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Russia as a Failing Economic State: Corruption's Acceptance

by

(b)(6)

(b)(6) United States Army
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ABSTRACT

TITLE OF THESIS: Russia as a Failing Economic State:
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COMMITTEE MEMBER: (b)(6), (b)(3)

Over the past 20 years, Russia has struggled to enrich its economic standing domestically as well as internationally. Its continued dependence on energy-based products and its lack of a balanced economy ensures the country will remain vulnerable to consumer demand and global pricing indices for energy for the foreseeable future. This thesis examines and assesses Russia's domestic and regional economic activities, primarily focusing on the impact of corruption and its ability to impede foreign investment ventures and Russia's business reformation/transformation from an extractive-based economy to a market-based economy. The success or failure of the Russian economy could have a serious impact on the national security of the United States and its allies in Europe and the Russian Near Abroad. The success of Russia's anti-corruption reform efforts are extremely important to the U.S. in four key areas, countering the proliferation of weapons of mass destruction (WMD), Middle East diplomacy, energy security, and strengthening international norms against corruption. As the hypothesis of this research identifies, it is assessed that Russia's economy will

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continue to decline because of its inability to combat corruption. This acceptance of corruption limits Russian opportunities to improve its internal economy and incorporate necessary improvements in order to prevent itself from becoming a failed economic state.

This research paper identified several causes and consequences of corruption from an academic lens and then viewed the perceptions and realities from a Russian lens to gain an accurate perspective on internal contributors that allow corruption to be as pervasive within the Russian society today as it currently is. Despite the repeated calls by recent Russian Presidents to fight corruption, little evidence exists that suggests that the Russian elite are committed to identifying the sources and motivations for such practices. As a part of this research process, a comparison of anti-corruption reform efforts in the former Soviet Republic of Georgia, with those efforts of Russia in the last 20 years, is utilized to highlight the success that Georgia has had as a result of its country's commitment to curbing the proliferation of corrupt practices inside the country. This comparison is intended to be a useful template for Russia, if it were to become serious about fighting corruption in the future.

In addition to the anti-corruption reform comparison between Russia and Georgia, three alternative futures scenarios and their associated indicators and warning were developed as possibilities for the future of Russia: 1) an expansion of its market economy and a greater commitment to democracy; 2) further erosion of democratic principles in order to preserve the current leadership; or 3) a future that is inextricably linked to the status quo. The likelihood of Russia realizing one of these scenarios, hinges on the Russian leadership's ability to effectively implement necessary anti-corruption reform measures. Based on these three scenarios, it is assessed with high probability that Russia

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will remain on the current path, the status quo, for the next ten years. There is currently little political will to influence the necessary change, as well as the ruling elite manipulating the system to increase their personal wealth through the identified corrupt practices.

Unfortunately, the acceptance of corruption within Russia today impedes its ability to introduce new and necessary reforms that diversify the Russian economy and avert a looming demographic crisis. A commitment to ending corruption will be the foremost determinant in possible future scenarios for Russia: This thesis also provides several suggestions for domestic and international measures that could be taken, or opportunities the West could find, to mitigate further economic decline in the near future and prevent potential problems between Russia and its neighbors.

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CHAPTER 1

Corruption's Acceptance – A Plague for Russia

*Corruption is a foreign word, but its very manifestation has acquired veritably Russian magnitudes.
The corrosive effect of bribery not only undermines the state mechanism,
it kills the faith of citizens in the fairness of state power.
Aleksandr I. Bastrykin¹*

Since the collapse of the Soviet Union nearly twenty years ago, Russia has diminished from the global power it once was, and corruption has played an enormous role in this decline as a key global player. Within its borders, Russia's acceptance of corruption and its inability to institute effective and meaningful anti-corruption reform measures has had a detrimental effect on both the economy and the society. The loss of revenues associated with corruption has limited Russia's ability to diversify its economy and introduce meaningful domestic investment to improve its aging infrastructure. With a narrow economic base that is dependent on its extractive industries, such as natural gas and petroleum, Russia is in desperate need of expanding its economy into other profit-producing markets, and perhaps into future technologies.

Russian de facto acceptance of corruption and its inability to tackle the challenges associated with its pervasiveness affects all facets of the government and society as a whole. While Russian leaders claim they will attack corruption, Russia lacks the control measures and resource capital from which to end corruption and find an opportunity to expand its economy, especially in the midst of the current global economic downturn. An understanding of how corruption and its byproducts are influencing the domestic and

¹ First Deputy of the Procurator General of the Russian Federation, Chairman of the Investigative Committee under the Auspices of the Procuracy of the Russian Federation State, and Advisor of Justice 1st Class.

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foreign policies of Russia's leadership, and whether or not this structure could change, is one of the crucial pieces to determining Russia's future impact on U.S. economic and security interests.

Hypothesis

Based on the findings identified during this research process, Russia's economy will continue to decline as a result of its inability to combat corruption. This corruption limits Russian opportunities to improve its internal economy and incorporate necessary improvements in order to prevent Russia from becoming a failed economic state.

Key Questions

The following questions, when answered, will address the research question and provide validation to the aforementioned hypothesis.

1. How does Russia perceive its current economic condition and what steps is Russia taking to regain economic strength in a global economy -- an economy dominated by the United States and China?
2. How does corruption limit economic growth?
3. How do the Russians perceive corruption?
4. What measures are the Russians taking to tackle corruption, if any?
5. What does a Russian economic failure mean to its near-abroad, European, and Asian neighbors?
6. How can intelligence best offer strategic warning of Russian intent under various scenarios, and what opportunities are there for the U.S. in these situations?

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Scope

This thesis first explores the pervasiveness of corruption in the marketplace that not only discourages foreign investment, but also limits the growth of its domestic economy. In addition, it is important to discuss, from a Russian perspective, how the country views corruption, its acceptance of corruption, and whether its current anti-corruption efforts are realistic enough to bring corruption to an acceptable level. This thesis assesses that there is still significant debate about whether the Russian government is serious about its anti-corruption endeavors as a step in the process of expanding its economy and enticing future foreign investment within its borders. Finally, the thesis looks at how intelligence can help define the direction in which Russia is heading by providing indications and warnings for the intelligence community to monitor.

Assumptions

A stable and secure Russia is better for U.S. National Security. The assumption is that a Russia that is less corrupt and transparent in its efforts will be easier for the West to conduct business with, and ensure the West's regional and national security interests. This implies that Russia has placed the appropriate measures to control/limit the pervasiveness of corruption; that the Russian government has or is implementing lawful means to deal with businesses and/or

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people that peddle corruption; and is committed to developing a market economy that is more open, honest and integrated into the global economy. These efforts should moderate Russian interests from a heavily extractive-based economy to one that is more broadly based and one tied into the global economic system.

Past, Present, and Current Issues with Corruption

With a rich history and potential for an even brighter future, Russia is the world's largest country in terms of land mass, with the ninth largest population, built upon an estimated 100 different nationalities.² Russian history is inundated with domestic infighting, conflict, repression, and economic stagnation.³ Since the demise of Communism inside Russia in the early 1990s, Russia introduced extensive economic and political reform measures with limited assistance from the West.⁴ Despite the moderate successes within democratic and free-markets reforms, the most recent Russian reformative period was plagued with greed, incompetence, and the societal inhibitors of alcohol and communicable disease.⁵

² Central Intelligence Agency (CIA), "Russia," *The World Factbook* 2010, <https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html> (accessed May 18, 2009).

³ Anders Aslund and Andrew Kuchins, *The Russia Balance Sheet* (Washington, D.C.: Center for Strategic and International Studies, 2009): 11-23. Authors Note: The use of the term Russia or the variation Russian is representative of Russia's historical roots to include the period under the Soviets. This simplified use of the term Russia to incorporate all of Russia's history is meant to simplify the writing of this research paper and not meant to misconstrue or hide pertinent facts about Russia's past.

⁴ Lilia Shevtsova and Martha Brill Olcott, "Russia Transformed," *Russia After Communism*, edited by Anders Aslund and Martha Brill Olcott. (Washington, D.C.: Carnegie Endowment for International Peace, 1999): 1-25, Anders Aslund, and Mikhail Dmitriev, "Economic Reform Versus Rent Seeking," *Russia After Communism* (Washington, D.C.: Carnegie Endowment for International Peace, 1999): 91-130.

⁵ Anders Aslund and Mikhail Dmitriev, "Economic Reform Versus Rent Seeking," *Russia After Communism* (Washington, D.C.: Carnegie Endowment for International Peace, 1999): 91-130.

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As part of the initial democratic reform initiatives under President Boris Yeltsin, local, regional, and state institutions achieved greater autonomy, allowing for the introduction of free and fair elections by the citizens within those areas.⁶ Inheriting a country plagued by economic inefficiencies and shortages of essential goods and services, a group of businessmen who later became rich tycoons, set out to institute profound economic reform initiatives on the basis of free-market ideals, while secretly amassing large amounts of personal wealth at the expense of the state.⁷

Following Yeltsin's tenure as President and subsequent appointment and national election of Vladimir Putin as President, the reversal from autonomous rule was pushed, while the reconstruction towards a centralized government was instituted -- a centralized government that controlled all political and economic aspects from the Kremlin.⁸ During the initial years of the first Putin administration, Putin's priorities centered around strengthening the central government, which entailed wresting the power and influence from the oligarchs and securing control of Russia's largest industrial markets, while neutralizing independent television and radio stations by re-nationalizing large firms such as Yukos Oil and nation-wide broadcast media.⁹ As President Putin's second term in office was ending in late 2007, Putin announced that his protégé, Dmitry Medvedev, was his choice to succeed him as president.¹⁰ Medvedev subsequently proclaimed that if elected, he would appoint Putin to serve as Prime Minister. Many political pundits

⁶ Jim Nichol, William H. Cooper, Carl Ek, Steven Woehrel, Amy F. Woolf, Steven A. Hildreth, and Vincent Morelli, "Russian Political, Economic, and Security Issues and U.S. Interests," *Congressional Research Service (CRS) Report for Congress* (January 10, 2010), www.fas.org/sgp/crs/row/RL33407.pdf (accessed April 14, 2010): 2-3.

⁷ David E. Hoffman, *The Oligarchs: Wealth and Power in the New Russia*, (New York: Public Affairs Publishing, 2003): 1-7.

⁸ Jim Nichol, et al., "Russian Political, Economic, and Security Issues and U.S. Interests," 2.

⁹ *Ibid.*, 3.

¹⁰ Aslund and Kuchins, *The Russia Balance Sheet*, 36-38.

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viewed this power-sharing arrangement as a means to ensure the political continuity for Putin and his cronies.¹¹

In March 2008, Dmitry Medvedev was elected President of Russia by obtaining over 70 percent of the votes.¹² Medvedev held true to his earlier proclamation by ensuring that Putin was confirmed as Prime Minister the day after he was sworn in as President, on May 7, 2008.¹³ Since the election, President Medvedev has ensured that several constitutional amendments have been approved, to include the extension of a presidential term from four to six years, as well as the extension of the terms of Duma (parliament) members from four to five years.¹⁴ These two amendments undoubtedly ensure that the ruling party is able to continue its tenure for years to come.

From an economic aspect, although its influence has greatly diminished since the Soviet period, Russia remains a formidable force on the global stage, and its influence seems to be growing. Russia's economy is large enough to influence regional economic conditions, as well as foreign political decisions.¹⁵ Many European countries and former Soviet states are highly dependent on Russian natural gas. From a financial aspect, high oil prices have been a major factor in the economic success Russia has enjoyed during the past 10 years, especially from 2002 to 2008.¹⁶ However, the collapse of world prices for oil and other commodities in 2008 exposed the downside of Russia's dependence on the

¹¹ Ibid., 36-38.

¹² Jim Nichol, et al., "Russian Political, Economic, and Security Issues and U.S. Interests," 5.

¹³ Ibid., 5.

¹⁴ Philip P. Pan, "Russia Lengthens Presidential Tenures," *Washington Post* (December 31, 2008), <http://www.washingtonpost.com/wp-dyn/content/article/2008/12/30/AR2008123000839.html> (accessed January 18, 2010). Of note, these constitutional changes will take affect during the next presidential election in 2012.

¹⁵ STRATFOR, *Russia's Expanding Influence: Part 3: The Extra's* (March 11, 2010), www.stratfor.com (accessed April 15, 2010); Aslund and Kuchins, *The Russia Balance Sheet*, 56-68.

¹⁶ Aslund and Kuchins, 56-68.

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production and export of oil, gas, and other natural resources.¹⁷ The failure of Russia to complete important economic reforms and the government's penchant for re-asserting its control over key economic sectors remains the most likely impediment to future high economic growth rates.

Literature Review

In the last two versions of the *National Security Strategy of the United States*, both Presidents George W. Bush and Barack Obama identified the imperative of curbing the spread of corruption and establishing the rule of law in at least 30 separate instances.¹⁸ President Bush noted that “economic freedom is a moral imperative [and] the liberty to create and build or to buy, sell, and own property is fundamental to human nature and foundational to a free society.”¹⁹ President Bush envisioned that anti-corruption measures and the opening of markets to developing countries would not only bring along countries like Russia into the World Trade Organization (WTO), but also assist in the “opening, integrating, and diversifying [of] energy markets to ensure energy independence,” which “reduces opportunities for corruption and diminishes the leverage of irresponsible rulers.”²⁰ President Obama highlighted the fact that the United State is working within the confines of the international system to “promote the recognition that pervasive corruption is a violation of basic human rights and a severe impediment to

¹⁷ Samuel Charap, and Andrew C. Kuchins, *Economic Whiplash: An Opportunity to Bolster U.S.-Russia Commercial Ties?* (Washington, D.C.: Center for Strategic and International Studies, February 2009): 2.

¹⁸ *The National Security Strategy of the United States of America*, (March 2006), <http://georgewbush-whitehouse.archives.gov/nsc/nss/2006/nss2006.pdf> (accessed November 16, 2009) and *The National Security Strategy of the United States of America*, (May 2010), http://www.whitehouse.gov/sites/default/files/rss_viewer/national_security_strategy.pdf (accessed May 28, 2010).

¹⁹ *The National Security Strategy of the United States*, 2006, 27.

²⁰ *Ibid.*, 28-29.

