⁵

However, the widespread growth of crime is the most noticeable change in Russia and has had the most profound social and economic consequences. There were many reasons for this. The fledgling Russian Republic lacked a body of commercial law regulating economic crimes, civil institutions laying out fiduciary responsibilities and expectations – indeed, even the tradition of a *Rechtstaat*; in which rules, and not powerful individuals or institutions, were paramount. As one expert put it, “[i]n contemporary Russia as well as in medieval Europe personal relationships are often more important than relations based on formal roles in political, social, or economic structures. This means that the most powerful people in the country are not elected officials, but the close friends of the president.”¹²⁶ As a result, *krysha*, a “private roof of protection,” has become a key element of business relations.¹²⁷ Additionally, the lack of a tradition of private property rights and a civic culture contribute to the pervasiveness of corruption. As one expert pointed out, politicians and government employees, “entertain close relationships with the companies whose stock they own.”¹²⁸ Western business ethics simply do not exist.

In this milieu, crime exploded, with profound social and economic consequences. Consequently, many began to associate lawlessness with post-Communist liberalization and democracy in general. The Russian word for privatization (*privitizatsia*) was replaced in common parlance by *prikhvatizatsia*, or “grabitization.”¹²⁹ As the Chairman of the U.S. House International Relations Committee put it,

123. See REMNICK, *supra* note 2, at 46.

124. *Id.*

125. *Id.*

126. Vladimir Shlapentokh, *Russia: Privatization and Illegalization of Social and Political Life*, WASH. Q. Winter 1996, at 66.

127. *Id.* at 65.

128. *Id.* at 72.

129. See Jean MacKenzie, *Eastern Pride and Western Prejudice*, THE MOSCOW TIMES, Feb. 13, 1999, available in LEXIS.

Russian organized crime groups have flourished like mold in a petri dish in this new and open economic environment. The evidence suggests that they buy parliaments, manipulate markets and currencies and engage in money laundering and cyber-crime. They are also trafficking in narcotics, as well as the illicit sale of arms, including possible weapons and technology of mass destruction.¹³⁰

B. The Soviet Economic System & Corruption

In many respects, the corrupt habits and institutions of the past Soviet system produce present day commercial crimes. Particularly, the Soviet socialist economic system is to blame. The system sustained and nurtured the necessary pre-conditions for the lawlessness of the current post-Soviet landscape.

1. "Irrational" Decision Making

In market economies, "rational" principles of supply and demand, not irrational preferences, govern micro and macro economic decision making. Generally, inefficiency is weeded out through competition. Badly run, unprofitable, or inefficient firms fail. Corruption, even in relatively transparent economies, such as the United States, is an attempt to evade this outcome. It is an attempt to achieve through illicit payments or similar favors results that could not be obtained through the neutral decision making of the market.

In nonmarket economies, some other mechanism must exist to allocate resources, set prices, and otherwise make the distributional decisions typically solved through the interaction of supply and demand. In the Soviet system, the Communist Party of the Soviet Union ("CPSU") made all such decisions by administrative fiat, within the parameters of the annual state budget.¹³¹ The CPSU, "determin[ed] the allocation of total output by end use among private consumption, investment, public consumption, defense, and administration."¹³² Instead of the neutral mechanism of the

130. *Webwire—Threat From Russian Organized Crime: Hearings on Russian Organized Crime, Before House International Relations Committee, 104th Cong.* (Remarks of Benjamin A. Gilman, Chairman of House International Relations Committee) *available in WESTLAW.*

131. See PAUL R. GREGORY & ROBERT STUART, *SOVIET ECONOMIC STRUCTURE AND PERFORMANCE* 191 (4th ed. 1990).

132. *Id.* See also RICHARD PIPES, *SURVIVAL IS NOT ENOUGH* 116, 117 (1984). [T]he

market, decisions were made by personal preference, political need — and corrupt practices. These “irrational” incentives were prime movers in the Soviet economy.¹³³ Among other side effects, this economic system created and sustained a high level of corruption. Inefficiency led to corruption, and corruption caused more inefficiency, creating a vicious and seemingly unbreakable cycle.

2. “Soft-budget” Constraints in Socialist Economies

The prevalence of corruption as a principal economic incentive was only possible due to a distinguishing feature of the socialist economic model: money as a “soft budget” constraint. The classic explanation for this dynamic was formulated by Hungarian economist Janos Kornai. Kornai differentiated between resource, demand, and budget constraints in socialist economies.¹³⁴ A budget constraint; that is, the ability of a firm to cover its expenditures from its own proceeds, can be either “hard” or “soft.”¹³⁵ In free market economies, budget constraints are typically “hard”; in other words, the inability of a firm to make a profit or sell its product results in economic loss. If a firm in a market economy sells fewer products, it will produce fewer of them. If a firm cannot sell any products, it will go bankrupt.

Conversely, in socialist economies such as the Soviet Union, money was a “soft budget” constraint.¹³⁶ The inability of a firm to sell its product was only marginally relevant to its status as a going concern. Put in economic terms, “there [was] little or no connection between monetary and real phenomena [in the Soviet economy]; money [was] *neutral* in terms of

system is so absurdly designed that those responsible for production may be said to have a vested interest in preventing it from improving. Instead of allowing costs and profits to determine what is produced and in what quantities, the government sets arbitrary production quotas for each branch of the economy.

Id. at 116.

133. See ED A. HEWITT, *REFORMING THE SOVIET ECONOMY: EQUALITY VERSUS EFFICIENCY* 196–98 (1988).

134. Janos Kornai, *Soft Budget Constraints*, in *FROM STALINISM TO PLURALISM* 184 (Gale Stokes ed., 1991).

135. *Id.* at 185.

136. *Id.* at 186. It was this difference, according to Kornai, that principally differentiated socialist and capitalist economies. “With the classical capitalist firm it is usually the demand constraint that is binding, while with the traditional socialist firm it is the resource constraint.” *Id.*

economic activity.”¹³⁷ In such a system, “financial outcomes, such as profits or credits, [do] not affect real economic variables, such as output, employment.”¹³⁸ The result, Kornai pointed out, was that if a firm continued to lose money, it would not necessarily go bankrupt.¹³⁹ Instead, the state would come to its aid through various means:¹⁴⁰ the firm would receive additional credit, its taxes would be reduced, it would be granted a subsidy, or its selling price would be raised.¹⁴¹ Whatever the means, the firm would survive financial difficulties.¹⁴² In such a soft-budget system, what in a normal economic system would have been a bankrupt firm might still continue for years, or even decades, as a going concern. As a result, enterprises became dependent upon government officials for patronage. Firms would receive state support not because of efficiency, but because of connections. The soft-budget model was inherently undisciplined, and because it relied on patronage and connections to function, it made corruption inevitable and far-reaching.

3. The Role of Corruption in Socialist Economies

The combination of a secretive, closed political system, a lack of budgetary constraints, and the monopolization of power by the CPSU created a climate conducive to widespread corruption. First, the absurd over centralization of the Soviet system ensured a “black market” or “second economy.”¹⁴³ This second economy, “encompass[ed] the barter of goods and services; moonlighting by state employees; the use of government equipment and material for personal profit; construction work; and, above all, the production and marketing of food.”¹⁴⁴ Bribery, police protection, and kickbacks were fundamental byproducts of this private economy. “The entire Soviet system — everything, without exception — was nothing more than an enormous black market,” one Soviet dissident

137. GREGORY & STUART, *supra* note 132, at 190.

138. *Id.*

139. Kornai, *supra* note 135, at 186.

140. *Id.*

141. *Id.* “Accordingly [a firm’s] demand is hardly constrained by solvency considerations.” *Id.*

142. *Id.*

143. PIPES, *supra* note 133, at 142–43.

144. *Id.* at 143.

wrote.¹⁴⁵ Although the formal structures of the Soviet state collapsed in 1991, the informal practices, mores, and relationships live on.

Secondly, the centralization of all national power and money in the hands of the CPSU fostered corruption amidst the ruling elite. As one observer noted: "Communist regimes represent an instance of public authority that owns all the nation's wealth and invades every sphere of its life. And since they provide no external checks on those who wield this authority, they inexorably become corrupted from top to bottom."¹⁴⁶

By the 1970s, criminal syndicates known as *vory v zakone* (or "thieves in law") were either aligned with or indistinguishable from the authorities and engaged in a multitude of criminal activities.¹⁴⁷ The principal beneficiaries of the Soviet economy had become the members of the *nomenklatura*, not society at large.¹⁴⁸ "The *nomenklatura*'s principal attributes — a paramilitary hierarchy, hostility towards outsiders, and a propensity for illegal behavior — established its similarity with the criminal societies of the old Russian underworld."¹⁴⁹ By the Brezhnev era, the *nomenklatura* had deteriorated from the small, ideologically motivated elite of revolutionary times to a large parasitic class, in many respects indistinguishable from a criminal syndicate. Bribery, extortion, and even murder were not an ugly side-effect of power (as they are, to some extent, in all economies) but the principal reasons for obtaining power, and the chief instruments of maintaining it. As one observer noted at the time: "[I]n the Soviet Union any post, whether in the Party, the state or the economic apparatus, entitles the incumbent to extort money and services from those who depend on his good will . . . [I]ndeed, for many officials, the reason for aspiring to office is to be able to engage in extortion."¹⁵⁰ The situation had so deteriorated that, just prior to the collapse of Communism, one observer pointed out, "[t]he system virtually compels honest people to turn criminal and thus to live under permanent threat of exposure and punishment."¹⁵¹

145. HANDLEMAN, *supra* note 51, at 64.

146. PIPES, *supra* note 132, at 153.

147. *Russia's Mafia: More Crime Than Punishment*, ECONOMIST, July 9, 1994, at 19. It is estimated that currently 289 *vory v zakone* operate in Russia, distributing favors, and dividing up territories and distribution networks. *Id.* See generally HANDLEMAN, *supra* note 51, at 28–43.

148. PIPES, *supra* note 132, at 29.

149. HANDLEMAN, *supra* note 51, at 99.

150. PIPES, *supra* note 132, at 153.

151. *Id.* at 157.

C. The Emergence of Business Crime In Post-Soviet Russia

While it was known that corruption thrived in the Soviet bloc, it took the end of the Cold War to really expose the depths to which it had become entrenched. Prior to the end of the Cold War, the costs of this massively corrupt economic order could be hidden behind an iron curtain of nationalized industries and bureaucratic regulations. Sprawling government bodies encouraged a black market of favors, the costs of which could easily be hidden by falsifying business records. Without the discipline of a bottom line, inefficient and corrupt enterprises could stagger along for decades. The corruption in the Soviet Union was so well disguised that few Western observers comprehended extent of the disintegration. Between 1928 and 1955, for example, Soviet GNP was estimated at increasing 4.4 percent to 6.3 percent per annum.¹⁵² Even by the mid-1980s, the CIA estimated Soviet growth at a healthy 2 to 2.3 percent growth per annum.¹⁵³ We now know the growth rate was closer to zero, and may have even been negative. The gears of the system had simply frozen up, but few outsiders could see it.

The end of the Soviet Union exposed this breakdown to world scrutiny. "Post-Soviet market reforms kicked over a rotting log, disclosing and also liberating the corruption and mayhem of the underground."¹⁵⁴ In the chaotic atmosphere accompanying the collapse of the old order, it was perhaps inevitable that the widespread criminal activity would overtly thrive. Whether inevitable or not, two factors were especially critical in allowing commercial crime to flourish as it has. First was the collapse of the centralized command-and-control economic model. The result has been that while the soft budget constraints of the old system continue to erode, the hard budget constraints of a truly free economy are not yet in place. The result is a sort of corrupt version of capitalism, operating largely outside the framework of law.¹⁵⁵

152. FRANCIS FUKUYAMA, *THE END OF HISTORY AND THE LAST MAN* 28 (1992).

153. *Id.* Even as late as 1984 John Kenneth Galbraith, an economist at Harvard University opined, "[the] Soviet system has made great economic progress in recent years One can see it in the appearance of solid well-being of the people in the streets." *Quoted in* Robert Conquest, *Academe & the Soviet Myth*, *NAT'L. INTEREST*, Spring 1993, at 91, 96.

154. Robert S. Leiken, *Controlling the Global Corruption Epidemic*, *FOREIGN POLICY*, Dec. 1996, at 55, 62.

155. *See* REMNICK, *supra* note 2, at 108.

Second, the breakdown of law and order permitted crime to flourish. As yet, there is little effective law enforcement in Russia. Nor is there an effective judiciary. Worse, both the law enforcement and the judiciary are thoroughly corrupt.¹⁵⁶ Personal protection and dispute resolution is largely a personal matter outside the regulation or competence of the state. "People look for protection by offering rewards on a private basis — either by making special arrangements with state agencies, powerful local bosses, or criminal organizations, or by creating private armies."¹⁵⁷ The result is what some regard as a "feudalization" of contemporary life, in which violence is rampant, state agencies are ineffective, personal relationships matter more than formal roles or legal structures, and no distinction exists between the public and private spheres of life.¹⁵⁸

D. Russian Business Crime

An understanding of this background is essential to Westerners engaged in business in Russia. Westerners need to be prepared for these realities, as well as the types of crime they are likely to encounter while doing business in Russia.

1. Extortion

The most threatening commercial crime affecting foreigners conducting business in Russia is extortion. Typically, extortion demands begin with mafia figures approaching Western investors for protection money.¹⁵⁹ If the Westerner agrees, demands then escalate from simply protection money to giving jobs to criminals.¹⁶⁰ In the worse situations, the criminals eventually take over the entire business.¹⁶¹ According to the U.S. Chamber of Commerce, of 199 businesses operating in Russia, 19 were approached for protection money.¹⁶² The numbers, however, may understate the degree to which criminal activity permeates business life. "[M]ost active people in the country are linked directly or indirectly with corrupt officials, with a criminal organization, or with both. Business in

156. See *infra* notes 235–46 and accompanying text.

157. Shlapentokh, *supra* note 127, at 67.

158. *Id.*

159. See GOLENPOLSKY, *supra* note 41, at 209.

160. *Id.*

161. *Id.*

162. *Id.*

the country is impossible without the support of a corrupt bureaucracy and criminal organizations.”¹⁶³ Even where businesses avoid outright extortion, the indirect need for *krysha* of some sort is paramount.¹⁶⁴

2. Bribery

Bribery has a venerable history in Russia. The Czarist empire was well known for its lethargic and corrupt bureaucrats, foreshadowing their Soviet (and now, again, Russian) successors by several centuries. Under the Czarist empire, once taxes and other dues were given over to the state, officials were allowed to keep whatever excess they could squeeze out of the population, a process known as *kormleniia* (“feedings”).¹⁶⁵ The institution of bribery was so prevalent that by the late seventeenth century, Moscow officials set formal tariffs on the loot that officials could carry over with them into retirement, with the government taking the remainder.¹⁶⁶ “Even in the Imperial period, . . . bribery was universal.”¹⁶⁷ During the Golden Age of Nineteenth century Russian literature, the bribe-taking government official was a common character.¹⁶⁸ In 1836, Nikolai Gogol lampooned the corruption of Imperial Russia in *The Government Inspector*, in which the town judge laments, “I freely admit I take bribes, but what kind of bribes? Borzoi puppies, that’s all!”¹⁶⁹

In contemporary Russia, bribery is by far the most prevalent commercial crime, and at the same time, the least punished.¹⁷⁰ In 1995, the Russian police reported 5,000 cases of bribery.¹⁷¹ In 1995, for example, of 15,000 plus charges filed for abuse of office, 5,000 were bribery counts.¹⁷² According to police officials charged with investigating and prosecuting

163. Shlapentokh, *supra* note 127, at 75.

164. *Id.* at 65.

165. PIPES, *supra* note 132, at 152.

166. *Id.*

167. *Id.*

168. See, e.g., GOGOL, *supra* note **, at 26. In the play, a case of mistaken identity results in the mayor, the town judge and other major figures of a small village heaping massive bribes on an itinerant stranger in the erroneous belief that he is a government agent from St. Petersburg. See generally, GOGOL, *supra* note **.

169. *Id.* at 26.

170. See Kislinskaya, *supra* note 123.

171. *Id.*

172. *Id.*

commercial bribery, the amount of bribery discovered by officials is as low as one percent of the amount of bribery that actually occurs.¹⁷³

3. Money Laundering

The objective of money laundering is to disguise the origins of criminals' cash by "laundering" it through apparently legitimate business concerns.¹⁷⁴ Laundering dirty money from the multitude of criminal activities in which the Russian mafia is engaged has become an extensive operation, involving collaboration with other criminal syndicates across Europe.¹⁷⁵ As a result, criminal penetration of the Russian banking system has become extensive. Some estimate that as many as eighty percent of Russia's banks may be under the control of the Russian mob,¹⁷⁶ while other European criminal syndicates funnel money into Russian banks under the guise of commercial deals or consulting contracts.¹⁷⁷ Once the money is "cleaned," it is then transferred back into European bank accounts.¹⁷⁸ The scope of the problem is such that some international agencies, such as the International Monetary Fund ("IMF"), and concerned nations, have begun to take action. In February 1997, Antigua closed down five out of six Russian offshore banks that were suspected of laundering money for the Russian mafia.¹⁷⁹

4. Violent Crime

With the spread of crime has come the spread of violence. "That Russian bankers are murdered in a gangland style on an [sic] almost weekly basis is part of the hard-edged reality of commercial life here," the U.S. Embassy in Moscow reported.¹⁸⁰ In the first five months of 1994, 664 crimes were committed with firearms or explosives in Moscow, and 188

173. *Id.*

174. *See That Infernal Washing Machine*, *ECONOMIST*, July 26, 1997, at 19.