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development and global security.”²¹ An understanding for the power that the globalized economy currently possesses as well as a committed effort by all to curb the proliferation of corruption is extremely important today. As a legal basis for anti-corruption measures here in the United States, the Foreign Corrupt Practices Act (FCPA) was signed into law in 1977. The FCPA and its subsequent amendments in 1988 and 1998 were ratified to “prohibit bribery of foreign officials by American corporations.”²²

In addition to understanding the legal basis for U.S. business endeavors, it is important that the United States monitor the economic activities of Russia in order to ensure that Russia does not slip towards becoming an impoverished state because of its economic problems. In this instance, an impoverished state is defined as one that is unable to provide basic goods and services to its citizens, unable to provide security to protect its citizens within its borders and one that requires increased aid from foreign partners. In the end, an impoverished state, the size, and scope of Russia, could destabilize the Central Asian and European markets. Therefore, a thorough understanding regarding corruption in Russia and its impact on the Russian economy is important, if the United States and its allies are to understand the issues and impediments in transforming the Russian economy. Unfortunately, a comprehensive assessment to determine to what extent Russia’s economic decline, as a result of its corruptive business and political practices, threatens regional stability and U.S. national security, has not been thoroughly researched in recent years.

²¹ The *National Security Strategy of the United States*, 2010, 38.

²² Michael V. Seitzinger, “Foreign Corrupt Practices Act: A Legal Overview,” *Congressional Research Service (CRS) Report for Congress* (September 2, 2004), <http://stuff.mit.edu/afs/sipb/contrib/wikileaks-crs/wikileaks-crs-reports/RS21925.pdf>, (accessed November 16, 2009): Introduction.

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Since becoming the Russian President in 2008, Dmitry Medvedev has championed anti-corruption efforts as a means to improve the economy and the livelihood of its citizens.²³ In a mere six months, President Medvedev was able to formulate an Anti-Corruption Legislative Bill, and subsequently have it become law in January 2009.²⁴ The Anti-Corruption Plan defines corruption; calls for transparency in government practices, provides an understanding for international cooperation and treaties as a basis for this plan, and suggests measures for preventing corruption.²⁵ In spite of the recent tough anti-corruption talk from President Medvedev, little evidence exists that translates this tough talk into the successful identification and prosecution of corrupt individuals and/or businesses. A thorough understanding of the Russian laws and their intended measures for countering corruption provides invaluable depth on Russian perspectives, and sets the basis for analysis of the Russian commitment to rooting out corruption in the future.

In addition to reflecting on President Medvedev's anti-corruption stance, several scholars and authors have written on the pervasiveness and acceptability of corruption in general, its impediments to growth, and its impacts not only on economic development, but also on investment and bank lending practices as well. For example, in her writings and teachings regarding corruption, Dr. Susan Rose-Ackerman, is a Henry R. Luce Professor of Jurisprudence, Law, and Political Science Professor at Yale University, assesses that "[c]orruption can significantly affect the efficiency, fairness, and legitimacy

²³ Dmitry Medvedev, "Go Russia," (September 10, 2009), <http://eng.kremlin.ru/transcripts/298> (accessed May 24, 2010).

²⁴ "Russian National Anti-Corruption Plan" (January 10, 2009) <http://eng.kremlin.ru/articles/corruption1.shtml> (accessed November 15, 2009).

²⁵ Ibid.

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of state activities.”²⁶ She goes on to articulate that while the expense of eliminating corruption entirely is too great, and could have a detrimental impact on the freedoms and rights of a country’s citizenry, “a fundamental increase in the honesty-and the efficiency, fairness, and political legitimacy of government,” should be pursued.²⁷ So, in an effort to police up corrupt business practices and individuals, caution must be enforced as to not infringe on the basic democratic rights of individuals while in pursuit of anti-corruption measures. In an attempt to strike this delicate balance, there must be an understanding of not only the negative impacts of corruption on economic growth, but also on the ability of banks to lend money towards potential investors that could help diversify and transition Russia towards a more open market economy.

By providing additional examples on the extent of corruption in Russia, an economist, Dr. Laurent Weill, as a visiting researcher for The Bank of Finland Institute for Economies in Transition (BOFIT), investigated:

the impact of corruption on bank lending in Russia...and the uncertainty of judicial decisions for banks, as they cannot count on the courts to enforce damages recoveries for losses...and consequently banks are expected to refrain from lending.²⁸

The inability to lend money to potential investors is a large impediment to pursuing alternative business ventures in Russia today and degrades economic

²⁶ Susan Rose-Ackerman, “The Political Economy of Corruption,” Institute for International Economics (1997), www.piie.com/publications/chapters_preview/12/2iie2334.pdf (accessed November 22, 2009): 32. Dr. Rose-Ackerman has written extensively on corruption and is also a visiting research scholar for the World Bank.

²⁷ *Ibid.*, 56.

²⁸ Laurent Weill, “How Corruption Affects Bank Lending in Russia,” *Bank of Finland – Institute for Economies in Transition: Discussion Papers 18/2008* (November 2008), www.bof.fi/NR/rdonlyres/01E1EC63-6F39-4E33-8B38.../DP1808.pdf (accessed October 1, 2009): 5. Dr. Laurent Weill is an economist and is currently serving as a Economics Professor at Université Robert Schuman, Strasbourg, France.

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performance. Analysis by specialists like Dr. Weill and an understanding in general of the role of corruption provided by researchers like Dr. Rose-Ackerman, provide the necessary building blocks to appreciate the impediments to economic diversification and growth inside Russia in the near-term.

After reviewing some of the economic inefficiencies and indicators to monitor, this thesis will explore what appears to be an acceptance of corruption at all levels in Russia, what corruption means to Russia, as well as identifying how different countries of the world view corruption in comparison with current Russian practices, such as bribes.²⁹ As an underlying theme to Russian corruption, the nature of organized crime throughout Russian political, economic, and social infrastructures will be explored to identify contributors and benefactors of corruption on not only an economic standing, but a political one as well.³⁰ The information provided by authors such as Michael Alexeev in his article, *The Russian Underground Economy in Transition*, and Ariel Cohen's, *Crime and Corruption in Eurasia: A Threat to Democracy and International Security*, provides the necessary insight into how much of a strain this criminal and corrupting underworld has on the legitimate economic progress of Russia.³¹

To present an understanding of basic economic structure in Russia, this thesis will utilize figures found in the *World Economic Outlook 2008*, and the *OECD Economic Outlook for 2009*. These figures will provide us the basis from which we can best

²⁹ Scott P. Boylan, "Organized Crime and Corruption in Russia: Implications for U.S. and International Law," *Fordham International Law Journal*, Vol. 19 (1999), provides an interesting overview of this topic.

³⁰ Michael Alexeev, "The Russian Underground Economy in Transition," *The National Council for Soviet and East European Research* (November 20, 1995), (Washington, D.C.: Brookings Institution), <http://www.ucis.pitt.edu/nceer/1995-809-04-Alexeev.pdf> (accessed November 15, 2009).

³¹ Ariel Cohen, "Crime and Corruption in Eurasia: A Threat to Democracy and International Security," *The Heritage Foundation* (March 17, 1995), <http://www.heritage.org/Research/RussiaandEurasia/bg1025.cfm>, 1995 (accessed October 20, 2009).

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understand the economic decline and current crisis that Russia faces. The World Economic Outlook provides figures from which to compare Russia to its regional partners, as well as comparisons for European and American economic standings.³² The figures from both the World Economic Outlook and OECD will show recessionary and inflationary trends and negative trade balances, that all compound the economic crisis to date. The OECD outlook points to a recovery through 2010, due to higher oil prices, which will provide some additional emphasis to the economic dependence of Russia to oil and gas markets in support of the overall hypothesis.³³

Findings as well as figures made available by the Energy Information Administration (EIA), an agency of the United States Department of Energy, assist in providing a basic understanding of the current economic dependence on extractive resources such as natural gas and petroleum-based capital by the Russians. The EIA provides energy-related data, as well as perspectives on energy interaction with economies to United States policy makers, as a means to understand market related changes. The EIA's analysis also provides indicators and warnings of further erosion of Russian gross domestic product (GDP), and market transformation as a result of resource overdependence.³⁴

Before a thorough and accurate assessment of Russian current economic affairs, as a result of corruption and negligence can be addressed, there must be a comprehensive understanding of how Russia views itself, not only in the economic framework, but also

³² World Economic Factbook, "World Economic Database: Russia." *World Economic Factbook 2009*, 16th Ed. (London: Euromonitor, 2009): 352.

³³ Organization for Economic Co-Operation and Development (OECD), "Developments in Selected Non-Member Economies: Russian Federation," *OECD Economic Outlook*, Vol. 1, No. 85 (Paris: Organization for Economic Co-operation and Development, 2009): 190-193.

³⁴ Energy Information Agency, "Official Energy Statistics from the United States Government," <http://www.eia.doe.gov/> (accessed November 15, 2009).

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its perceived power and influence at the international level. Authors such as a Dmitri Trenin, the director of the Moscow Carnegie Center, and Anders Aslund, a Swedish economist and former economic advisor to President Boris Yeltsin, in their books *The End of Eurasia: Russia on the Border between Geopolitics and Globalization* and *The Russia Balance Sheet*, respectively, articulate some of the fundamental cornerstones for the Russian way of life.³⁵

Trenin proposes that “[d]espite its poor governance and backward economy, Russia is essential to the international system by virtue of its unique geographic position in Eurasia.”³⁶ The way that Russia organizes itself internally will have tremendous repercussions on the domestic system and indirectly on the international system.³⁷

Trenin’s premise is that all of Russia’s struggles today are a combination of internal indifference and poor decision making in global economics.³⁸ In *The Russia Balance Sheet*, Aslund takes some of Trenin’s thoughts of historic Russia and places them in the context of Russia today, specifically in the economic arena. Aslund touches on some key components, such as the declining Russian economy, its abundance of natural gas and oil reserves, and how a mismanagement of these economic resources has placed the country at risk for further domestic instability.³⁹

Finally, several specific scenarios, along with their associated indicators and warnings, that will help provide timely and informed alternatives for the future, will be developed. In the end, this thesis will debate whether the Russian government is serious

³⁵ Dmitri Trenin, *The End of Eurasia: Russia on the Border Between Geopolitics and Globalization* (Washington, D.C.: Carnegie Endowment for International Peace, 2007).

³⁶ Trenin, *The End of Eurasia: Russia on the Border Between Geopolitics and Globalization*, 19.

³⁷ *Ibid.*, 19

³⁸ *Ibid.*

³⁹ Aslund and Kuchins, 39.

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about its anti-corruption efforts, and whether it is capable of bringing corruption down to an acceptable level, which would expand its economy and entice future foreign investment within its borders. These future scenarios, will debate what domestic and international measures can be taken, or opportunities the West can find, to mitigate further economic decline in the near future, and prevent future problems between Russia and its neighbors.

Research Design, Data Collection, and Analytical Strategy

As this thesis attempted to assess linkages between corruption and economics, it was appropriate to utilize an approach that was flexible enough to allow for the predictive analysis of different relationships within Russia and its regional and strategic partners. This process allowed for a determination of the extent to which changes in the economy are based on the potential receding or expanding of corruption measures in Russia, to identify if they constitute a threat to U.S. national security strategy.⁴⁰

Data Collection

The data collection process primarily involved academic, bibliographical research and all-source analysis of events relating to the development and enforcement of effective anti-corruption reform initiatives inside Russia today. The first collection method utilized was that of archival research, which provided a sound baseline from which to identify and address an ongoing problem. This archival research included reviewing past reporting of open source and classified materials, all of which produced invaluable and

⁴⁰ All Business, "Correlation Analysis," <http://www.allbusiness.com/glossaries/correlation-analysis/4964988-1.html> (accessed November 15, 2009).

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factual information to begin this research process. After conducting extensive historical research, it was important to maintain a thorough review of pertinent scholarly journals, economic reporting, and current statements from within Russia, to maintain an understanding of the Russian elite's updated intent and means to achieve that intent.

Analytical Strategy

This research process depended greatly upon determining the correlation between the economy and corruption. The opaque environment inside Russia today, an environment where what is reported is not always what really may be occurring, as well as the lack of verifiable information, provides a hard target to assess Russian commitment to necessary reform initiatives. Conflicting or even lack of reporting regarding the implementation of economic and political reform initiatives, as well as assessing the success of those reforms through interviews and statistical studies within Russia, is difficult at best for analysts monitoring Russia. However, a comparison of the anti-corruption reform efforts in the former Soviet Republic of Georgia offers a useful template that Russia could imitate, if it were to become serious about ending corruption in the future. Finally, it is important to highlight the occurrences of Russian-U.S. policy differences in expanding anti-corruption measures over the last twenty years, as a means to explore Russian commitment to curbing the further debilitation of their economy because of the accepted practice of corruption.

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CHAPTER 2

Corruption Revealed

The Soviet meaning of corruption is best described as an alliance of law and informal political rules. Law is by all accounts the weaker ally.
Charles A. Schwartz⁴¹

An accurate assessment and development of the issues and repercussions surrounding corruption are important endeavors to explore with regard for the globalized economy that the international community shares today. As many developed and developing nations begin to emerge from the global economic downturn of 2008-2009, the issue of corruption will remain a significant drain on economic development and prosperity. The success of developed and developing nations, especially the Russian Federation, hinges on their ability to incorporate and enforce new laws and regulations targeting corruption. Understanding the sources and causation of corruption from a general theoretical mindset, as well as an in-depth look into Soviet and Post-Soviet attempts at anti-corruption reform, provides an assessment of potential areas of concern and likelihood of success of the Russian economic system. It must be understood that corruption is not merely an economic influencer/hindrancer to market growth and expansion, but also a detrimental force in the governing of societies within the political apparatus of nations that can affect the legitimacy and efficiency of a state.⁴²

⁴¹ Charles A. Schwartz, "Corruption and Political Development in the USSR," *Comparative Politics*, Vol. 11, No. 4 (July 1979): 429. Mr. Schwartz was a former Professor of Political Science and Law at the University of Alabama and at the Marshall-Wythe School of Law of the College of William and Mary, respectively.

⁴² Susan Rose-Ackerman, "The Political Economy of Corruption," 32. Wayne Sandholtz and William Koetzle, "Accounting for Corruption: Economic Structure, Democracy, and Trade," *International Studies Quarterly*, Vol. 44, No. 1 (March 2000): 31-50.

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One organization that highlights the perceived levels of corruption is Transparency International (TI).⁴³ Transparency International's definition of corruption is: "the abuse of entrusted power for private gain."⁴⁴ Examples of corrupt behavior include bribery, extortion, fraud, embezzlement, racketeering, and the appropriation of public assets and property for private use. These examples are the most common occurrences associated with corruption inside Russia today.⁴⁵

To further elaborate and provide a common understanding for corruption as it depicted in this framework, there are two additional divisions of corruption: state capture and administrative corruption, both of which are described in generic terms as impediments for growth and investment. State capture or grand corruption, is defined when "parties attempt to wield undue influence on government rules, regulations and decision-making through private payments to public officials."⁴⁶ The transferring of funds or other special services by a monopolistic business enterprise to a lawmaker, in

⁴³ Transparency International, <http://www.transparency.org/>. Transparency International is a non-profit organization that attempts to end corruption practices by educating and raising public awareness. Based in Berlin, Germany, Transparency International produces several annual products, to include, the Corruption Perceptions Index (CPI), the Global Corruption Report, a Global Corruption Barometer, and a Bribe Payers Index that develop tools for companies, organizations, and governments to construct measures to end corruption.

⁴⁴ Transparency International, "How Do You Define Corruption?" http://www.transparency.org/news_room/faq/corruption_faq (accessed November 15, 2009). Both the World Bank and Transparency International utilize this definition to varying degrees when describing and defining corruption in their anti-corruption efforts. For more information from the World Bank and its definition of corruption see The World Bank, "Anticorruption," (2010), <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPUBLICSECTORANDGOVERNANCE/EXTANTICORRUPTION/0,,menuPK:384461~pagePK:149018~piPK:149093~theSitePK:384455,00.html> (accessed May 10, 2010).

⁴⁵ U. Myint, "Corruption: Causes, Consequences, and Cures," *Asia-Pacific Development Journal*, Vol. 7, No. 2 (December 2000): 35.

⁴⁶ Transparency International, "Emerging Economic Giants Show High Levels of Corporate Bribery Overseas," http://www.transparency.org/news_room/latest_news/press_releases/2008/bpi_2008_en (accessed November 15, 2009).

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order to erect market entry barriers and prevent competition would be an example of State Capture.⁴⁷ On the other hand, administrative corruption is the

intentional imposition of distortions in the prescribed implementation of existing laws, rules, and regulations to provide advantages to either state or non-state actors as a result of the illicit and non-transparent provision of private gains to public officials.⁴⁸

In this situation, an example of administrative corruption includes the bribing of an official inspector to ignore major or minor deficiencies or infractions of standing rules and/or regulations. Another example would include the payment of a bribe to secure public procurement contracts, or to have an agreed upon priority in procurement of government services. Both of these incidences distort competition and reduce fair market practices, based on the imposition of bribes to gain favor in business.⁴⁹

The Dimensions of Corruption

Leading economic assessment teams highlight that corruption impedes social and economic development, by undermining and weakening the rule of law and the foundation from which institutional reform can influence fundamental change within a country.⁵⁰ In developing an understanding of corruption, it is important to differentiate between what societal and economic instances may cause corruption, as well as what

⁴⁷ Ani Matei and Florin Marius Popa, "State Capture versus Administrative Corruption: A Comparative Study for the Public Service in Romania" (September 1, 2009), <http://ssrn.com/abstract=1438573> (accessed March 15, 2010): 1-5. Also see Joel Hellman, and Daniel Kaufmann, "Confronting the Challenge of State Capture in Transition Countries," *Finance and Development*, Vol. 38, No. 3 (September 2001): 1, for additional information regarding state capture and administrative corruption.

⁴⁸ Matei and Popa, 6.

⁴⁹ *Ibid.*, 6.

⁵⁰ World Bank's Anti-Corruption website also describes the fundamental and inherent issues of corruption and its effect of societal and economic development.

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types of corruption could possibly occur, before a true appreciation of the consequences of unabated corruption can be evaluated for a nation state and the international community as a whole.

In corruption's simplistic form, bribery, or the offering of a financial reward, can be utilized to influence the rewarding of contracts, to grant/acquire necessary licenses and permits, as well as reduce the amount of start-up fees and dues required during the conduct of business.⁵¹ On a grander scale, local, state, and national governments can reduce or increase taxes and the allocation of subsidies to influence pricing and exchange rates. All of these instances are intended to produce incentives to varying parties to induce or restrain action, ensure favored selection in bidding, control economic and political decisions, and/or increase personal wealth.⁵²

Despite the many dimensions of corruption, there is little doubt that the effects of corruption undermine accepted norms and laws and weaken society's economic development, by preventing the expansion of free-market ideals through transparent measures.⁵³ Corruption can be perceived as part of a spectrum that spans simple *quid pro quo* to the abuse of state power, with an assortment of questionable activities sprinkled

⁵¹ Transparency International, *Business Principles for Countering Bribery*, (2009), http://www.transparency.org/global_priorities/private_sector/business_principles (accessed March 13, 2010): 5. Transparency International, defines bribery as "the offering, promising, giving, accepting or soliciting of an advantage as an inducement for an action which is illegal or a breach of trust, " and U. Myint, "Corruption: Causes, Consequences, and Cures," 33-58. Dr. Rose-Ackerman also simplifies bribery as a means to obtain government benefits and avoid cost in her article "The Political Economy of Corruption," 34. Myint is the former Chief, Least Developed Countries Section, Development Research and Policy Analysis Division, United Nations Economic and Social Commission for Asia and the Pacific (ESCAP). In his article, Myint differentiated between the behavior commonly associated with corruption; activities such as fraud and embezzlement can be undertaken by an official alone and without involvement of a second party. While others such as bribery, extortion and influence peddling involve two parties – the giver and taker in a corrupt deal.

⁵² *Ibid.*, 33-58.

⁵³ Susan Rose-Ackerman, *Corruption and Government: Causes, Consequences, and Reform* (New York: Cambridge University Press, 1999): 2-3.

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between.⁵⁴ When discussing its origins and effects, one must understand that corruption is a universal practice that can be traced throughout history, across continents, and throughout civilizations.⁵⁵ Corruption is present in all developed and developing countries, in both public and private sectors, and in organizations that are charitable or non-profit affiliated.⁵⁶ Within Russia, corruption today is not unique, nor is it something that is new to the country. With a few exceptions, the formation of corrupt practices emerged out of necessity as witnessed during the Soviet period, but more often, corruption, motivated by personal gain, has become the rule from which economic and political decisions are created and enforced.⁵⁷

Unfortunately, the detrimental effects of corruption are not readily observable or easily quantified, based on the inability to depict accurate supporting numerical data. However, the effects of and extent to which payments or gifts are exchanged, can be devastating to future investment, free trade, and competition within the market.⁵⁸ Countries that have a high level of corruption in all facets of law and society, undoubtedly generate more corrupt behavior and practices throughout a continuous cycle, which hinders the development of legitimate business endeavors in that society.⁵⁹ If the actual presence of corruption is not enough to shake the internal political and economic foundations of a country, the mere perception by foreign states of the presence of

⁵⁴ Anti-Corruption Resource Centre, <http://www.u4.no/helpdesk/faq/faqs1.cfm> (accessed January 21, 2010). The Anti-Corruption Resource Centre works in collaboration with Transparency International and is located at the Chr. Michelsen Institute (CMI) in Bergen, Norway.

⁵⁵ Vito Tanzi, "Corruption around the World: Causes, Consequences, Scope, and Cures," *International Monetary Fund Staff Papers*, Vol. 45, No. 4 (December 1998): 559-560.

⁵⁶ U. Myint., 33-58.

⁵⁷ Virginie Coulloudon, "Putin's Russia: A Confusing Notion of Corruption," *Columbia International Affairs Online*, Columbia University Press, <http://www.ciaonet.org/wps/cov01/cov01.pdf> (accessed May 10, 2010): 2-6. In this article, Coulloudon explores the relationship between Soviet and Post-Soviet anti-corruption efforts.

⁵⁸ Rose-Ackerman, *Corruption and Government: Causes, Consequences, and Reform*, 1-6.

⁵⁹ *Ibid.*, 3.

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corruption, could have serious ramifications on future trade and investment opportunities. This perceived corruption may compel international organizations such as the International Monetary Fund (IMF) or World Bank to limit investment opportunities and necessary loans for enhancing aging infrastructure, among other required internal improvements.⁶⁰ Outside of government regulations and political biases, few organizations are working to bring corrupt practices from the nefarious shadows to the forefront, as a means of combating the questionable activities and procedures of businesses and governments around the world.

Impetus of Corruption

With a basic understanding of the different forms of corruption, it is important to understand the causes or sources that make corruption fertile in economic and political arenas. The mere existence of laws and regulations can often introduce impediments to entrepreneurial endeavors, investments, and other economic activities. When laws and regulations are opaque, enforced differently, and cause abnormal delays in the business process, bribes are encouraged as a means to induce the system to process the necessary permits or licenses in a timely and efficient manner, in order to carry out economic endeavors.⁶¹ Another area that generates corrupt behavior lies within the development and enforcement of tax codes; the confusing and unclear interpretations of the law can tempt people to ignore or neglect tax requirements.⁶² Other areas that are conducive to corruption occur as result of low and irregular salaries, which imply that the strength for

⁶⁰ Leslie Holmes, "Corruption and the Crisis of the Post-Communist State," *Crime, Law and Social Change*, Vol. 27, No. 3 (May 1997): 283.

⁶¹ Tanzi, "Corruption around the World: Causes, Consequences, Scope, and Cures," 566-567.

⁶² *Ibid.*, 567.

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incentives can outweigh the cost or penalties associated with activity as a means of survival in some aspects.⁶³ Finally, there can be a certain level of ambivalence towards anti-corruption laws and reform in general. In many instances, there is no political will to curb the power and pervasiveness of corruption; there is often a shortage of experience and expertise to combat corruption, and very few benefits that outweigh the loss of that additional source of income.⁶⁴

Consequences of Corruption

Because of the inability to depict the true extent of corrupt practices, Transparency International has created a Corruption Perception Index (CPI), which “measures the perceived level of public-sector corruption in 180 countries and territories around the world.”⁶⁵ In conjunction with the tools provided by TI, outside agencies or organizations are able to assess the overall impact of corruption on economic efficiency and a country’s ability to develop, invest in future projects, and recover from a global economic crisis.⁶⁶ The implications of the CPI are emphasized when compared to the

⁶³ Ibid., 572.

⁶⁴ Ibid., 564-576. See also United States Agency for International Development (USAID), “A Handbook on Fighting Corruption,” *U.S. Agency for International Development: Center for Democracy and Governance*, (February 1999), (Washington, D.C.: USAID Center for Democracy and Governance Technical Publication Series), www.usaid.gov/our_work/democracy_and.../pdfs/pnace070.pdf (accessed April 14, 2010): 18.

⁶⁵ Transparency International, “Corruption Perception Index,” (2009), http://www.transparency.org/policy_research/surveys_indices/cpi/2009 (accessed November 23, 2009). CPI ranks countries relative to the perceived degree to which corruption exists among public officials and politicians in a specific country. The CPI is based on corruption-related data collected through 13 different expert and business surveys. The surveys related to perceived corrupt acts such as misuse of public power for private benefit, to include, bribery, kickbacks, embezzlement, as well as perceptions of the strength of anti-corruption policies and measures in specific countries.

⁶⁶ Transparency International, <http://www.transparency.org/>.

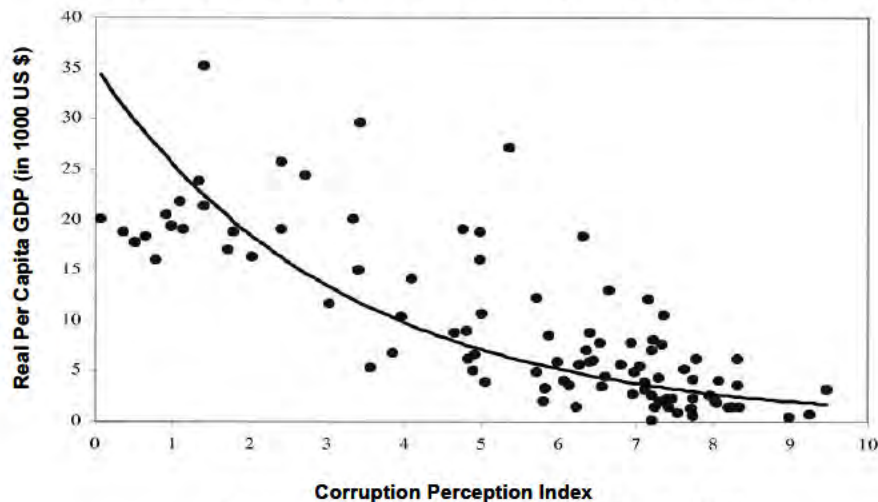
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GDP of a country.⁶⁷ The following figure (Figure 2-1) depicts an example of the negative relationship between the levels of economic development and the corruption perception indices as it is measured by real per capita gross domestic product.⁶⁸ This figure can be understood in one of two ways: first, countries with higher perceived corruption generally have lower per capita income; second, countries with lower perceived corruption generally have higher per capita income. When GDP growth was high and personal wealth increased, the perception of corruption inside Russia was favorable, despite the negative connotations associated with corruption.⁶⁹

Figure 2-1 Corruption and Development in 97 Countries



Source: *International Monetary Fund Working Paper, No. 00/182*, (Washington, D.C.: International Monetary Fund, November 1, 2000)

⁶⁷ Bureau of Economic Analysis, "Gross Domestic Product," <http://www.bea.gov/glossary/glossary.cfm>, (accessed March 12, 2009). The Bureau of Economic Analysis defines GDP as "[t]he market value of goods and services produced by labor and property."

⁶⁸ Vito Tanzi and Hamid R. Davoodi, "Corruption, Growth, and Public Finances," *International Monetary Fund Working Paper, No. 00/182* (Washington, D.C.: International Monetary Fund, November 1, 2000): 5. This figure is a sample of 97 countries in 1997 utilized to assess the affects of corruption on development. While the information is dated, its corollary emphasis is still accurate today and this point will be annotated further in this paper. The scale from which the perception index is utilized depicts 0 (highly corrupt) to 10 (highly clean).