175. *See* GOLENPOLSKY, *supra* note 41, at 214.

176. *Id.*

177. *Id.*

178. *Id.*

179. *That Infernal Washing Machine*, *supra* note 174, at 20.

180. U.S. Embassy in Moscow, Russia, *Russia's Emerging Commercial Class*, (visited Nov. 10, 1998) <<http://iepnt1.itaiep.doc.gov/ns-search/b...-set=\33493\s7h.493041&NS-doc-offset=13&>>.

cases of hostage-taking were reported.¹⁸¹ In 1995, there were 29,000 murders, of which two-thirds went unsolved.¹⁸² Russian Interior Minister Anatoly Kulikov estimated that there were 560 contract killings in 1995, and 450 in the first ten months of 1996.¹⁸³

Many murder victims have been extremely prominent people. In April 1994, Andrei Azderdzis, a Member of Parliament, was shot dead, allegedly because he owned a newspaper that had published a list of the top thieves in Russia.¹⁸⁴ The following year, Vladislav Listyev, a popular television journalist, was murdered. Listyev was slated to take over as head of Russian Public Television at Ostankino and was probably killed because the mafia feared that reorganizing advertising sales and other business practices would hurt their business.¹⁸⁵ Shortly thereafter in November 1996, Paul Tatum, an American partner in the Radisson-Slavyanskaya Hotel, fell victim to a gangland style killing.¹⁸⁶ This was the first incident of mob violence against a Western businessman and received major media attention.

The largest and most prominent murder in post-Soviet Russia occurred on November 20, 1998 when Galina Starovoitova, an outspoken member of the Russian Duma, an associate of the late Nobel Laureate Andrei Sakharov (considered by many to be the conscience of post-Communist Russia), and an international campaigner for human rights, was gunned down in her apartment building in St. Petersburg.¹⁸⁷ Ms. Starovoitova was regarded as a liberal pro-Western voice in Russian politics, as well as a vocal campaigner against corruption.¹⁸⁸ Her killing, occurring during the ongoing melt-down of the Russian economy, symbolized the fears of many that corruption was slowly strangling Russian's nascent democracy.¹⁸⁹

181. See *Russia's Mafia*, *supra* note 147, at 19.

182. See *Russia. Money Kills*, *ECONOMIST*, Nov. 16, 1996, at 51.

183. *Id.*

184. See *Russia's Mafia*, *supra* note 147, at 19.

185. See *Crime in the New Independent States: the U.S. Response*, U.S. DEPT. OF ST. DISPATCH (U.S. Dept. of St., Washington, D.C.), Apr. 3, 1995, at 680. After the Listyev murder, the U.S. State Department noted, "[t]he murder represents a great tragedy for Russia and for democracy; it also illustrates the viciousness of the new criminal breed in Russia." *Id.*

186. Lelyveld, *supra* note 55, at 2A.

187. Marcus Warren, *International: Russia Mourns its Leading Lady*, *DAILY TELEGRAPH*, Nov. 23, 1998, at 11; Elizabeth Williamson, *Thousands Mourn Russian Lawmaker*, *CHICAGO TRIBUNE*, Nov. 25, 1998, at 3.

188. Williamson, *supra* note 187, at 3.

189. Warren, *supra* note 187, at 11.

E. Effects of Russian Commercial Crime

1. Economic Effects on the Russian Economy.

The economic consequences of corruption have been extensively documented.¹⁹⁰ Generally, corruption misallocates resources, drains national treasuries of tax revenue, and allows incompetent and inefficient industries to escape the chastening rigors of the free market.¹⁹¹ Russia is no exception to the hardships and inefficiencies caused by the prevalence of commercial crime.

a. Corruption as a Hidden Business Tax

Commercial crime in Russia acts as a hidden tax on businesses, discouraging investment, and further burdening honest enterprises.¹⁹² The expenses are numerous. Yeltsin officials estimate that seventy to eighty percent of private businesses pay extortion fees in order to acquire *krysha*.¹⁹³ In order to move around Moscow, one might endure costs of \$10 to \$20 a day to bribe corrupt police officers.¹⁹⁴ A visit to a nuclear complex runs around \$3,000, while interviews with government officials — which are necessities to any Western investor seeking to do business in Russia —

190. See, e.g., Paulo Mauro, *Corruption and Growth*, Q. J. OF ECONOMICS, Aug. 1995, at 680. See also Michael A. Almond & Scott D. Syfert, *Beyond Compliance: Corruption, Corporate Responsibility, & Ethical Standards in the New Global Economy*, 22 N.C. J. INT'L L. & COM. REG. 389 (1997). "Corruption distorts markets because it sets prices not through supply and demand, but through self-serving, inefficient preferences. The efficient enterprise is often punished; the corrupt enterprise prospers." *Id.* at 434. See also Leiken, *supra* note 158, at 55, 64–65; Gregory Miles, *Crime, Corruption, and Multinational Business*, INT'L BUS., July 1995, at 34.

191. See generally Daniel Kaufmann, *Corruption: The Facts*, FOREIGN POLICY, Summer 1997, at 114.

192. *Id.* at 119–20. "[I]nvesting in a relatively corrupt country, as compared with an uncorrupt one, is equivalent to an additional 20 percent ('private') tax on the investment. The statistical relationship between corruption and lower foreign investment is valid across all regions." *Id.* at 120. Economists point out that corruption is even more punitive and distortionary than taxation. Andrei Shleifer & Robert W. Vishny, *Corruption*, Q. J. OF ECON., Aug. 1993, at 599–600.

193. *Webwire—Threat From Russian Organized Crime: Hearings on Russian Organized Crime, Before House International Relations Committee*, 104th Cong. (Remarks of John Deutch, Director of the Central Intelligence Agency) available in WESTLAW [hereinafter "John Deutch"]

194. See *Bribes in Russia: Just Say No?*, RUSSIA & COMMONWEALTH BUS. L. REP., Sept. 15, 1995.

run from \$200 to well over \$1,000, depending upon the officials' ranks.¹⁹⁵ In a 1995 report on barriers to trade and investment the American Chamber of Commerce in Russia exclaimed, "[w]hat used to be a reasonable and codified system of payments has now lost all sense of reality."¹⁹⁶ The spread of corruption and organized crime in the former Soviet Union has been a boom to one sector however — Western security agencies. A security service in Moscow costs between \$2,500 and \$5,000 per month per full-time guard.¹⁹⁷

b. Corruption as a Non-monetary Disincentive

Doing business in a corrupt society not only costs money but more importantly, time. One economist found a positive relationship between the prevalence of bribery and the amount of time a manager must spend with public officials.¹⁹⁸ Entrepreneurs who must elicit official permission for numerous business activities spend excessive amounts of time soliciting advice from government officials. High bribe-paying firms are forced to spend seventy-five staff weeks per year of (nonowner) administration time to deal with government officials, compared with a yearly average of only twenty-two staff weeks for firms that do not engage in extensive illicit payments.¹⁹⁹ Overall, it is estimated that managers in Russia spend between thirty to forty percent of their time dealing with government officials, rather than running their enterprise.²⁰⁰

c. Corruption and Capital Flight

Corruption also has a less obvious effect on nations: capital flight. Crime exacerbates social unrest, as well as political uncertainty, which causes investors to shelter their wealth abroad. This investment risk, coupled with large domestic savings rates, produces capital flight.²⁰¹ This dynamic has been observed in both China²⁰² and Russia.²⁰³ As a result,

195. Miles, *supra* note 190, at 28.

196. *Russia: Crime Counts*, BUS. E. EUR., July 10, 1995, at 5.