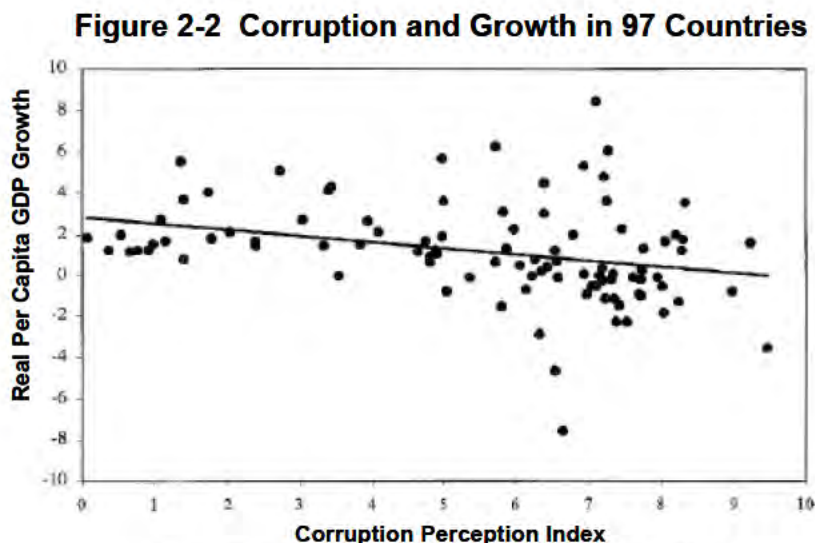
⁶⁹ Daniel Treisman, "The Popularity of Russian Presidents," *University of California, Los Angeles, Department of Political Science* (February 1, 2008), www.international.ucla.edu/media/files/Treisman.pdf (accessed May 28, 2010): 3.

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Figure 2.2 shows the relationship between perceived higher corruption levels and the anticipated lower growth rates of countries, for example, the more corrupt a country is perceived to be, the lower the actual growth rate tends to be.⁷⁰ Between 2000 and 2008, Russian trends have followed the pattern as outlined in Figure 2.1.⁷¹



With a negative trend and an associated taxation on a nation's GDP, corruption threatens economic stability, reduces the availability of resources, and creates political instability, by depriving the government the ability to provide basic services to meet the needs of citizens within their country.⁷² In addition, the denial, distortion, and delaying of developmental priorities has a considerable impact on both foreign and domestic investment opportunities.⁷³ In terms of investment, which helps build and/or expand business enterprises in countries, corruption raises the associated cost of doing business

⁷⁰ Tanzi and Davoodi, "Corruption, Growth, and Public Finances," 5.

⁷¹ *Ibid.*, 5.

⁷² John D. Sullivan and Aleksandr Shkolnikov, "Combating Corruption: Private Sector Perspectives and Solutions," *Economic Reform Issue Paper No. 409* (Washington, D.C.: Center for International Private Enterprise, 2004): 4-6 and James Roaf, "Corruption in Russia," International Monetary Fund Conference on Post-Election Strategy, Moscow, Russia (April 5-7, 2000), <http://www.imf.org/external/pubs/ft/seminar/2000/invest/pdf/roaf.pdf> (accessed 1 May 2010): 5.

⁷³ Anti-Corruption Resource Centre, 6.

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by adding a superfluous tax.⁷⁴ Corruption also increases uncertainty and risk by creating unfair competition, discouraging future entrepreneurial endeavors, and encouraging tax evasion, which in turn limits the funds available to encourage investment from both foreign and domestic businesses.⁷⁵

When corruption becomes so pervasive that it has infected all aspects of daily life and business practices, the introduction of a second or underground economy emerges to meet the needs of consumers at all levels.⁷⁶ Inside these second economies, are businesses that provide basic goods and services to citizens where items of necessity are in finite availability. This practice is not necessarily illegal, but the mere fact that the transaction itself is not recorded officially, as a means to evade taxes, etc., is detrimental to economic growth.⁷⁷ Other forms of underground transactions are more nefarious and involve illegal activities such as drug trade or people smuggling, to include human trafficking and the trafficking of gems, illegal materials, and animals.⁷⁸

Good Corruption?

In spite of the negative connotations associated with corruption, some authors claim that corruption can be beneficial for an economy, and is a necessity to accomplish

⁷⁴ Sullivan and Shkolnikov, "Combating Corruption: Private Sector Perspectives and Solutions," 4.

⁷⁵ Anti-Corruption Resource Centre, 12.

⁷⁶ See Axel Dreher and Friedrich Schneider "Corruption and the Shadow Economy: An Empirical Analysis," *Center for Research in Economics, Management and the Arts, Working Paper No. 2006-01* (January 18, 2006), <http://www.econ.jku.at/papers/2006/wp0603.pdf> (accessed April 14, 2010) and Gregory Grossman, "The 'Second Economy' of the USSR," *Problems of Communism*, Vol. 26, No. 5 (Sept-Oct 1977) for additional information regarding the imperatives and incentives that induce the formation of an underground economy. Dreher and Schneider hypothesize that second economies in higher income countries are substitutes for the primary market place and conversely in low-income countries, the second economies complement the primary economy.

⁷⁷ *Ibid.*

⁷⁸ U. Myint, 46. While these areas of concern are important to understand as a part of corruption, their emphasis is outside the scope of this research.

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even the most trivial of tasks. For example, Nathaniel Leff argues in support of the acceptable benefits of corruption as a means to overcome bad governmental policies.⁷⁹ Leff describes corruption as the “buying of favors from the bureaucrats responsible for formulating and administering the government’s economic policies.”⁸⁰ Despite these associated ‘benefits of corruption’ for society, most studies conclude that corruption reduces future investment and developmental opportunities.⁸¹

Given the universal depiction of corruption and its associated negative repercussions, it is important to understand how Russian society perceives corruption and overall commitment to implementing effective anti-corruption reform efforts. To assist in the development of an understanding for the perceived acceptance of corruption within Russia today, it is essential to describe corruption in historical terms, specifically during Soviet and post-Soviet times, which provides context to the power of Russian domestic and international policies. Most of the Soviet and Russian corrupt practices can be rationalized through the arguments presented by Leff, but while Russian officials

⁷⁹ Nathaniel H. Leff, “Economic Development through Bureaucratic Corruption,” *The American Behavioral Scientist*, Vol. 8, No. 3 (November 1964): 8. In justification for his argument, Leff, contends that most objects that fall into acceptable corrupt practices are in limited or finite quantities and therefore the imposition of a bribe will ensure that the intended object is available for those businesses that “are able to make the highest bids which are compatible with remaining in the industry.” Leff’s argument asserts that monopolistic businesses are efficient in their practices and therefore there is little need for competing businesses in the market.

⁸⁰ *Ibid.*, 8. See also Daron Acemoglu and Thierry Verdier “Property Rights, Corruption and the Allocation of Talent: A Great Equilibrium Approach,” *The Economic Journal*, Vol. 108, No. 450 (September 1998): 1381-1403., for additional suggestions that imply that the employment of corruption may be economically beneficial to society as it bypasses bureaucratic red tape and regulatory inefficiencies. In his writings, Leff also provides examples for which bribery can be justified as a means to obtain certain services or expedite administrative documents necessary for the conduct of business.

⁸¹ Andrei Shleifer and Robert W. Vishny, “Corruption,” *The Quarterly Journal of Economics*, Vol. 108, No. 3 (August 1993): 600. See also Michael Alexeev and Robert Legvold “Corruption: A Constraint on Growth and a Threat to Security?” *Economic Change in Russia*, (October 10, 2008), Center for Strategic and International Studies, (CSIS) Economic Change in Russia and its Implications for U.S. Policy, <http://csis.org/program/economic-change-russia> (accessed May 24, 2010). This article is a summary of their fourth presentation to the Center for Strategic and International Studies on “Corruption: A Constraint on Growth and a Threat to Security?” which occurred in October 2008 for further evidence in support of the detrimental effects towards the acceptance of corruption.

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announce new anti-corruption reform initiatives at every possible opportunity, little legal enforcement is realized in the investigation, apprehension, and prosecution of individuals suspected of having a hand in some aspect of corruption. This lack of enforcement can be attributed to the associated gain in personal wealth, which is acquired through corruption; any actual or perceived crackdown on corruption could decrease future opportunities for increased personal wealth.⁸²

A Second Economy

Economists today warn that corruption inside Russia is depriving the country of basic economic growth and limiting the prospect of Western investment opportunities, all of which reduces necessary resources and social programs to enhance the standard of living for Russians.⁸³ Economists around the world provide ample indications and warnings regarding the deep-seated acceptance of corruption inside Russia; so why does Moscow do so little to curb its devastating impact? Corruption in Russia can be traced back to Peter the Great, who was accused of deliberately underpaying his servants because he understood they would recover the difference in wages through trade and/or bribes. He epitomized and even, encouraged corruption.⁸⁴ Following the rise of the Bolsheviks and the subsequent capturing of the State by the Communists, there appeared to be many opportunities for governmental negligence, and overall acceptance to what

⁸² Coulloudon, "Putin's Russia: A Confusing Notion of Corruption," 2-6.

⁸³ John C. K. Daly, "Moscow Launches Major Anti-Corruption Drive," *Eurasia Daily Monitor*, Vol. 4, Issue 4 (January 2007), http://www.jamestown.org/programs/edm/single/?tx_ttnews%5Btt_news%5D=32362&tx_ttnews%5BbackPid%5D=171&no_cache=1 (accessed November 3, 2009).

⁸⁴ *Ibid.*

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has become known as a second economy or black markets.⁸⁵ This second economy greased the wheels of the Soviet system, and ensured its continuation by acquiring foreign currency, gemstones, and other items, outside the auspices of and sometimes with, the compliance of the Soviet State.⁸⁶

During Communist rule, the Soviets accepted the inevitability of corruption as a means to survive. Due to a shortage of clothing, food, and basic services, people resorted to corruption, often through bribery, giving of gifts, and evasion of laws and rules, to acquire necessary items.⁸⁷ The lack of available goods and services was intended to be a minor inconvenience during this period, as emphasis was placed on the establishment of large-scale industrial investment rather than consumer-based goods and services.⁸⁸ This resulted in hardships being faced by the common citizen, while the elite enjoyed immeasurable benefits at their expense.

A Levy of Necessity

The first example of what could be considered 'simple corruption' provides insight into the conduct of business and the requirement of employees to subsidize the activities of their own plant managers. The necessity to demand a levy from employees was meant to ensure that the plant was able to acquire the necessary parts and materials to meet required *kbota* (quotas) outside of inefficient Soviet supply and distribution

⁸⁵ See both Roaf, "Corruption in Russia," and Grossman, "The 'Second Economy' of the USSR," for additional information.

⁸⁶ Konstantin M. Simis, *USSR: The Corrupt Society* (New York: Simon and Schuster, 1982).

⁸⁷ Coulloudon, "Putin's Russia: A Confusing Notion of Corruption," 2-6.

⁸⁸ Simis, *USSR: The Corrupt Society*, 211. Also see Daniel Kaufmann, and Paul Siegelbaum, "Privatization and Corruption in the Transition," *Journal of International Affairs*, Vol. 50, No. 2 (Winter 1997): 419.

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channels.⁸⁹ Following the receipt of their paycheck, workers were notified of the portion of their paycheck that must be surrendered; this taxation or levy equaled 30 to 100 percent of their earnings at any given time.⁹⁰ Why would the plant workers relinquish their earnings with little debate? In such cases, the plant administration utilized these subsidies not for personal gain, but for bribes disbursed at varying levels of the supply distribution system, to ensure that the plant had the necessary materials and equipment to complete its job. This process was intended to ‘grease the wheels’ of the supply distribution channel. The employees understood this additional taxation as a necessity, even if its payoff was subsidizing bribes and gifts, so the plant could keep running, and they could keep their jobs.⁹¹



Beating the Queue

Bribery was also intended for the personal gain of individuals.

Anyone that understands life under Communist rule is familiar with images of people standing in lines that stretched for blocks,

⁸⁹ Simis, 141-142. Simis relates this story as a means to understand this process as an inevitable reality by the workers of the plant and the administration to accomplish the required jobs as demanded by the Soviet State.

⁹⁰ Ibid., 141.

⁹¹ Ibid., 141-142.

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a process that was unofficially referred to as “queuing.”⁹² Citizens would stand in long lines for hours awaiting the opportunity to purchase meat, to be seen by a physician, or to acquire tickets to the opera, often to be turned away, because meat products or tickets had sold out or the business day was complete for the doctors and staff.⁹³ This ‘queuing’ process appeared to be futile for those that could not or did not receive the products or services required, so bribery became commonplace in almost every aspect of goods and services provided.⁹⁴ Bribing storeowners or its employees ensured that citizens could secure the items required, without enduring the cumbersome endeavor of the ‘queuing’ process.⁹⁵ Despite the eagerness to avoid standing in long lines, many could not afford the luxury of bribes to acquire goods or services. As a result, a “tiered” system developed in what was supposed to be an egalitarian society,⁹⁶

At the Corner of Elitism and Corruption

⁹² See Dmitry Yakimenko, “Queues,” *Real USSR: Lifting the Iron Curtain*, <http://www.realussr.com/ussr/queues/> (accessed March 20, 2010) for a link to picture. For further elaboration on this topic see, Hedrick Smith’s, *The Russians*, (New York: The New York Times Book Company, 1976): Smith, 64-68.

⁹³ Smith, 64-75. Smith recounts various stories of his three-year adventure in the Soviet Union during the 1970s, none more notable than the depiction of ‘the queue.’ He describes the necessity and sheer patience of the citizens to endure long hours, even days at a time, to purchase, or just place their name on a list to acquire an item at a later date. Smith further elaborates on the magnetism of the queue by describing the power of the lines that would draw people to jump in line, even before they knew for which they were waiting

⁹⁴ *Ibid.*, 81-101. In Chapter 3 of his book, Smith discusses the necessity of bribes to facilitate the acquisition of products and services. The term ‘*na levo*’ which means, ‘on the left,’ but is interchangeably used as ‘on the side’ or ‘or under the table’ is presented by Smith to describe this process.

⁹⁵ Simis, 207. Simis describes a story told by a friend that had several important arrangements to put in order before he was set to entertain special guests at his residence. Bribes were necessary to accomplish all tasks by his friend. The specific case in point was an instance where the friend stated he had clothes that needed to be pressed and instead of queuing like everyone else was doing, the acceptance of gifts, i.e., candy, perfume, brandy, etc., was also often bestowed upon the employee as a means to accomplish the task before everyone else.

⁹⁶ See Mildred Fairchild, “Social-Economic Classes in Soviet Russia,” *American Sociological Review*, Vol. 9, No. 3, (June 1944): 236-241 for additional information regarding a short historical perspective on the intended classless society of the Soviet Union.

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Despite the hardships faced by the common Soviet citizen, the ruling elite inside the Communist Party apparatus enjoyed a higher standard of living at the expense of the ordinary people inside the country. The caste from which the ruling elite thrived was closed; not accessible to just anyone. Special privileges and benefits set the conditions from which corruption and social inequality were an acceptable form of conducting business.⁹⁷ In a society where scarce goods were rationed and could not be freely bought, the real corruption among the Soviet elite was not their higher wages but the existence of special and exclusive housing, stores, hospitals, and other service-oriented establishments, paid for by the hard-earned wages of the general population.⁹⁸ With these special shops and services came the opportunity to secure their own private supply of food, clothing, perfumes, chocolates, American cigarettes, and other assorted items.⁹⁹

The disparate services provided to the ruling elite, allowed for an environment plagued by double standards, and from which corruption found roots in all aspects of general business transactions. Ceasing corrupt practices for the elite during the Soviet period was almost as abhorrent as the act of bribing someone for special services. For the ruling elite, the Politburo and other high party members, why would they want to destroy or admit to the existence of a system that provided them with goods and services that were inaccessible to the general population? Another concern was that too many members of the ruling elite were themselves involved in these corrupt exchanges, and to prosecute the crimes of some would eventually tear down the very foundation of the

⁹⁷ Simis, 38-39.

⁹⁸ Ibid., 39.

⁹⁹ Simis recounts that the elite secured their special food items through what was called the Kremlin Canteen, or *Kremlyovskaya stolovaya*, with authorized patronage only by the members of the elite, their families, and their servants. Those members with access to the canteen received vouchers to use at the stores either in the amounts of 80 or 140 rubles; the amounts were based on their position within the elite.

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system. Finally, prosecuting the elite for their corrupt business endeavors would force an admission that the Communist system was fundamentally flawed and could prove to be disastrous for its survival – none of which was acceptable to the Communist Party and the ruling elite.¹⁰⁰

The Economy Since the Fall

While generally accepted as a necessity under Communist rule, corruption became an institution within itself; corruption created a parallel economy and encouraged entrepreneurial opportunities within a weak centralized economy.¹⁰¹ The cynicism of Russian citizens in response to the government's failure to uphold the rule of law, and the erratic and inconsistent manner at which regulations were enforced, ensured that corruption maintained a presence in Russian economic and political decision-making into the 21st Century.¹⁰² Following the collapse of the Soviet Union in 1991, Russia embarked on a tumultuous transition period that not only included political reform meant to move the country towards a democratic state, but also the privatization of state controlled assets.¹⁰³ As this period of transition continued during the 1990s, especially during the early part of the decade, the opportunities to abuse power and position became a core function, due to a lack of transparency and increased executive control of the government over the economy.¹⁰⁴ The loss of essential revenues through trade and market

¹⁰⁰ Ibid., 39-64.

¹⁰¹ Mikhail Heller, *Cogs in the Wheel: the Formation of Soviet Man*. Translated by David Floyd. (New York, Alfred A. Knopf, 1988). Originally published as *Mashina i vintiki*: 139.

¹⁰² Roaf, 2.

¹⁰³ Shevtsova and Olcott, "Russia Transformed," 1-25.

¹⁰⁴ Coulloudon, 3-8. Ms. Coulloudon argues that despite essential transformations of political programs in the early 90s, the newly formed Russian government still possessed three fundamental characteristics of the old Soviet system: supremacy of informal networks over institutions; an overly

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inefficiency created higher budgetary deficits, while foreign investment opportunities dried up, all culminating in hyperinflation and creating shortages of food and service items.¹⁰⁵

In an effort to ensure the smooth transition towards democratic and market reform, many decisions and business transactions were conducted behind closed doors, between members of President Boris Yeltsin's administration and leading members of the banking and industrial institutions.¹⁰⁶ With accusations of 'cronyism' running rampant, it was widely assessed that managers of state companies were purchasing commodities such as oil and metals from the state-controlled establishments they managed.¹⁰⁷ These managers utilized funds from their private accounts to acquire these commodities at well-below market value prices, which were then sold in the international market at an increased price.¹⁰⁸ Even when announcements were made about an open auction during privatization sales, the bidding process quickly became closed, allowing for businessmen such as Boris Berezovsky, Mikhail Khodorkovsky, and Vladimir Potanin to secure large portions of companies such as Sibneft Oil, Yukos Oil, and the television stations NTV and ORT, with little to no competition.¹⁰⁹ This process was exasperating for many Russians, because of complex tax codes, loopholes in the new privatization laws, a

powerful executive branch; and an extremely secretive decision making process. These characteristics facilitated the continuation of corruption beyond the collapse of the Communist state.

¹⁰⁵ Aslund and Dmitriev, "Economic Reform Versus Rent Seeking," 93.

¹⁰⁶ Coulloudon, 3-4. It is argued that these dealings occurred amongst those loyal to Yeltsin to avoid competing ideologies that would undermine the transformation process.

¹⁰⁷ Aslund and Dmitriev, 96. In addition, Ms. Coulloudon utilized the term 'cronyism' in her article in several different instances to describe the ruling elite's inner circle that controlled the political and economic landscape of the country.

¹⁰⁸ Aslund and Dmitriev, 96. Aslund continues by emphasizing that these managers were able to accomplish these efforts with the assistance of corrupt officials who provided export licenses and then political allies, who likely received some form of questionable payment to provide protective measures for this illegal process. See also Coulloudon, 6.

¹⁰⁹ Ibid., 102-103.

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general unwillingness to enforce laws, an aversion towards paying taxes, and a lack of education about free markets among the population.¹¹⁰

Between 1992 and 1997, Russia endured an extreme recession, triple digit inflation, the mass privatization of over 15,000 state assets, most of which went into the private coffers of the oligarchs, and an annual budget deficit that equaled approximately eight percent of total GDP.¹¹¹ Annual economic declines stabilized in 1995 as a result of the creation of a fixed exchange rate, and an increase in international financial assistance from organizations such as the International Monetary Fund (IMF).¹¹² By 1997, it appeared that Russian economic instability had been negated, and that the country was on pace to enter a period of revenues and growth, vice debt and recession; but as Russia entered 1998, economic disaster once again loomed. In 1998, Russia experienced a financial crisis, highlighted by a bad harvest that reduced agricultural output by 19 percent and the drop in oil prices to only \$11 per barrel, and an East Asian financial market crash.¹¹³ The result was a 64 percent devaluation of the Rouble, default on Russia's sovereign debt, and suspension of payment to foreign creditors.¹¹⁴ Despite

¹¹⁰ See Coulloudon and Roaf articles for additional information regarding the atmosphere of contempt. John Locke's article "Corruption in Russia," *Associated Content* (October 30, 2009), http://www.associatedcontent.com/article/2338924/corruption_in_russia.html?cat=9 (accessed April 24, 2010), describes an environment inside Russia where a small group of businessmen quickly took control of state assets for a low price and then turned a profit in their subsequent sales of portions of those enterprises.

¹¹¹ See Kenneth Rogoff's article "Has Russia Been on the Right Path?" *International Monetary Fund* (August 26, 2002), <http://www.imf.org/external/np/vc/2002/082602.htm>, (accessed March 20, 2010) and John Hardt's presentation to the Joint Economic Committee, Congress of the United States, *Russia's Uncertain Economic Future*, Edited by John P. Hardt for the Joint Economic Committee, Congress of the United States, (New York: M.E. Sharpe, 2003), for additional information relating to the economic devastation of the early 1990s.

¹¹² Hardt, *Russia's Uncertain Economic Future* 27.

¹¹³ Abigail J. Chiodo and Michael T. Owyang article "A Case Study of a Currency Crisis: The Russian Default of 1998," *The Federal Reserve Bank of St. Louis* (November/December 2002), <http://research.stlouisfed.org/publications/review/02/11/ChiodoOwyang.pdf> (accessed April 15, 2010): 11-13. The price for oil dropped from \$23 per barrel down to \$11 per barrel in nearly a year.

¹¹⁴ See the Chiodo and Owyang article and Hardt, 29-30 for additional information regarding the financial hardships faced by Russia in 1998.

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international concern and investor fears as Russia entered the 21st Century, oil prices began to increase, and by 2006 with the increase in the value of oil, energy production accounted for an estimated 16-20 percent of Russian GDP.¹¹⁵ The importance of energy exports has become the linchpin for Russian economic resurgence and vitality. Without the possibility of exporting its energy products, Russia would likely endure a tumultuous period of economic stagnation and societal conditions not witnessed since before the end of the Soviet Union.

Crisis in Review

Since Vladimir Putin assumed the mantle of President in 2000, Russia has become an energy superpower, which has raised the standard of living and brought forth economic strength through its large oil and natural gas reserves.¹¹⁶ Russia's integration into the global economy has allowed for the introduction and increased trading of its raw materials with European nations, resulting in real GDP increases of 6.9 percent on average since 1999, despite its recent problems during the recent global recession.¹¹⁷ In addition, the Russian population has begun to realize an increase in its standard of living, with a 10.5 percent increase in average real wages, and a decline in the unemployment rate from 12.6 to 6.3 percent.¹¹⁸ However, this growth in wages and revenues, Russia remains unable to reduce pervasive corruption, while conducting extensive reinvestment

¹¹⁵ Richard Sakawa, *Putin: Russia's Choice*, (New York: Routledge, 2008): 243.

¹¹⁶ William H. Cooper, "Russia's Economic Performance and Policies and Their Implications for the United States," *Congressional Research Service (CRS) Report to Congress* (June 29, 2009), www.fas.org/sgp/crs/row/RL34512.pdf (accessed April 15, 2010): 5.

¹¹⁷ These figures culminate in growth at the onset of the 2008 global economic crisis.

¹¹⁸ Cooper, 5. Since the economic downturn, Russian unemployment rates have grown; current unemployment numbers in 2008 (6.5 percent) to 2009 (8.9 percent), Central Intelligence Agency (CIA), "Russia," *The World Factbook*, 2010, <https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html> (accessed May 18, 2009). In comparison, Russian unemployment figures are lower than U.S. and Republic of Georgia figures, 9.3 and 16.4 percent, respectively, during the same period.

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to improve its aging infrastructure and improve social conditions that are bringing about a dangerous depopulation boom.

At present, Russia boasts the world's eighth largest GDP at \$2.116 trillion purchasing power parity (PPP), just slightly below the United Kingdom (\$2.149 trillion), but well below the United States (\$14.260 trillion).¹¹⁹ Despite these immense GDP estimates, little funding is dedicated to domestic social and health services throughout the country.¹²⁰ At the same time, lower fertility and life expectancy and higher mortality and disease rates have reduced the Russian population to alarming levels that portray a dismal prospect for its future.¹²¹ On top of a 4.4 percent (almost 6.6 million) decrease in its population between 1991 and 2009, estimates indicate that if current negative demographic trends continue, the Russian population will dwindle to approximately 128 million by 2025, and just over 124 million by 2030.¹²²

In a recent experiment to determine the macroeconomic effects of corruption in Russia, it was determined that corruption places an additional five percent tax on all

¹¹⁹ CIA, "Russia Economy: GDP (Purchasing Power Parity)," *The World Fact Book*, <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2001rank.html?countryName=Russia&countryCode=rs®ionCode=cas&rank=8#rs> (accessed May 18, 2010).

¹²⁰ David Hauner, "Benchmarking the Efficiency of Public Expenditure in the Russian Federation," *International Monetary Fund (IMF) Working Paper, No. 07/246* (October 2007): 3-15. This report was developed to assess the efficiency of Russian public expenditures in social sectors. In its findings, the IMF assessed that there is "substantial room for efficiency gains...[in] health care and social protection."

¹²¹ According to the CIA World Fact Book, with the world's ninth largest population of 140 million, Russian birthrates equal 11.1/1,000 people (178th world ranking), mortality rates equal 16.6 deaths/1,000 people (12th world ranking, these figures place them ahead of war-torn countries such as Sudan and Somalia), overall life expectancy is 59.33 for males and 73.14 for females.

¹²² Nicholas Eberstadt, "Russia's Peacetime Demographic Crisis: Dimensions, Causes, Implications," *The National Bureau of Asian Research Project Report* (May 2010), http://www.nbr.org/downloads/pdfs/psa/Russia_PR_May10.pdf (accessed April 14, 2010): 10 and Nicholas Eberstadt, "Drunken Nation: Russia's Depopulation Bomb," *World Affairs Journal*, Vol. 171, No. 4 (Spring 2009): 53.

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business transactions throughout Russian economic sectors.¹²³ The model found that this additional ‘taxation’ resulted in not only an estimated loss of \$2 billion each year from overall GDP gains, but that it also reduced a significant amount of resources available to maintain and improve the economy, by shifting assets to and from other economic sectors.¹²⁴

From a microeconomic perspective, corruption has permeated the daily life of local Russian citizens, as well as small business owners. A recent public opinion poll conducted by the Levada-Centre (Levada-Tsentr) agency indicated that 69 percent of those polled did not have to pay a bribe; of those that did pay, 92 percent paid in order to register a firm or obtain required paperwork to conduct their business.¹²⁵ While the number of bribe-making occurrences appears to be relatively low, the poll indicates that there has been a substantial increase in the overall price of bribes, which is now close to 9,000 rubles per bribe, up from 5,000 rubles in 2006.¹²⁶

Summary

With those facts in mind, and despite the recent economic downturn, why has there been no substantial economic or political reform to maximize purchasing power,

¹²³ Michael P. Barry, “Corruption in Russia: A Model Exploring its Economic Costs,” *Caucasian Review of International Affairs*, Vol. 3, No. 4 (Autumn 2009): 388.

¹²⁴ Barry, 388. Barry developed a computable general equilibrium (CGE) model to quantify the economic effects of corruption in Russia. His findings indicate that corruption costs Russia billions of dollars annually. His conclusion highlights the need for Russia to implement and enforce the provisions of the United Nations Convention against Corruption (UNCAC), for which Russia ratified in 2006.