197. *Id.*

198. See Kaufmann, *supra* note 191, at 119.

199. *Id.*

200. *Id.* at 121. By contrast, managers in Chile, El Salvador, and Uruguay spend eight to twelve percent of their time, while in Lithuania it is fifteen percent. *Id.*

201. See GOLENPOLSKY, *supra* note 41, at 51.

202. See NICHOLAS D. KRISTOF & SHERYL WUDUNN, CHINA WAKES 361 (1995).

Russia has already become a major exporter of capital. Money that could be invested in factories, services, or infrastructure at home, is instead invested abroad. Much of the capital is dirty money, being sheltered abroad to protect Russian criminals fearing investigation. The Russian Interior Ministry estimates that criminal groups and shell corporations export \$1.5 billion a month to Western bank accounts.²⁰⁴ In May 1995, it was revealed that the Russian mafia had funneled hundreds of millions of dollars into Israeli banks, corporations, and the Tel Aviv Stock Exchange.²⁰⁵ One Israeli paper reported that Russian dirty money was the cause of a record \$9.5 billion foreign currency reserve reported by the Bank of Israel.²⁰⁶

On the other hand, a great proportion of exported capital consists of legitimate wealth, many from gas or oil monopolies. Much of this wealth will likely return to Russia once the political and economic situation stabilizes.²⁰⁷ If the wealth returns, this “hot” money will pour into the vast Russian market, much as émigré Chinese capital from Taiwan, Hong Kong, Indonesia, and the United States helped power the Chinese economic boom. Some predict that, “[w]hen Russian ‘hot’ money is combined with Russia’s huge markets, it surely will create a great power on the world stage.”²⁰⁸

2. Effects on Western Investment

Not surprisingly, corrupt nations — such as Russia — have difficulty attracting much-needed foreign capital. One economist found that nations that tolerate high levels of commercial corruption achieve five percent less aggregate investment levels than non-corrupt societies and lose about half a percentage point of GDP growth per year.²⁰⁹ “The negative association between corruption and investment, as well as growth, is significant, both in a statistical and in an economic sense.”²¹⁰ As CIA Director Deutch

According to the International Monetary Fund, Chinese sent \$27.9 billion in 1992. *Id.* at 361–62. While some of the money returned, disguised as foreign investment, much of remained in private foreign bank *Id.* at 362.

203. *Id.* at 186–209. For a summary of commercial corruption in China, see *Id.*

204. John Deutch, *supra* note 194.

205. See *Israel: Russian Mafia Invests Hundreds of Millions*, ARAB PRESS SERVICE DIPLOMATIC REP., May 20, 1995, available in LEXIS.

206. *Id.*

207. See GOLENPOLSKY, *supra* note 41, at 51.

208. *Id.* at 52.

209. See Kaufmann, *supra* note 191, at 119. See Mauro, *supra* note 191, at 683.

210. Mauro, *supra* note 190, at 683. “I find that corruption lowers private investment,

testified, "[t]he pervasiveness of crime and corruption in Russia and other newly independent states make it difficult for U.S. and Western firms to do business honestly in Russia . . . such a business climate impedes the flow of much-needed outside foreign investment to the Russian economy."²¹¹

3. Non-Economic Effects

Pervasive crime also causes extensive social problems. Respect for law enforcement and for government evaporates. Western investors, or multinational institutions, such as law or consulting firms, have trouble convincing their employees to relocate to such an environment. Social instability grows, creating opportunities for civil unrest, or even coup attempts. Perhaps worse, democracy becomes associated with lawlessness. As a result, citizens lose interest in democratic procedures or find them useless in solving their problems. A U.S. State Department report noted, "[r]ampant crime undercuts the development of fledgling democratic institutions, and allows criminal groups, rather than the citizenry, to become strong enough to become the ultimate brokers of power."²¹²

4. Effects on the United States and Europe

Russian commercial crime impacts neighboring countries and the world. According to John Deutch, Director of the CIA, "Russian crime groups have spread rapidly beyond the former Soviet borders and have a presence in up to 50 countries."²¹³ A report released by the Attorney General of California in March 1996 showed that Russian organized crime was an increasing threat to California's public safety.²¹⁴ The report showed that through sophisticated tax fraud schemes, Russian criminal syndicates had bilked governments out of \$2 billion a year.²¹⁵ According to this report, Russian expatriate criminal organizations are engaged in a variety

thereby reducing economic growth, even in subsamples of countries in which bureaucratic regulations are very cumbersome." *Id.*

211. John Deutch, *supra* note 193.

212. *Crime in the New Independent States*, *supra* note 185.

213. John Deutch, *supra* note 193.

214. See *Lungren Says Russian Organized Crime Is Growing Threat to State*, METROPOLITAN NEWS-ENTERPRISE, March 18, 1996, at 13, available in LEXIS.

215. *Id.*

of criminal operations, including drug trafficking, money laundering, auto theft, prostitution, and extortion.²¹⁶

V. ATTEMPTS AT CURBING ECONOMIC & COMMERCIAL CRIME

Since the collapse of the Soviet Union in 1991, various administrations under President Yeltsin have embarked on economic reform programs designed to turn the Russian Federation into a free-market, democratic society. The process has been slow and uneven. Perhaps the central issue of post-Communist economic life has been the continued monopolization of the "means of production" in various key sectors, and the attempts by various reform administrations to undo the monopolies through privatization, price deregulation, the creation of a system of private property rights, and foreign investment.

A. Government Efforts At Controlling Corruption

Crime fighting has always been a vocal priority of post-Soviet administrations. In February 1993, Boris Yeltsin declared, "organized crime has become a direct threat to Russia's strategic interests and national security."²¹⁷ Since then numerous anti-corruption initiatives have been put forward, only to slowly peter out. A 1992 Presidential *ukase*²¹⁸ (or decree) forbade all civil servants from exploiting their office for commercial gain. However, the vagueness of the decree and the breadth of institutionalized corruption undermined the effectiveness of the decree.

President Yeltsin attempted to make anti-corruption a theme of his 1996 Presidential campaign, at one point promising to "pound the stuffing out of bribers in Russia."²¹⁹ After Yeltsin's election, the appointment of General Alexander Lebed as national security advisor in June 1996 was thought to signal a serious effort to tackle corruption. But Lebed's fall shortly thereafter ended his "Truth and Order" campaign even before it had begun.²²⁰ Boris Nemtsov later made anti-corruption part of a longer

216. *Id.*

217. *Russia's Mafia*, *supra* note 147, at 19.

218. *Ukase of the President of the Russian Federation: On the Fight Against Crime in the Civil Service System*, ROSS. GAZETA, 7 Apr. 1992.

219. Marshall Ingwerson, *Russia's New Head Cop Aims His Broom at Graft Among Elite*, CHRISTIAN SCI. MONITOR, June 27, 1996, at 6.

220. Boris Yeltsin: "We must pound the stuffing out of bribers in Russia," CURRENT DIG. OF POST-SOVIET PRESS, May 29, 1996, at 12.

strategy of liberalizing the economy. At the Parliamentary level, Vladimir Volkov, a member of the Defense Committee of the State Duma, began drafting a proposed military policy law in February 1997.²²¹ It would establish a pilot 5,000-person unit in the first year. Thereafter, if the test unit is effective, the force would be expanded to a full anti-corruption military police force of 27,000.²²² Yet despite these and many similar initiatives, corruption both within the business and political elite and in society at large remains as intractable as ever.

B. Tax Reform

The byzantine nature of the Russian tax structure is one of the principal sources of corruption, and appropriately the Russian government (under intense pressure from Western governments and multinational lenders) has attempted to reform the tax code. Stanley Fischer, an IMF official, noted that nonpayment is routine, and overlapping tax levels often drive rates to outright confiscatory levels.²²³ Special tax privileges and loopholes contribute to the criminal activity. In May 1997, the withdrawal of tax privileges for an Afghani veterans group led to a bombing that killed fourteen people.²²⁴ Tax avoidance has also risen to new and perilous levels. In 1996, twenty-six tax collectors were killed and seventy-four injured while carrying out their official duties; six were kidnaped, while another forty-one had their homes burned down.²²⁵ Stanley Fischer further noted, "the revenue picture has been nothing short of calamitous [with non-payment getting worse] it will not be possible to continue to keep a stable economy or to continue rational policies unless this [tax] issue is dealt with."²²⁶

221. See Simon Saradzhyan, *Russia: Military Declares War On Crime In Its Ranks*, Radio Free Europe/Radio Liberty (visited Nov. 5, 1998) <<http://www.rferl.org/nca/features/1997/02/F.RU.970221145015.html>>.

222. *Id.*

223. See Robert Lyle, *Russia: 'Fix the Tax System!' say Moscow and Washington*, Radio Free Europe/Radio Liberty (visited Nov. 5, 1998) <<http://www.referrl.org/nca/features/1997/04/F.RU.970402152114.html>>.