¹²⁵ Interfax, “Average Bribe Size in Russia Jumps to Nearly 9,000 Rubles – poll,” (May 13, 2010), <http://www.interfax.com/newsinf.asp?y=2010&m=5&d=13&pg=6&id=164257> (accessed May 14 2010). This number increased significantly from 2005 (by 19 percent) when the Center asked the same question.

¹²⁶ Interfax, “Average Bribe Size in Russia Jumps to Nearly 9,000 Rubles – poll.” The poll identified additional areas that bribes were offered to include, court proceedings, receiving in-patient care, university entrance exams, and obtaining residence registration; most indicated that anyone who deals with officials has to offer a bribe. Of note, 9,000 rubles is about \$293 USD at current rates; 5,000 rubles in June 2006 was worth \$163 USD. Yahoo, “Finance: Currencies Center,” <http://finance.yahoo.com/currency-converter/#from=USD;to=EUR;amt=1> (accessed May 28, 2010).

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avert a growing domestic demographic issue, and improve an aging infrastructure?

Chapter 3 will show that Russia's inability to improve its domestic infrastructure and social programs are the result of rampant corruption within all levels of political and economic agencies, in comparison to the relatively successful anti-corruption reform efforts within the Republic of Georgia over the past 20 years.¹²⁷

Under Communist rule, corruption appeared to be necessary for survival, either to acquire goods or services or to accomplish tasks. Once a bribe was paid, the consumer had the assurance that bribes were no longer needed for that same good in the future.¹²⁸ Through this mechanism, it was often reported that bribes were funneled through the local Communist Party apparatus, which ensured a controlled process.¹²⁹ With the expansion of privatization and the growth of a fledgling market economy, bribes in Russia today are not merely a means to survive, but are often required to accomplish the same task in the future.¹³⁰ Corruption today is not intended to enrich the Party of old, but to provide additional income to those in power, as a means to control/deny access to entrepreneurial endeavors.

Today, heads of ministries, agencies, and local organizations control and manipulate the process to acquire licenses, permits, gain access to universities, maintain

¹²⁷ The inefficient use of revenues and resources greatly reduces economic growth and reduces the initiative to implement effective reform measures to address issues, specifically within the social, economic, and political arenas.

¹²⁸ Andrei Shleifer and Robert W. Vishny, "Corruption," *The Quarterly Journal of Economics*, Vol. 108, No. 3, (August 1993): 600.

¹²⁹ Shleifer and Vishny, 600. Other authors such as William Clark, *Crime and Punishment in Soviet Officialdom: Combating Corruption in the Political Elite, 1965-1990* (New York: M.E. Sharpe, 1993): 208-214, point out some of the positive aspects, which reduced bureaucratic rigidity, decreased political violence, and encouraged the development of entrepreneurial endeavors.

¹³⁰ Shleifer and Vishny, 605. With the fall of Communism and the expansion of new freedoms, many Russians had unique opportunities to exploit loopholes and realize large fortunes while the State and its political and economic infrastructure were formed. See also Coulloudon, 3 for additional insight into this subject matter.

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control of governmental positions, and enforce contradictory and discriminatory law enforcement techniques.¹³¹ There also continues the everyday low level bribes, e.g., to the traffic police—regarded as corrupt by most of the urban population—to avoid tickets or arrest. Despite recent proclamations by President Medvedev and former President Putin to fight corruption, little legal enforcement of anti-corruption laws exists today.¹³² Chapter 3 will explore recent anti-corruption reform efforts, highlight the mechanisms that encourage corrupt practices, and assess the Russian government commitments to controlling and/or eliminating corruption, in order to increase economic viability and reduce uncertainty in social service investments.

¹³¹ Ibid., 605.

¹³² Aslund and Kuchins, *The Russia Balance Sheet*, 38. In Chapter 3, Aslund and Kuchins present a quote from President Medvedev indicating, “corruption is one of the gravest domestic problems facing Russia.”

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CHAPTER 3

Reform Initiatives – A Comparison

Despite all of the efforts we have made, we have still not yet managed to remove one of the greatest obstacles facing our development, that of corruption.
*Vladimir Putin, then President of Russia*¹³³

Chapter 2 highlighted the dysfunctional nature of corruption inside Russia and the general malaise towards curbing the spread of further corrupt practices. This chapter will assess Russian anti-corruption efforts in comparison to those in the Republic of Georgia, in order to provide an assessment highlighting the paths taken by two countries that once shared a common philosophy and a common government.¹³⁴ While it is important to understand what corruption is, it is even more important to understand what measures are appropriate to combat corruption's pervasive nature. The lack of accountability towards public officials and their authority allows corrupt practices to occur; not to mention their low salaries, which induce further corruption and bribery.¹³⁵ In order to combat corruption, it is important to increase accountability and transparency in business and political transactions, as well as establish laws to punish corrupt offenders and reduce the incentives for corrupt practices.¹³⁶

¹³³ Pavel K. Baev, "Putin's Fight Against Corruption Resembles Matryoshka Doll," *The Jamestown Foundation* (May 22, 2006), http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=31700 (accessed May 26, 2010).

¹³⁴ While Russia is much larger in area and number of citizens, the fact remains that the two countries once shared common Communist ideologies and state-controlled economies, which provides a common baseline from which to assess the success of anti-corruption reform efforts between these two countries.

¹³⁵ USAID, "A Handbook on Fighting Corruption," 18.

¹³⁶ Rob McCusker, "Review of Anti-Corruption Strategies," *Australian Institute of Criminology: Technical and Background Paper, No. 23* (Australia: Canberra Australian Institute of Criminology, 2006), www.aic.gov.au/.../%7B8F179E8B-B998-4761-84B3-AD311D7D3EA8%7Dtbp023.pdf (accessed May 1, 2010):10.

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Drafted in 2003, the United Nations Convention against Corruption (UNCAC) provides “standards, measures, and rules” that if applied by all countries would help in the struggle against corruption by furthering internal legal system reforms that should be emplaced and enforced in a free and fair manner.¹³⁷ The Convention discusses several areas of concern, to include the link between corruption and organized crime, the stealing of assets, which threatens political and economic stability, and the effect that corruption has in undermining and endangering the enforcement and sustainment of the rule of law.¹³⁸ In its present form, Russia signed the convention on December 9, 2003, and then ratified it within the Duma on May 6, 2006.¹³⁹ Since its ratification, Russia has indicated that there are difficulties in institutionalizing reform efforts to curb the spread of corruption.¹⁴⁰ Several requirements inside the Convention encourage countries to mandate that their leaders declare income and assets, as well as establish a peer review system to assess compliance and improvements within the articles outlined in the Convention.¹⁴¹ In the latter half of 2009, several UNCAC signatories including, Russia,

¹³⁷ United Nations, *United Nations Convention against Corruption (UNCAC)*, (New York: United Nations Press, 2004), <http://www.unodc.org/unodc/en/treaties/CAC/index.html> (accessed April 14, 2010): iii. UNCAC addressing an endemic problem that affects the quality of life for people around the world.

¹³⁸ UNCAC, “Preamble,” 5.

¹³⁹ UNCAC, “United Nations Convention Against Corruption: Signatories to the United Nations Convention Against Corruption,” <http://www.unodc.org/unodc/en/treaties/CAC/signatories.html> (accessed April 14, 2010). Russia is one of 140 countries that has signed the convention and one of 136 countries that has ratified it. Currently Georgia has not ratified the Convention, but is formulating anti-corruption measures to induce compliance with the provisions set for the in the Convention. See the aforementioned link for a full listing of countries and their most recent status.

¹⁴⁰ Robert Ortung, “Causes and Consequences of Corruption in Putin’s Russia,” *PONARS Policy Memo. No. 430* (December 2006), (Washington, D.C.: American University Press), csis.org/files/media/isis/pubs/pm_0430.pdf (accessed December 22, 2009): 2. President Putin declared in 2006, that one of his administration’s greatest failures was “an inability to make much progress in the battle against corruption”

¹⁴¹ UNCAC, <http://www.unodc.org/unodc/en/treaties/CAC/index.html> (accessed April 14, 2010). See Christian Aid statement at Christian Aid, “UN Anti-Corruption Convention Rendered Toothless; Countries Roll Back Progress on Global Anti-Corruption Efforts” (November 13, 2009), <http://www.christianaid.org.uk/pressoffice/pressreleases/November2009/un-corruption-convention-rendered-toothless.aspx> (accessed May 26, 2009), for a full assessment of the November 2009, UNCAC meeting in Doha, Qatar.

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China, and Egypt, pressed for weakened provisions inside the peer review system. These weakened provisions are reportedly reducing fundamental measures to ensure transparency and accountability by requiring peer review teams to request permission from the partner country to make a visit of talk with leaders outside the political apparatus. In addition, it was decided that the findings will not be released to the UNCAC membership at large, further reducing external pressures that could invoke sustainable change within countries that have a large corruption problem.¹⁴²

The first area to address in anti-corruption reform efforts is a review of the accountability of public officials. In order for the public to hold its leadership accountable, decisions made by officials at all levels of local, regional, and national institutions must be transparent and addressed in public forums, to provide necessary checks and balances on procedural activities.¹⁴³ Efforts should ensure that accountability initiatives should not be too intrusive or disruptive, to a point where political and economic decisions are unnecessarily delayed; yet they must be effective to reduce overall levels of corruption, to include mere levels of public perception as well. Within governmental institutions, the drafting of rules that define appropriate and standardized bureaucratic procedures, techniques, and punitive measures, are necessary at the beginning of this process.¹⁴⁴ Follow-on anti-corruption measures should include the equitable balancing of power between the three branches of government, each providing

¹⁴² Ibid.

¹⁴³ Michelle Man, "Political Corruption in Russia: An Evaluation of Russia's Anti-Corruption Strategies, 1991-2009," *POLIS Journal*, Vol. 2 (Winter 2009): 15.

¹⁴⁴ World Bank, "Administrative and Regulatory Reform in Russia: Addressing Potential Sources of Corruption" Poverty Reduction and Economic Management Unit (October 13, 2006), <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/EXTECAREGTOPANTCOR/0,,contentMDK:21093933~menuPK:704720~pagePK:34004173~piPK:34003707~theSitePK:704666,00.html> (accessed April 20, 2010): 27.

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oversight and a check on possible abuses of power as well as ensuring that all decisions and proclamations are publicly announced to its electoral body.¹⁴⁵

Before internal governmental reforms can occur, leadership within the country must have the political will to introduce and enforce anti-corruption measures.¹⁴⁶ Within the political will of its elected officials, citizens can begin to conceptualize the intentions and motivations of its elected officials through public proclamations, personal accountability, and the development of programs targeting the sources of corruption, not just illegal acts by themselves.¹⁴⁷ Reform efforts without the political will to encourage positive change will not produce a profound and sustainable improvement within society.¹⁴⁸ Outside of governmental institutions, it is important for a country to possess and encourage the participation in politically neutral organizations, such as independent media sources (i.e., print, radio, and television) as a means of oversight and accountability for its citizens.¹⁴⁹

While laws and public accountability measures are important, they alone are not enough to prevent further corrupt activities. With the stick (rules and punishment), there

¹⁴⁵ USAID, 8-15, World Bank, (2000), 39-57, and Man, 16. An adequate balancing of power is encouraged in the executive, legislative, and judicial branches of the government, to ensure the legality of laws and activities within all levels of governmental institutions. The government must also ensure legal protection for persons who identify and report corrupt acts, through the development of a 'whistleblower program'.

¹⁴⁶ U4 Anti-Corruption Centre, "Unpacking the Concept of Political Will to Confront Corruption" (May 2010), No. 1, <http://www.cmi.no/publications/file/3699-unpacking-the-concept-of-political-will-to.pdf> (accessed May 20, 2010): 1. A lack of political will by elected officials is generally regarded as the primary reason that most anti-corruption reform efforts under perform or satisfactorily produce positive outcomes.

¹⁴⁷ Ibid, 2-3. Caution should be taken to not over estimate success based on statements by elected officials; as will be discussed later on in this chapter, Russia's anti-corruption reform efforts in the past have been assessed as mere rhetoric intended to discredit political opponents.

¹⁴⁸ Ibid., 1.

¹⁴⁹ Daniel Kaufmann, "Revisiting Anti-Corruption Strategies: Tilt Towards Incentive-Driven Approaches?" *Corruption and Integrity Improvement Initiatives in Developing Countries*, (New York: United Nations Development Program (UNDP), Management Development and Governance Division, 1998): 74.

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must be a carrot (incentives) to induce behaviors that are acceptable and legal. Some preferred incentives for global organizations include fair and equal salaries, which are commensurate with responsibilities, performance based incentives and rewards, and incorporating professional codes of conduct and organizational training opportunities that highlight examples of appropriate/inappropriate behavior.¹⁵⁰ With anti-corruption measures addressed, it is important to compare the effectiveness of these efforts. Sharing a common and historical precedence for the prevalence of corruption, both the Republic of Georgia and Russia have embarked on similar paths of reform, but with differing levels of success. The following is a brief comparison of their reform initiatives and effectiveness.

Republic of Georgia

In 2003, Transparency International's Corruption Perception Index ranked the Republic of Georgia as one of the worst countries in the world.¹⁵¹ With a ranking of 124 out of 133 countries, Georgia was in the bottom seven percent of corrupt countries, with levels comparable to Angola, Tajikistan, and Cameroon, to name a few.¹⁵² Over the last six years, Georgia has invoked extreme reform initiatives to curb the pervasiveness of corruption, which has steadily improved international perceptions of corruption within the country. Currently, Georgia ranks 66th out of 180 countries, placing them in the top forty percent of all countries, well ahead of former Soviet states such as Kazakhstan

¹⁵⁰ For additional information regarding incentive-based opportunities, reference the associated materials provided by Transparency International, <http://www.transparency.org/>, Organization for Economic Co-Operation and Development (OECD), "Developments in Selected Non-Member Economies: Russian Federation," *OECD Economic Outlook*, Vol. 1, No. 85 (Paris: Organization for Economic Co-operation and Development, 2009), and the United States Agency for International Development (USAID), "A Handbook on Fighting Corruption," *U.S. Agency for International Development: Center for Democracy and Governance*, (February 1999).

¹⁵¹ Transparency International, "Corruptions Perception Index: 2003."

¹⁵² *Ibid.*

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(#120), Belarus (#139), and Russia (#146).¹⁵³ While anti-corruption results in Georgia are similar to other states that suffer the same debilitating acceptance, President Mikheil Saakashvili's extensive reform efforts have focused on eliminating corruption in several key areas, to include its political, financial, educational, and legal institutions.¹⁵⁴ While Western nations may view corruption as problematic and an unrelenting hindrance to economic growth, the ubiquitous acceptance of corruption was considered by most Georgians as a necessary step in the conduct of routine business practices.¹⁵⁵ These so-called "necessary" business practices and transactions provided institutions and individuals the means to facilitate corrupt practices, which ultimately undermined economic and political institutions, as well as the overall security and sovereignty of the nation.¹⁵⁶

The Republic of Georgia is roughly the size of South Carolina, with a population of over 4 million.¹⁵⁷ Its current borders with Russia to the North, Turkey, and Armenia to the South, and Azerbaijan to the South and East, have allowed Georgia to remain an influential trade partner despite tenuous relations with its neighbors, especially to the North.¹⁵⁸ After nearly 70 years of Soviet rule, Georgia declared its independence from the USSR in 1991 when it began a period of reform and a move towards a democratic

¹⁵³ Ibid. Georgia's rankings on the CPI between 2004 and 2008 were; 133 out of 146, score 2.0 (bottom 10%); 130 out of 159, score 2.3 (bottom 20%); 99 out of 163, score 2.8 (bottom 40%); 79 out of 180, score 3.4 (top 50%); and 67 out of 180, score 3.9 (top 40%), respectively. Georgia's 2009 score was 4.1. While the rankings changed, it is important to understand the scores (based on a scale of 1 (most corrupt) to 10 (least corrupt) are a more accurate estimate of perceived corruption in a country.

¹⁵⁴ See *Organized Crime and Corruption in Georgia* (2007) edited by Louise I. Shelly, Erik R. Scott, and Anthony Latta, (New York: Routledge, 2007), for an in-depth assessment of additional anti-corruption reform efforts not highlighted in this chapter.

¹⁵⁵ Louise Shelley, "Introduction," in Shelly et al., *Organized Crime and Corruption in Georgia*: 1-16.

¹⁵⁶ Ibid., 4.

¹⁵⁷ Wesley Shoemaker, "Georgia," *Russia and the Commonwealth of Independent States*, 40th Edition. (Baltimore, Maryland: Stryker-Post Publications, 2010): 215.

¹⁵⁸ Ibid.

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government.¹⁵⁹ During this period of economic and political reform, Georgia, like many other newly independent successor states from the Soviet Union, experienced secessionist movements that led to civil war, and the disintegration of its economy.¹⁶⁰

Before its declaration of independence in 1991, Georgia's unofficial economy under the Soviet system was reportedly 'second to none,' based in part on what is referred to as its "underground entrepreneurs" that had a significant grasp over Communist party appointments within the Republic.¹⁶¹ This unparalleled and unrivaled underground activity, specifically through the Brezhnev era, resulted in an expansion of corrupt practices that included the acquisition of official posts through bribes, extra payments or bribes to gain admission into universities, as well as the extortion of citizens by the local police force.¹⁶² The intrusion of underground entrepreneurs into Georgian politics and widespread abuse of public office reached a point where change was necessary. In 1972, the Central Committee of the Communist Party in Moscow issued a resolution directed at the Communist Party Committee of Tbilisi, which aimed at eliminating corruption, illegal private economic activity, and other economic crimes and violations.¹⁶³ Following the issuance of this resolution, which was pushed by its then Minister of Internal Affairs, Edward Shevardnadze, many members of the Georgian ruling elite were removed for "health concerns" and subsequently forced into

¹⁵⁹ Ibid., 217.

¹⁶⁰ Shelley, 4.

¹⁶¹ Grossman, "The 'Second Economy' of the USSR," 34-35. Grossman articulates that the 'second economy' comprises all production and exchange activity that fulfills at least one of the two following tests: (a) being directly for private gain; (b) being in some significant respect in knowing contravention of existing law. It is hard to differentiate between legal and illegal private activity because one may be a front for the other and both may support the actions of the other.

¹⁶² Erik R. Scott, "Georgia's Anti-Corruption Revolution," in Shelly, 18.

¹⁶³ Simis, 53.

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retirement.¹⁶⁴ In spite of their removal for illegal business and political practices, not one member of the ruling elite faced legal repercussions.¹⁶⁵

In retrospect, attempts at anti-corruption reform during the Soviet period were inadequate and unsuccessful; many Georgians were able to amass large amounts of personal wealth through the second economy. This growth in personal wealth continued until the beginning of an open economy that followed the break-up of the Soviet Union. This openness resulted in the influx of goods to the market, which reduced the necessity for a black market.¹⁶⁶ While there was a decrease in the operations of a black market, corruption remained a staple among public officials, who utilized their positions to gain control of state assets through illegitimate privatization deals. In addition to the illegitimate privatization of Georgian assets, there was widespread tax evasion that routinely left the Georgian government millions of dollars short of budget estimates.¹⁶⁷ These events resulted in an endemic erosion of social services and deterioration in the Georgian infrastructure.¹⁶⁸ This neglect and irresponsible management of the economy left much of the population impoverished and unable to provide for themselves.

¹⁶⁴ Edward Shevardnadze was reportedly adamant that the end of corrupt practices in Georgia was necessary. Shevardnadze was once quoted as saying, "Once, the Georgians were known throughout the world as a nation of warriors and poets; now they are known as swindlers [.]". Further accounts of Shevardnadze's campaign against corruption can be found in, Simis, "USSR: The Corrupt Society."

¹⁶⁵ Grossman, 35 and Scott, "Georgia's Anti-Corruption Revolution," 18.

¹⁶⁶ Scott, 18.

¹⁶⁷ Ibid., 18

¹⁶⁸ Ibid., 18. For a good rundown on Georgian perceptions of corruption in 2000, see the World Bank, "Georgia Country Brief 2009" (April 2010), <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/GEORGIAEXTN/0,,menuPK:301755~pagePK:141132~piPK:141107~theSitePK:301746,00.html> (accessed April 24, 2010).

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A Failed Path to Reform

In 1990, Georgians elected Zviad Gamsakhurdia as the President; unfortunately, he showed tendencies of leading with an authoritarian mindset.¹⁶⁹ During his short term as President, Gamsakhurdia's administration was plagued with protest and civil unrest directed at his policies, and in 1992, Edward Shevardnadze replaced him.¹⁷⁰

Shevardnadze led Georgia through grueling economic times, but under his leadership, corruption became a serious problem, and by some estimates the reemergence of a large underground economy was realized, which was estimated to make up almost 30 percent of Georgia's GDP.¹⁷¹

During Shevardnadze's 11 years as Georgia's leader, the once vibrant and richest former-Soviet republic was transformed into one of the most destitute nations in the region. Almost 20 percent of the population migrated from Georgia, because of the worsening conditions during its economic and social downturn.¹⁷² With a much-maligned government and a planned economy that was eerily similar to Communist days of old, the pervasiveness of corruption inside Georgia overshadowed all elements of societal reform and development.¹⁷³

By 2000, a young reformer, Mikheil Saakashvili, became the Justice Minister, and fought to bring the issue of corruption to the forefront by proposing, that all government officials reveal their sources of wealth.¹⁷⁴ This effort was met with stiff resistance and

¹⁶⁹ Shoemaker, 217-220.

¹⁷⁰ Ibid., 217. Gamsakhurdia quickly fled the country after intense riots by the opposition movement.

¹⁷¹ Ibid., 220.

¹⁷² Louise I. Shelley, and Erik R. Scott, "Georgia's 'Revolution of Roses' Can be Transplanted," *Washington Post* (November 30, 2003), <http://www.washingtonpost.com/ac2/wp-dyn?pagename=article&contentId=A20186-2003Nov28¬Found=true> (accessed March 27, 2010).

¹⁷³ Ibid.

¹⁷⁴ Shoemaker, 220.

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criticism from officials inside the government. Ultimately, President Shevardnadze rejected the proposal, which led to Saakashvili's subsequent resignation as Justice Minister and his rise in popularity in the opposition party.¹⁷⁵ Public dissatisfaction with the government and the ailing economy brought about the end of the Shevardnadze's rule during the so-called "Rose Revolution in November 2003."¹⁷⁶ New life and optimism toward change guaranteed Saakashvili's ascension to the presidency, and the expectations of many Georgians encouraged him to rid the country of corruption and bring back the economic prosperity they once knew.¹⁷⁷

A New Approach

As the Rose Revolution came to fruition and Georgians witnessed the rise of Mikheil Saakashvili as President, the culture of corruption had firmly immersed itself into daily transactions within the Georgian society. There was an immediate need for change that extended beyond mere rhetoric to a more meaningful prosecution of corrupt practices and individuals, which included an open and independent media to investigate and verify the accountability of public officials.¹⁷⁸ By 2003, Georgia's perceived

¹⁷⁵ Ibid. President Shevardnadze initially rejected this proposal under pressure from his senior officials, but then pushed through a watered-down version of the proposal, which only required government officials to formally claim their assets, not the sources of those assets. This attempt to hide the sources of corruption led to Saakashvili's resignation. Unfortunately, corruption remained a drain on the Georgian economy due to its prevalence in all government offices and business transactions for the next two to three years as a result.

¹⁷⁶ Scott, 22-23. Scott emphasized that two factors contributed to the removal of Shevardnadze, the role of popular expectations and nationalism; both were grounded in the anticipation of economic prosperity that had yet to be realized since their declaration of independence in 1991.

¹⁷⁷ Ibid., 20-22. During this time, Saakashvili demanded the resignation of President Shevardnadze due to claims of vote rigging following the elections in November 2003. The subsequent demonstrations, under the auspices of the Rose Revolution, forced the resignation of Shevardnadze and new elections that saw Saakashvili become President in January 2004.

¹⁷⁸ Scott, 19-21. In his inauguration speech, Saakashvili declared that a "new, educated, energetic, and patriotic generation" was in position to combat corruption in order to improve the political and economic institutions of Georgia.

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acceptance of corruption had permeated beyond its borders and created an image that made it unsuitable for economic growth through foreign investment, as Western countries did not want to invest in a country where corruption could undermine and erode the development of a legitimate business entity.¹⁷⁹ In June 2005, a National Anti-Corruption Strategy was approved by President Saakashvili, which identified specific measures to combat corruption through public participation, reform, and economic liberalization.¹⁸⁰ A few months later, the Georgian government approved the National Anti-Corruption Plan, which called for increasing the efficiency of anti-corruption activities and strengthening the mechanisms for fighting corruption.¹⁸¹ By improving the laws, reducing administrative barriers, and increasing the privatization of state-owned business entities, the government assessed that they could increase the efficiency of the plan and subsequently strengthen the mechanisms for fighting corruption by reforming both law enforcement and judicial institutions, while increasing support for independent media development.¹⁸²

Law Enforcement

The first set of reforms under Saakashvili focused on the Georgian police force, which was assessed as highly corrupt and extremely criminalized through the

¹⁷⁹ Ibid., 17-20.

¹⁸⁰ Tamuna Karosanidze, "National Anti-Corruption Strategy and Action Plan: Elaboration and Implementation" (June 2007), <http://www.u4.no/training/in-country-open/Georgia-materials/anti-corruption-strategy-georgia.pdf> (accessed on April 24, 2010): 3. The National Anti-Corruption Strategy was approved in Presidential Decree 550. While highlighting the priorities for the campaign against corruption, the decree reportedly lacked analysis of the sources and motivators of corruption that would be helpful in curbing its pervasiveness.

¹⁸¹ Karosanidze, 4-5.

¹⁸² See the Karosanidze article for a complete rundown of reform initiatives and an assessment of their individual successes. While the action plan was a big step in the fight against corruption it appeared to be vague in setting milestones to accurately assess compliance and overall success.

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Shevardnadze era. The traffic police were in large part similar to the law enforcement apparatus under the old Soviet system, where officers were notorious for accepting bribes and servicing the needs of the ruling elite, rather than the needs of the citizenry.¹⁸³ Under this previous system, positions within the police force were purchased through bribes rather than by merit or demonstrated skills and expertise. This crooked practice further encouraged police officers to expect and accept bribes, all while creating closer business ties with criminal organizations.¹⁸⁴ In addition, the local government made little effort to ensure that the police force received acceptable salaries. Wages were approximately \$45-50 per month; these low wages encouraged bribery as an additional source of income to offset worsening economic conditions.¹⁸⁵ Following the revolution, Saakashvili's government signaled change was afoot by removing nearly half of the police force, approximately 15,000 officers.¹⁸⁶ This extreme measure to reform Georgia's police force was intended to rebuild public trust and confidence in law enforcement, in hopes of legally identifying, investigating, and prosecuting corrupt individuals and practices.¹⁸⁷

¹⁸³ Lauren Horoschak, "Fighting Corruption in Saakashvili-era Georgia: Successes, Challenges and Public Perceptions," *Anti-Corruption Resource Centre* (2007), <http://www.u4.no/training/incountry-open/Georgia-materials/saakashvili-georgia-horoschak-2007.pdf> (accessed April 1, 2010): 93.

¹⁸⁴ Alexander Kupatadze, Giorgi Siradze, and Giorgi Mitagvaria, "Policing and Police Reform in Georgia," in *Shelly*: 93-110. This article also discusses the system of fining drivers for minor traffic infractions by making fines payable to local banks rather than payments directly to the police officer.

¹⁸⁵ *Ibid.*, 95.

¹⁸⁶ Horoschak, 3. The police force reformation is widely considered one of the most significant successes of Georgia's anti-corruption reform efforts. Also see Jozsef Boda and Kornely Kakachia, "The Current Status of Police Reform in Georgia," *From Revolution to Reform: Georgia's Struggle with Democratic Institution Building and Security Sector Reform*, edited by Philipp H. Fluri and Eden Cole, (Austria: Bureau for Security Policy at the Austrian Ministry of Defence, July 2005), <http://www.dcaf.ch/publications/kms/details.cfm?lng=en&id=19845&nav1=4> (accessed May 28, 2010), for an in-depth assessment of Georgian Police Reform efforts.

¹⁸⁷ Kupatadze et al. 93-110 and Shalva Machavariani, "Overcoming Economic Crime in Georgia Through Public Service Reform," *Organized Crime and Corruption in Georgia*, (New York: Routledge, 2007): 37.