224. See *Disappearing Taxes: The Tap Runs Dry*, *ECONOMIST*, May 31, 1997, at 21.

225. *Id.*

226. Lyle, *supra* note 223.

C. Anti-bribery Legislation

1. Anti-bribery Restrictions Under the Criminal Code

Bribery restrictions exist in Russia law but are usually dealt with under the laws against corruption. "Corruption" is a vague term in Russian jurisprudence and encompasses several crimes under the Russian Criminal Code.²²⁷ Article 147(2)(2) criminalizes, "illegal appropriation of state property with selfish goals in favor of the culprit or other culprits through abuse of office."²²⁸ Article 175(1) notes corruption as that which, "violat[es] anti-monopoly legislation."²²⁹ In 1996, 3,504 criminal cases were filed on corruption charges, an increase of 30.8 percent over the previous year.²³⁰

2. Weaknesses in Russian Anti-bribery Enforcement

a. Vague and Unenforceable Anti-bribery Legislation

Current anti-bribery legislation is wholly ineffective for several reasons. First, the legislation is rarely enforced, and when it is enforced is done so for political reasons. Second, anti-corruption campaigns are hampered by vague and self-defeating legal provisions.²³¹ Under the current regulations, only government officials can be tried for bribery, while those engaged in private business are immune from prosecution.²³² Therefore, the bribee may be tried (if caught) but the briber can not. Fighting only the demand for corruption but not the supply has had predictably poor results. According to one Interior Minister, the police solve less than one percent of official bribery cases, even though bribery is by far the most widespread commercial crime.²³³ Further, there is no clear-cut legal definition of bribery, which hinders prosecution of even those few who are caught. For this reason, no one can be held guilty of fraudulent business activities, of failure to repay loans or government

227. *Interior Ministry Press Briefing Regarding the Control of Corruption*, OFFICIAL KREMLIN INT'L NEWS BROADCAST, Jan. 23, 1996, available in LEXIS.

228. *Id.*

229. *Id.*

230. *Id.*

231. See Kislinskaya, *supra* note 122.

232. *Id.*

233. *Id.*

credits, or of misuse of funds.²³⁴ As a result, not only bribery, but also money laundering, fraud, and false advertising go virtually unpunished.²³⁵

b. Police Corruption

Third, corruption has pervaded the very institutions that are ostensibly set up to combat it. The police force in Russia is thoroughly corrupt.²³⁶ The chief of Moscow's police force estimated in 1994 that ninety percent of his policemen were "on the take."²³⁷ The national traffic police, or GAI, who are posted at every major intersection are especially corrupt, often stopping motorists for minor or nonexistent infractions and collecting on-the-spot cash fines.²³⁸ As a sign of the ubiquity of bribery and the inability — or unwillingness — of the police to address it, consider the report that when Interior Minister Anatoly Kulikov sent a truck carrying vodka around Russia to measure police corruption, Kulikov found that police demanded bribes at twenty-two of twenty-four police checkpoints.²³⁹

c. Judicial and Prosecutorial Corruption

Fourth, the judiciary is equally corrupt.²⁴⁰ Almost all judges are carryovers from the Communist regime; they have no experience in administering a *Rechtsstaat*, and now use their position for self-enrichment. Yuri Boldyrev, who was briefly the government's chief investigator into corruption, succinctly stated that the decay in state and public institutions, "goes beyond the limits of the imagination."²⁴¹ In October of 1992, an Interior Ministry chief was arrested for bribery.²⁴² When his home was searched nearly \$500,000 in cash was found.²⁴³ In February 1996, Alexei

234. *Id.*

235. *Id.*

236. See *Russia's Mafia*, *supra* note 147, at 19.

237. *Id.*

238. See Clara Germani, *Business As Usual: Bribery Accepted, Jeered in Russia Old Tradition Enters New Era*, *BALTIMORE SUN*, Oct. 15, 1995, at A33.

239. See James P. Gallagher, *Yeltsin Targets Corruption*, *CHI. TRIB.*, Dec. 26, 1995, at 14.

240. *Russia's Mafia*, *supra* note 147, at 19.

241. REMNICK, *supra* note 2, at 109.

242. *Id.*

243. *Id.*

Ilyushenko, Russia's former top law enforcement official, was charged with bribery and abuse of power.²⁴⁴

In short, corruption has thoroughly permeated Russia's civic institutions, rendering enforcement of much anti-corruption legislation impossible. According to CIA Director Deutch, "it's truly impossible in many instances to differentiate between Russian organized crime and the Russian state."²⁴⁵ Not surprisingly, citizens are loathe to involve the police in disputes. Russia's prosecutor-general estimated that two out of three crimes went unreported.²⁴⁶ Many victims of commercial crime, both Russians and Westerners, refuse to report crimes that have been committed against them because they believe that police and prosecutors are involved in the criminal underworld.²⁴⁷ Consequently, commercial crimes, including, but not limited to bribery and graft, are recognized as an unavoidable cost of business. In the vast majority of instances, the cost of business crime is simply left "off the books," unreported, or ignored.

D. Antitrust as A Weapon Against Corruption

One potential tool against corruption is the establishment of an antitrust, or competition policy, possibly one modeled along the lines of the United States. Under Soviet socialism, the pervasiveness of rules, and the enormous degree of discretion given to bureaucrats to create, produce, or interpret regulations, allowed corruption to flourish.²⁴⁸ Much of this system remains in place. Indeed, to a large degree, the criminalization of business has occurred due to ex-Soviet bureaucrats becoming involved with organized crime.²⁴⁹ "[I]nstead of corruption being the grease for the squeaky wheels of a rigid administration, it becomes the fuel for excessive and discretionary regulations."²⁵⁰

244. *Russia's Former Prosecutor Charged With Bribery*, REUTERS N. AM. WIRE, Feb. 23, 1996, available in LEXIS.

245. John Deutch, *supra* note 193.

246. *Russia: Money Kills*, ECONOMIST, Nov. 16, 1996, at 51.

247. Gallagher, *supra* note 239, at 14.

248. See Kaufmann, *supra* note 191, at 116.

249. See HANDELMAN, *supra* note 51, at 69. "The relaxation of the command-administrative system had done little more than allow enterprising apparatchiks and black marketeers to convert the wealth they earned through the manipulation of the system into 'real' money." *Id.*

250. Kaufmann, *supra* note 191, at 116.

1. The Economic Relationship Between Corruption and Antitrust

Regardless of whether it occurs in established economies or emerging markets, bribery and other forms of commercial corruption destroy or undermine competition.²⁵¹ As one expert points out, whether made by an inefficient firm or an efficient firm that intends to reap monopoly prices, "the bribes very purpose is to avoid competition and thereby maintain higher prices (or poorer quality)."²⁵² Regardless of the circumstances, bribery levies an additional tax on business which is eventually passed onto consumers, directly through higher costs or indirectly through slower growth.²⁵³ Simply put, the purpose of bribery and other corrupt practice is to avoid the chastening mechanism of the market, and therefore wherever it occurs, it is ipso facto anti-competitive. Implementing a vigorous and effective competition policy is necessary to fight the very conditions that make corruption possible.

2. Monopolization as a Basis for Russia's Economic Problem

Greater use of antitrust is especially pressing in Russia, because extreme monopolization has been instrumental in creating the conditions for corruption and bribery to exist. President Kuchma of Ukraine pointed to the establishment of "state rackets" based on criminal use of monopoly power.²⁵⁴ "Bribery and corruption have become integral attributes of certain state institutions and organizations," he argued,²⁵⁵ "Those most encumbered with power in fact turned their state authorities and state property into a means of personal enrichment. . . . Whole semi-criminal clans appeared on this soil monopolizing individual sectors of the economy [and] seriously influencing all layers of state authority."²⁵⁶ Arguably, only

251. See Franklin Gevurtz, *Commercial Bribery and the Sherman Act: The Case for Per Se Illegality*, 42 U. MIAMI L. REV. 365, 373 (1987). Where a bribe is given to create a monopoly, the nexus with antitrust is clear. *Id.* Usually however, bribery would not produce such a drastic impact on the market. *Id.* "Indeed, it may only affect one sale." *Id.* at 374. Yet some economists have shown that even in oligopoly conditions, bribery is still a restraint to trade. *Bribonomics: Does Corruption Slow Growth?*, ECONOMIST, Mar. 19, 1994, at 86.

252. Gevurtz, *supra* note 251, at 391.

253. *Id.*

254. *Kuchma on Need to Fight "Fifth Power" of Shadow Economy and Illegal Wealth*, BBC SUMMARY OF WORLD BROADCASTS, Aug. 8, 1994, available in LEXIS.

255. *Id.*

256. *Id.*

the creation of a competitive market economy, with free enterprises operating within a stable rule of law, will break down the old state monopolies.

Antitrust is well suited to this purpose. One expert notes, “[a]s price regulation is removed, and privatization of enterprises continues, the need for establishing a set of rules of conduct covering the behavior of firms becomes increasingly apparent.”²⁵⁷

3. Russian Antitrust Law

a. Anti-monopoly Committees

The foundation of antitrust law in Russia is the “Law on Competition and Limitation of Monopolistic Activity in Goods Market” adopted by the Supreme Soviet in March 1991.²⁵⁸ The law was applicable to all goods and services traded in Russia, with the exception of financial markets, for which there is no comparable legislation. After the dissolution of the Soviet Union, the Yeltsin administrations of the Russian Federation have continued the legal efforts by creating Anti-Monopoly Committees (“AMCs”) in each region and one state AMC.²⁵⁹ A decree “On the State Committee of the Russian Federation for Antimonopoly Policy and Support of New Economic Structures” issued August 24, 1992 set out to make the state AMC “the central organ of the executive power of the Russian Federation” for antitrust issues.²⁶⁰ This body is responsible for implementing state policy regarding antimonopoly issues, limiting monopolistic activity, preventing unfair competition, and protecting consumer rights.²⁶¹ To this end, the state AMC was given sweeping powers.²⁶² Separate AMCs exist in the

257. Rose Anne Devlin & Sylianos Perrakis, *Legislating Competition Policy in the Russian Federation: A New Challenge for Antitrust Policy*, ANTITRUST BULL. Dec. 22, 1995, at 901-02.

258. *Id.* at 902.

259. *Id.* at 903. *See also* Law of the Russian Soviet Federated Socialist Republic On Competition and Restriction of Monopolistic Activities in Commodity Markets, Art. 3, *reprinted in* TRADE & COMMERCIAL LAWS OF THE RUSSIAN FEDERATION: OFFICIAL CODIFICATION & COMMENTARY (1994) [hereinafter “RSFSR Antimonopoly Law”].

260. *See Russia to Establish Legal Framework to Enforce Antitrust Matters, Control Monopolies*, RUSSIAN & COMMONWEALTH BUS. L. REP., Oct. 16, 1992.

261. *Id.*

262. *Id.* Enumerated powers included:

the authority to break up [enterprises] that occupy a dominant position in the market and engage in monopolistic activity; submitting proposals to

eighty-eight regions that comprise the Russian Federation.²⁶³ Regional AMC's implement local measures, while the state AMC formulates national policies and oversees the local boards.²⁶⁴

b. Antitrust Provisions that Relate to Commercial Corruption

The purpose of Russian antitrust policy is to promote free competition.²⁶⁵ According to the Law of the Russian Soviet Federated Socialist Republic On Competition and Restriction of Monopolistic Activities in Commodity Markets ("RSFSR Antimonopoly Law") "competition" is defined as "the contest between proprietary entities in which their independent activities effectively curtail the ability to influence the general conditions of a particular market and stimulate the production of goods and the supply of services."²⁶⁶

The RSFSR Antimonopoly Law is designed to prevent any firm from achieving a "dominant position on the market." To this end, Article 5 lists certain activities that are *per se* abuses of dominant market position.²⁶⁷ While corrupt practices are not specifically enumerated, the Criminal Code does criminalize, "monopolistic actions committed by means of the establishment of monopolistically high or monopolistically low prices, and likewise the limitation of competition by means of dividing the market,

appropriate government agencies for prohibiting or terminating export-import operations of enterprises that violate anti-monopoly legislation; authority to restrict and prohibit monopolistic activities and unfair competition; monitoring compliance with legislation for the protection of consumer rights; enforcement of antimonopoly legislation; [and] hearing cases involving violations of antitrust laws.

Id.

263. *Id.*

264. *Id.*

265. RSFSR Antimonopoly Law, *supra* note 259, art. 1.

266. *Id.* at art. 4.

267. *Id.* art. 5. Under the RSFSR Antimonopoly Law, the following are considered violations of dominant market position: (1) "the withdrawal of products from the market in order to create or maintain a shortage or to increase price;" and (2) "forcing a purchaser to accept unfavorable or unnecessary contract terms or irrelevant to the subject of the contract." *Id.*

limitation of access to the market. . . .”²⁶⁸ The provision is clearly intended to encompass a broad range of impermissible activities.

Without doubt, commercial corruption could be used to restrict competition, and thus could fall within the general prohibitions of the Antimonopoly Policy. Indeed, in February 1996, the state AMC found PepsiCo Inc. guilty of misappropriation and theft of trade secrets from American Medical.²⁶⁹ The state AMC also made known its intention in July 1996, to amend Russia’s consumer rights law to include financial institutions within the Antimonopoly Policy.²⁷⁰ Other new provisions could protect consumers from bank fraud and corruption within the Russian banking system by forcing banks to reveal more information about credit policies before signing up for loans.²⁷¹ This could be especially useful given the nexus between Russian crime and the banking system. Nevertheless, experts point out that formidable obstacles still lie in the way of the effective implementation of competition policy in this previously monopolized regime.²⁷² Without properly understanding the state’s role in the economy “Russia risks being mired in this economic no-man’s-land between a centrally planned system and a fully functioning market economy,” noted IMF Director Camdessus.²⁷³

E. Privatization and Corruption

A related strategy in de-monopolizing Russia’s economy, and thus removing the preconditions for commercial corruption, has been removing assets from state control through privatization. Privatization began as, “a pragmatic struggle to restore order and legitimacy to a transition market, where the state bureaucrats and politicians would have less control over the enterprise sector.”²⁷⁴ At the time, it was believed rapid privatization had

268. Criminal Code of the Russian Federation, art. 178, *Sobr. Zakonod. RF*, 1996, No. 25 [weekly], Art. No. 2954, *reprinted and translated in WILLIAM E. BUTLER, CRIMINAL CODE OF THE RUSSIAN FEDERATION 104 (1997)*. See also RSFSR Antimonopoly Law, *supra* note 259, art. 10.

269. See *American Medical Clinics Inc.: Russian Panel Finds PepsiCo Guilty in Trade-Secret Suit*, WALL ST. J., Feb. 27, 1996, at 4.

270. Alexei Smirnov, *More Bank Data Due Clients*, MOSCOW TIMES, July 19, 1996, available in LEXIS.

271. *Id.*

272. See Devlin & Perrakis, *supra* note 257, at 903.

273. *Russia Weighs Price of Privatization*, FINANCIAL TIMES, May 9, 1997, at 2.

274. Daniel Kaufmann & Paul Siegelbaum, *Privatization & Corruption in Transition Economies*, J. INT’L AFFAIRS, Winter 1997, at 419, 425.

become necessary.²⁷⁵ However, well before formal strategies of reform took place, a process of "spontaneous privatization" began to occur whereby well-placed functionaries stole state assets and revenue and funneled these assets abroad.²⁷⁶ The privatization program, originally headed by Anatoly Chubais, proceeded through several stages. In the fall of 1992, vouchers were issued to Russian citizens.²⁷⁷ The vouchers could then be used in auctions for state enterprises, at which approximately twenty percent of the shares of any enterprises would be exchanged for vouchers.²⁷⁸ The privatization of factories began in 1992, and within eighteen months "voucher" privatization was complete.²⁷⁹ By then, over eighty percent of Russian industry had been privatized.²⁸⁰

Privatization and corruption have been related phenomena in post-Soviet economic transition.²⁸¹ Until recently, the general wisdom was that market reforms in Eastern Europe and the former Soviet Union, which had followed the Revolutions of 1989–1990, caused the explosion of crime and corruption. The Interior Ministry reported 1,700 privatization crimes in 1996, 880 of which went to trial.²⁸² The Ministry was investigating seventy-four cases in 1997, many of them involving top government officials.²⁸³ One scam involved state officials selling properties at far less than their value in return for kickbacks.²⁸⁴ A metallurgical factory in Magnitogorsk was sold by a group of investors for 300 million rubles.²⁸⁵ A court vacated the sale when it appraised the property to be valued at 22 billion rubles.²⁸⁶ The Russian Interior Ministry recently created a special

275. LAYARD & PARKER, *supra* note 22, at 126.

276. Kaufmann & Siegelbaum, *supra* note 274, at 424.

277. LAYARD & PARKER, *supra* note 22, at 127.

278. *Id.*

279. *Id.*

280. *Id.*

281. Kaufmann & Siegelbaum, *supra* note 274, at 420–21.

282. Paul Goble, *Analysis From Washington: Fighting Russia's Privatization Crimes*, Radio Free Europe/Radio Liberty, March 14, 1997 (visited Nov. 8, 1998) <<http://www.rferl.org/nca/features/1997/03/F.RU.970314154617.html>> [hereinafter "Goble"].

283. *Id.*

284. *Id.*

285. *Id.*

286. *Id.*

task force to combat crimes arising from the privatization of state property.²⁸⁷

The dismantling of the centralized state has allowed many of the *nomenclatura* to use their positions to enrich themselves. Yet, on the other hand, it is increasingly apparent that the spread of commercial crime in Russia is a result, not of free market reforms, but rather of free market reforms not being carried far enough. One economic study found, “[h]alf-baked, poorly designed, inadequately implemented market reforms may indeed boost corruption. Well designed and properly executed market reforms do not.”²⁸⁸

Nevertheless, it is equally true that “spontaneous privatization,” and subsequent illegalities, resulted in the unjust enrichment of many, including many servants of the old regime.²⁸⁹ Jeffrey Sachs, the Harvard economist who was one of the key architects of “shock therapy” in Poland and Russia, believes that Russia’s natural gas resources were essentially stolen from the Russian people through questionable privatization decisions, and that the gas giant Gazprom ought to be renationalized.²⁹⁰ Yet despite this and other abuses, further attempts at divesting the government of state assets remain the best corrective to the abuse of the privatization process.

VI. CONCLUSION: JOINT VENTURES IN RUSSIA — PLANNING FOR THE CORRUPT MARKET

The currency crisis of 1998 may spell the end of Western investment in Russia for some time to come. And it may not. Either way, many multinational corporations have already made substantial investments in Russia and will attempt to ride out the current storm. Others — some brave, others reckless — will continue to do business in Russia despite the current turmoil. The experiences of Western investors provide objective lessons for future investors on how to prosper (or at least survive) in the potentially lucrative, large, and corrupt Russian market.

287. *Id.*

288. Kaufmann, *supra* note 191, at 122.

289. Kaufmann & Siegelbaum, *supra* note 274, at 454. “The theft of assets effectively started, in fact, a few years before communism fell.” *Id.* “Following the break-up, the state’s assets were being stolen by enterprise managers, politicians, and bureaucrats at an intolerable rate. . . .” *Id.*

290. REMNICK, *supra* note 2, at 179.

A. *Lesson One: Avoid the Russian Legal System*

As a general rule, Western investors are strongly recommended to avoid structuring their investments under Russian law.²⁹¹ Instead, to the extent possible, investors should seek to define their legal relationships under their respective foreign legislation, and then spell out in detail the legal relationships between the Russian and Western partners in joint venture or operating agreements.²⁹² “[L]aws exist in Russia,” recommends one Western investment guide, “but you are recommended to use them only after consulting with an appropriate authorized official.”²⁹³ Better yet is to avoid using them at all.

B. *Lessons from Semtek: Find an Honest Partner*

As in many developing markets, the choice of business entity or formal legal guarantees are worth much less than Western investors expect in their home countries. One American corporation, Semtek International Inc., recently discovered this aspect of Russian business life to its detriment.²⁹⁴ Semtek embarked on a fifty-fifty joint venture with Mercuriy Ltd., Russia's largest communications satellite maker.²⁹⁵ Semtek was to secure financing while Mercuriy was to provide the satellites and support staff. Together the joint venture would lease military satellites to private companies.²⁹⁶ Despite signing various documents, including letters of intent and a detailed protocol spelling out the terms of their joint venture, the Russian businessmen suddenly dumped Semtek in favor of Lockheed Martin, with whom Mercuriy was conducting parallel negotiations.²⁹⁷ Semtek then sued Mercuriy winning a default judgment of \$381 million.²⁹⁸ The judgment was then set aside because Mercuriy was not given proper notice under international law standards.²⁹⁹

291. GOLENPOLSKY, *supra* note 41, at 108.

292. *Id.*

293. *Id.* at 95.

294. See Joann Muller, *Firm's Lifeline Ends Up a Tangled Web to Russia*, BOSTON GLOBE, Oct. 20, 1996, at F1.

295. *Id.*

296. *Id.*

297. *Id.*

298. *Id.*; see *Semtek Intl. Inc. v. Mercuriy Ltd. and Pyotr Sivirin*, No. 95-11820, 1996 U.S. Dist. LEXIS 22248, (Aug. 13, 1996).

299. *Id.*

Semtek began pursuing its complaint against Merkuriy and its director, Pyotr Sivirin, through letters rogatory while also bringing suit against Lockheed Martin ("Lockheed"). On February 26, 1997 Semtek sued Lockheed Martin in Los Angeles Superior Court for breach of contract, intentional infliction of emotional distress, negligent interference with economic advantage, and conspiracy to interfere with prospective economic advantage, all under California law.³⁰⁰ Lockheed removed the suit to the Central District of California, which subsequently dismissed Semtek's claims based on California's two-year statute of limitations.³⁰¹ (On February 25, 1999, the Ninth Circuit Court of Appeals affirmed this decision.)³⁰²

Semtek responded by suing Lockheed in Baltimore City Circuit Court for the same four causes of action, but hoping to take advantage of Maryland's three-year statute of limitations.³⁰³ On July 24, 1997 Lockheed filed a notice to remove the case to U.S. District Court.³⁰⁴ Semtek moved to remand to the Circuit Court, claiming a lack of federal jurisdiction. That remand was granted on December 31, 1997, where the case awaits trial.³⁰⁵ The outcome of Semtek's international claims against Merkuriy and its Maryland state law claims against Lockheed remain to be seen. Regardless, Semtek's foray into the Russian business world did not prove as successful as anticipated.

As Semtek discovered, formal legal guarantees often do not count in the wild West of Russian business. In Russia, as in China, *guanxi* or "connections" are far more important than formal legal strictures to successful business in Russia. Choosing an honest, industrious business partner is therefore far more important than the legal entity chosen, letters of intent, or meticulously drafted contracts. The U.S. Embassy in Moscow notes, "you can do business in Russia without a formal legal partner or joint venture, though you cannot do it without a multitude of informal partners."³⁰⁶ *Doing Business in Russia*, an investment guide to the New Russia puts it bluntly: "Russia is still a country where business can't exist

300. *See Semtek Intern., Inc. v. Lockheed Martin Corp.*, 988 F. Supp. 913, 914 (D.Md. 1997), *aff'd*, No. 97-55840, 1999 U.S. App. LEXIS 3150, at *2 (Feb. 25, 1999).

301. *Id.*

302. *Semtek Intern., Inc. v. Lockheed Martin Corp.*, No. 97-55840, 1999 U.S. App. LEXIS 3150, at *2 (Feb. 25, 1999).

303. *Semtek*, 988 F. Supp. 914.

304. *Id.*

305. *Id.*

306. *Working With Russian Business Partners*, *supra* note 105.

independently of those in power. No one can point out a single case of successful foreign capital investment in Russia that prospered without direct or indirect participation of local authorities or state administration bureaucrats in one way or another."³⁰⁷

C. Lesson Three: Avoid Corrupt Business Practices

1. Perils of Tolerating Corrupt Practices

Corrupt practices are a way of business life in Russia. Unless they are extremely fortunate, corporations that enter the Russian market will be faced with a dilemma: to "play the game" and tolerate or engage in the practices this paper has discussed, or to stand aloof. Virtue may be its own reward, but in the Russian market, the refusal to conform to the norms of Russian business culture may hinder an honest business from succeeding, or even from getting started. Corporations have successfully invested in corrupt markets while adamantly refusing to go along with questionable commercial practices. When Colgate-Palmolive invested in Guangdong province, China, for example, company officials steadfastly and vocally publicized the corporation's refusal to countenance bribery.³⁰⁸ Their verve paid off. Colgate-Palmolive was able to open a \$20 million dollar factory without any questionable payments.³⁰⁹

Of course, for every honest business that succeeds there are countless that fail. Corporations that choose to tolerate a low-level of corruption to survive in Russia must be aware of the possible consequences. First, a general dynamic that has been observed throughout the world is that bribery begets bribery. That is, corporations that pay bribes in order to secure business are typically hounded thereafter by other individuals or entities demanding more bribes. Companies or executives, perhaps under pressure to get the deal done and with little or no guidance from higher level executives back home, may feel pressured to make an illicit payment "just once" to overcome a rough patch in negotiations or to close a deal. The reality is that one payment soon becomes several, and corporations soon find themselves in a downward spiral of escalating payments (and possibly even a growing cast of characters).

307. GOLENPOLSKY, *supra* note 41, at 39.

308. See Daniel Pines, *Amending the Foreign Corrupt Practices Act to Include a Private Right of Action*, 82 CAL. L. REV. 185, 211 (1994).

309. *Id.*

2. The Foreign Corrupt Practices Act

American corporations who tolerate bribery face the further threat of federal prosecution. While payments in most of the world are considered a routine cost of business (the French export insurance program, *Compagnie Francaise d'Assurance pour le Commerce Exterieur*, or COFACE, for example, covers foreign bribery as export risk)³¹⁰ American corporations risk violating the Foreign Corrupt Practices Act ("FCPA").³¹¹ Generally, the FCPA prohibits payments by Americans to foreign officials in order to obtain or retain business.³¹² The FCPA prohibits direct payments to foreign officials, or payments by third persons, when these payments are used to influence any act or decision of the foreign official in his official capacity.³¹³ The FCPA also prohibits direct payments used to induce a foreign official to act or refrain from acting in violation of the official's duty.³¹⁴ Finally, the FCPA prohibits payments used to induce a foreign official to use his or her influence with a foreign government or agency to influence its decision making.³¹⁵ In addition to prohibiting illicit payments, the FCPA requires that entities required to report to the Securities and Exchange Commission (generally public companies) must maintain certain financial records in order to be able to detect such payments.³¹⁶

The FCPA is in many respects a vague statute, and because so many of the investigations of illicit payments result in consent decrees, there is little case law (especially at the appellate level) explaining or clarifying its provisions. Compliance is further complicated for corporations in Russia. One observer noted, "U.S. companies working in a country like Russia face dilemmas that are difficult to resolve as a result of the ambiguities

310. See Folsom & GORDON, *supra* note 109, at 335.

311. 15 U.S.C. §§ 78m(b), 78dd-1, 78dd-2, 78ff (1988) (originally enacted as Pub.L. No. 95-213, 91 Stat. 1494 (1977), and amended by Foreign Corrupt Practices Act Amendments of 1988, Pub.L. No. 100-418, §§ 5001-5003, 102 Stat. 1107, 1415-25).

312. The FCPA (and its 1988 amendments) amended the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll (1982), making it unlawful for any issuer of securities registered under Section 12 of that Act, 15 U.S.C. § 78l, or an issuer required to file reports according to Section 15(d) of the 1934 Act, 15 U.S.C. §§ 78(o)d, to make (with some exceptions) payments to foreign officials in order to obtain or retain business. For a general survey of the FCPA see FOLSOM & GORDON, *supra* note 109, at 312-37.

313. 15 U.S.C. § 78dd-1(a)(1)(A)(i).

314. 15 U.S.C. § 78dd-1(a)(1)(A)(ii).

315. 15 U.S.C. § 78dd-1(a)(1)(B).

316. 15 U.S.C. § 78m(b)(2)(A)-(B).

surrounding the FCPA. Their problems are compounded by the frustration of knowing that other Western, Asian, and local investors are not bound by laws similar to the FCPA."³¹⁷

For example, only payments to "foreign officials" are criminalized under the FCPA, not payments made to foreign businessmen. In the chaotic world of post-communist Russia, in which privatization is ongoing and in many respects never fully developed, who is an "official" and who is not?³¹⁸ As one observer pointed out, "[u]ntil recently, the Soviet Union and other communist states fully managed every aspect of their countries' economies and, therefore, employees of all entities were technically 'foreign officials' under the FCPA."³¹⁹ Since many of the functionaries of the Soviet regime are still in positions of power, and the lines between privatized corporations and government controlled agencies remains in many cases blurred, clarifying who is or is not an "official" can be a very uncertain exercise — one with potentially expensive results.³²⁰

Similarly, American corporations can be held liable for illicit payments of their agents, vendors, or subsidiaries in Russia if they make payments to these third parties "while knowing" that the ultimate recipient of the money will be a foreign official.³²¹ "Knowing" is a defined term under the FCPA, but in many respects it is an unclear standard³²² that has

317. Agnieszka Klich, *Bribery in Economies in Transition: The Foreign Corrupt Practices Act*, 32 STAN. J. INT'L L. 121, 122 (1996).

318. See Christopher F. Dugan and Vladimir Lechtman, *Current Development: the FCPA in Russia and Other Former Communist Countries*, 91 AM. J. INT'L. 378, 384-85 (1997).

319. Klich, *supra* note 317, at 134.

320. See Dugan & Lechtman, *supra* note 318, at 382.

321. 15 U.S.C. § 78dd-1(a)(3)(1998).

322. §78dd-1(f)(2) of the Act specifies:

(A) A person's state of mind is "knowing" with respect to conduct, [if]:

(i) such person is aware that such person is engaging in such conduct . . . ; or conduct, that such circumstance exists, or that such result is substantially certain to occur; or

(ii) such person has a firm belief that such circumstance exists or is substantially substantially certain to occur.

(B) When knowledge of the existence of a particular circumstance is required for an offense, such knowledge is established if a person is aware of a high probability of the existence of such circumstance, unless the person actually believes that such circumstance does not exist.

15 U.S.C. § 78dd-1(f)(2)(A)-(B). In the 1988 amendments to the FCPA, Congress warned against a "head in the sand" attitude by U.S. corporations and cautioned against "conscious disregard" of indications of a high likelihood of a violation. H.R. CONF. REP. 576, 100th CONG. 2d SESS. 918-20 (1988). Thus, an American corporation that is willfully blind or

generated uncertain results and does not give entities operating abroad a clear standard of what level of knowledge is required to be found liable under the Act.³²³ Given the prevalence of illicit payments by agents or vendors in Russia, American corporations employing third parties potentially face a tremendous amount of potential liability. Finally, there is no bright-line rule as to what is and is not a “corrupt” payment under the FCPA. While payments to obtain or retain business are illegal, so called “grease” or “facilitating” payments are not.³²⁴ These and other uncertainties add a new and unwelcome level of potential liability under the FCPA to American corporations operating in Russia.

D. Capitalism or Corruption — What Does the Future Hold for Russia?

Russia is a land of great potential. It is also a land of great problems, foremost of which has been the high level of criminal activity and its negative economic effects. What does the future hold? Will the Russian government tackle the problem of commercial corruption, thus removing the chief impediment to a Russian economic *chudo*? Or will Russia enter the next millennium much as it left it; struggling internally with the arduous process of reconstruction, the state apparatus powerless to reign in the rapaciousness of the criminal class? Much rides on the resolution of this question, both for Russia and the world.

As this Article has set forth, the criminalization of social and business life that followed the collapse of the Soviet Union has had far reaching and profound effects, both for Russia and the world community. The scope of the problem is daunting and, especially recently, does not lend itself to

consciously avoids learning whether or not its foreign agent is violating the FCPA is probably in violation.

323. FOLSOM & GORDON, *supra* note 109, at 323–24.

324. The Act exempts “facilitating or expediting” payments where the purpose is to “expedite or to secure the performance of a routine governmental action.” 15 U.S.C. § 78dd-1(b). Such allowable “routine governmental actions” are defined as:

1. obtaining permits, licenses or other official documents to qualify a person to do business in a foreign country;
2. processing governmental papers, such as visas and work orders;
3. providing police protection, mail pick-up and delivery, or scheduling inspections associated with contract performance or inspections related to transit of goods across country;
4. providing phone service, power and water supply, loading and unloading cargo, or protecting perishable products or commodities from deterioration; or
5. actions of a similar nature. 15 U.S.C. § 78dd-1(f)(3)(A)(i)–(v).

optimistic forecasts. And yet, despite the turmoil of recent months (and perhaps because of it), optimism is called for. First, there is some evidence that the scope of the crime epidemic that followed the end of the Soviet Union is anomalous. Some believe the government is beginning to control the situation.³²⁵ Though Russian statistics are notoriously slippery, one estimate maintains that the crime rate was flat in 1993, and has since fallen five percent in 1996 and nine percent in the first nine months of 1997.³²⁶ And it is possible that the shock of August 1998 may perhaps jolt the government into coping with commercial crime.

In short, there are reasons for hope even amidst the current state of pessimism and despair. Russia's problems, though serious, are surmountable. "A new era has begun," one noted Russia watcher believes, "Russia has entered the world, and everything, even freedom, even happiness, is possible."³²⁷

325. Åslund, *supra* note 3, at 25.

326. *Id.*

327. David Remnick, *Can Russia Change?*, FOREIGN AFFAIRS, Jan./Feb. 1997, at 35, 49.