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Under this reform, they newly hired police force was promised higher wages and received new uniforms, and the equipment necessary to conduct their jobs.¹⁸⁸

Economy

In response to overwhelming international and domestic pressure, President Saakashvili began a large-scale privatization campaign of state controlled assets, and a reduction in the enormous state bureaucracy that was enabling corruption to undermine economic development.¹⁸⁹ Although, much attention has been given to the area of privatization, there are still some concerns that remained within the process of privatizing itself, namely in the lack of transparency in some of the transactions.¹⁹⁰ Opponents claimed these privatized sales were conducted directly between friends or family members of state officials, rather than through public auctioning or bidding; some state assets have been reportedly sold well below their actual value.¹⁹¹ Despite this reported lack of transparency in the privatization process, success in other economic reform measures helped erode the control corruption had on Georgia. Laws were ratified that reduced the number of licenses required by entrepreneurs to open their new businesses, as well as the implementation of new tax codes that reduced the quantity of taxes and overall percentage rates.¹⁹² These reforms helped ease the grasp of corruption in the

¹⁸⁸ Horoschak, 3. Also of note, Kupatadze et al. highlights that wages increased on average to approximately 350 GEL, which is equivalent to \$190-\$280 USD, 101. Kupatadze further expands on reform efforts that included the unification of the Ministries of Internal Affairs and State Security as a means to reduce redundancy and corrupt practices.

¹⁸⁹ Horoschak, 4.

¹⁹⁰ Ibid., 4.

¹⁹¹ Horoschak, 4 and Shelly, "Introduction," 7. Both authors describe a lingering presence of corrupt practices inside the economic arena, despite recent anti-corruption efforts.

¹⁹² Horoschak, 4. In her summary of economic reforms, Horoschack discusses the success of a new tax code that ultimately reduced the number of taxes collected as well as eliminating approximately 90% of previously required documents for licenses.

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economy, and increased the overall state budget by eliminating redundant licensing requirements and financial burdens.¹⁹³

With a bloated bureaucracy weighing down the potential for growth, the need for eliminating redundant and unnecessary ministries was overwhelming. In 2004, a new law came into effect called “On Structure, Authority, and Regulation of the Activities of the Government of Georgia,” which eliminated 3 of the 18 ministries, and reduced the number of civil servants by nearly 20 percent.¹⁹⁴ By developing a coherent and unified public service plan, Georgia was able to realize budget surplus of almost \$142.5 million: this surplus increase of nearly 15 percent was the first in Georgia since 1991.¹⁹⁵ Finally, by approving “On Support for Banning the Legalization of Illegal Incomes” in 2004, Georgia was able to effectively target its illegal shadow economy and reduce the conduit for money laundering and illicit goods that undermined economic prosperity.¹⁹⁶

Georgian Summary

While recent anti-corruption reform efforts have met success and praise throughout the international community, the Georgian leadership must continue its efforts to eliminate corrupt practices within all aspects of society. Recent reports by the World Bank indicate a strong economic revival by Georgia that witnessed a rise in GDP by 10.5 percent, based on the increase of tax to GDP ratio and a reliance “on the private sector for

¹⁹³ Ibid., 4.

¹⁹⁴ Machavariani, 46.

¹⁹⁵ Ibid., 46.

¹⁹⁶ Friedrich Schneider, “The Size of Shadow Economies in 145 Countries from 1999 to 2003,” *The Brown Journal of World Affairs*, No. 11, Vol. 2 (Winter/Spring 2005): 113-129. Schneider highlighted that Georgia was able to legalize approximately 2.6 percent of the shadow economy in the first quarter of 2004, which helped spur economic revitalization. While a mere two percent seems small, the ability to incorporate the seemingly once lost revenues into annual budgetary estimates is a huge boost for the country. See also Shalva Machavariani’s, “Overcoming Economic Crime in Georgia through Public Service Reform,” for a good summary of the resulting factors.

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growth in a highly liberal trade, investment[,] and business environment.”¹⁹⁷ With this praise must come an increased awareness on the emphasis of transparency and accountability in the government and its business transactions. Continued reform during the next five to ten years could ensure that Georgia becomes the model for the other 13 former-Soviet states to engage successful anti-corruption reform efforts within their respective countries.

Russian Attempts at Reform

Unlike the negative international assessments of corruption in Georgia in 2003, Russian perceived levels of corruption during the same period were relatively favorable, but those perceptions have worsened over the past seven years. At present, Russia ranks 146th out of 180 countries, placing them in the bottom 20 percent of all countries rated. This ties them with Ukraine, and just slightly higher than former Soviet countries on the verge of failing, such as Tajikistan (#158) and Kyrgyzstan (#162).¹⁹⁸ Despite President Medvedev’s announcements of the way ahead regarding Russian anti-corruption efforts, little evidence exists that there are appropriate measures in place to effectively identify and prosecute corrupt individuals and eliminate corrupt practices.

¹⁹⁷ The World Bank, “Georgia Country Brief 2009,” April 2010.

¹⁹⁸ Russia’s rankings on the CPI between 2004 and 2008 were; 90 out of 146, score 2.8 (top 60%); 126 out of 159, score 2.4 (bottom 20%); 121 out of 163, score 2.5 (bottom 25%); 143 out of 180, score 2.3 (bottom 20%); and 147 out of 180, score 2.1 (bottom 20%), respectively. Russia’s 2009 score was 2.2. Despite recent admissions by President Medvedev that corruption is endemic in Russia, TI raised the country’s current ranking one place (147 to 146), Transparency International, “Corruption Perception Index: Russia.” Ironically, following the release of the 2009 TI report, accusations surfaced that a formal deal had been reached between Russian negotiators and TI to make its evaluation criteria more favorable to Russia; claims that TI has aggressively denied, see Rianovosti, “Transparency International Denies Formal Deal with Russia to Monitor Corruption,” *Rianovosti* (February 1, 2010), <http://en.rian.ru/russia/20100201/157737556.html> (accessed April 20, 2010) for additional information.

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Recent reports this year indicate that despite the increasing perception of corruption's prevalence in Russia today, Russian authorities are claiming that there is, in fact, a decline in corruption-related cases from prior years. Highlighted by Interior Ministry figures from 2009, which depict the prosecution of over 2,351 people due to the increased enforcement of anti-corruption laws and the investigations of an estimated 7,800 people for bribery related charges, Russian officials claim a minor success in that there has already been a seven percent decline in the number of corruption related cases this year.¹⁹⁹ Figures presented by the Interior Ministry depict the cost of an average bribe in 2009 increased by an estimated 9,000 rubles from 2008, to more than 23,000 rubles (\$780 USD).²⁰⁰

Typical of the most recent anti-corruption efforts is a common theme, which encourages its use as a political instrument to engage opponents and preserve political power.²⁰¹ Anti-corruption reform within Russia has followed an identical path under all leaders since Yuri Andropov, to include power struggles, the need to build an image of incorruptibility, and restructuring the state.²⁰² The following quote is a brief look into each of the three 'typical' reform patterns conducted within Soviet and Post-Soviet societies. First, there are two types of motivations within "struggle for power" anti-corruption reform efforts. One begins with the gathering of information that could be used to discredit a rival in an effort to enhance one's own position--this effort is called

¹⁹⁹ Alex Anishyuk, "Cost of Bribes More than Doubles in '09," *The Moscow Times* (March 26, 2010), <http://www.themoscowtimes.com/business/article/cost-of-bribes-more-than-doubles-in-09/402571.html> (accessed March 10, 2010).

²⁰⁰ *Ibid.* These figures while they appear to show signs of the decline in corrupt practices, Transparency International Russia cautions the response by stating that bribery is only one aspect of the corruptions totality inside the country.

²⁰¹ Coulloudon, 9.

²⁰² *Ibid.*, 2-3.

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the “Andropov type.” The second is called the “defensive strategy,” where the group in power utilizes compromising information to discredit their opponent, again enhancing their position, “*kompromat*.” Under “building an image of incorruptibility,” anti-corruption campaigns were conducted in an effort to eliminate political opponents by publicizing enhancements to anti-corruption reform, and following up with very public crackdowns and arrests. While this effort appears to follow the path to targeting corrupt individuals, its enforcement and application is not transparently applied across the board, but merely used to eliminate political rivals during campaigns.²⁰³ The final reform pattern “restructuring the state,” is typically applied when the previous reform efforts have failed, and the selective application of anti-corruption targeting has brought about negative perceptions of those in power. Under this state restructuring reform effort, large bureaucracies within state institutions are targeted as a means to eliminate corruption within upper levels of political institutions, rather than targeting specific individuals.²⁰⁴ What becomes problematic during this phase is that new laws target the elimination of corruption within specific functions of state institutions, rather than the root cause of corruption as a whole. New laws are approved and implemented to strengthen the role of the state, rather than the entrepreneurial endeavors of a capitalistic society.²⁰⁵

The Path of Little Reform

Under President Boris Yeltsin, many Russians felt that the reform initiatives the country desperately needed were plagued by missed opportunities, and ended in

²⁰³ Ibid., 9-10.

²⁰⁴ Ibid., 11-12.

²⁰⁵ Additional information regarding the previous examples can be found in Virginie Coulloudon’s article “Confusing Notion of Corruption, 2003.”

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unnecessary losses in financial stability.²⁰⁶ At the beginning of Yeltsin's tenure as president, during the period of vast privatization and economic reforms, fears of corruption spread across both economic and political institutions.²⁰⁷ In 1992, President Yeltsin initiated his first anti-corruption reform measure, by issuing Presidential Decree 361, a directive for public figures to declare their personal holdings and assets.²⁰⁸ Overwhelmed by the complexities associated with market and political reformation, Yeltsin's administration, in a manner eerily similar to the days under Communist domination, ruled the country through presidential decrees and direct appointments to political posts throughout the country.²⁰⁹ Despite this extensive executive control of political appointments, an important stage of democratization occurred through the growth in rival political parties; unfortunately, none of these rival parties were able to compete against Yeltsin.²¹⁰ President Yeltsin's anti-corruption reform efforts were assessed as failures, which further heightened public cynicism toward reform, and

²⁰⁶ Russian Academy of Sciences, "Ten Years of Russian Reforms Through the Eyes of Russians," translated by Kim Braithwaite, *Russian Social Science Review*, Vol. 45, No. 6 (Nov-Dec. 2004): 23. This study assessed the feelings and perceptions Russians over a ten-year period following the collapse of the Soviet Union. During this period, almost 54 percent of the respondents felt a loss in the standard of living and 35 percent felt a loss in morality; both findings indicate an environment that is conducive for corruption. The survey indicated that while Yeltsin received the majority of the blame for the conditions within Russia, Putin's ascension to President brought about high hopes for quantifiable and favorable changes.

²⁰⁷ *Ibid.*, 22-25.

²⁰⁸ *Ibid.*, 22. As it will be identified again later in this chapter, recent decrees that call for the declaration of assets seem to miss one critical aspect – the source of income.

²⁰⁹ Coulloudon, 6. This information was recorded during personal interviews between Coulloudon and various former ministerial appointees. Many of the respondents felt that the tightening decision making under the executive branch was extremely important during the process to democratize the country, despite similarities to governance under the Communist state. See also Janine R. Wedel's book *Collision and Collusion: The Strange Case of Western Aid to Eastern Europe (1989-1998)* (New York: St. Martin's Press, 1998), for additional information regarding Yeltsin's rule by decree during his time as president of Russia.

²¹⁰ Coulloudon, 6.

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facilitated the growth of public perceptions that criminality and corrupt behavior were acceptable.²¹¹

Following closely on the heels of his predecessor, President Putin also declared that corruption was a problem that needed to be addressed, and he appeared to say the right things that would indicate change was afoot. During his speech to the Russian Federal Assembly in January 2000, President Putin discussed the “struggle against organized crime and corruption,” and that criminal acts and actors were “mercilessly consuming the economy...discrediting the organs of government, and undermining the international authority of the Russian Federation.”²¹² Unfortunately, while his words addressed the right concerns, his actions proved to be more of the same rhetoric as his predecessor. By appointing his own personal representatives, Putin was able to control, manipulate, and “deprive regional leaders of a direct voice in national policy.”²¹³ These personal representatives coordinated activities at the federal and regional levels, adding unnecessary layers of bureaucracy.²¹⁴

Within a short period, Putin’s administration had gained control of the three largest Russian television networks for the state, while companies that were closely tied to the Kremlin purchased the other print publications.²¹⁵ By acquiring independent media

²¹¹ Man, 25.

²¹² Robert Coalson, “Can Medvedev Find A 'Systemic Solution' To Corruption?” *Radio Free Europe/Radio Liberty Analysis* (May 23, 2008), <http://www.rferl.org/content/Article/1117537.html> (accessed May 20, 2010).

²¹³ Aslund and Kuchins, 31.

²¹⁴ Jasmine Martirossian, “Russia and Her Ghosts of the Past,” *The Struggle against Corruption: A Comparative Study*, edited by Roberta Ann Johnson (New York: Palgrave Macmillan, 2004): 90. It was reported that between 2005 and 2006 alone, the number of bureaucrats increased from 143,500 to 1,462,000, which likely prevented the increase in public sector salaries and provided further impetus for corruption, specifically bribery to occur.

²¹⁵ Orttung, 3. Also see Paul Goble, “Russia: Analysis from Washington: Repression by Selective Prosecution,” *RFE/RL Newslines* (May 5, 2000), <http://www.rferl.org/content/article/1093914.html>

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publications, President Putin effectively eliminated accountability efforts, i.e., the voice of opposition or independent groups or the public to ensure appropriate checks and balances were in place.²¹⁶ Moreover, not only did pro-government owners muzzle the press, but journalists themselves were murdered. Since 2000, 17 Russian journalists have been killed, marking Russia as one of the deadliest countries in the world for journalists.²¹⁷ Of these 17 murders, only one case resulted in the conviction of the suspected killers. The lack of legal protection and prosecution of crimes against journalists and the media has created an environment of self-censorship, where journalists underreport or do not investigate issues that are particularly sensitive, like corruption within politics and the economy.²¹⁸

By the end of 2006, Putin publicly admitted that one of his administration's greatest failures was an inability to make progress against corruption.²¹⁹ Until 2008, little had been accomplished in the fight against corruption, but almost as immediately as he was sworn in as president of Russia, Dmitry Medvedev made fighting corruption a cornerstone of his administration, by highlighting his concern for corruption and its detrimental effects on progressive domestic reform.²²⁰

In the months prior to the 2008 presidential election, Medvedev outlined his National Anti-Corruption Plan, which highlighted the need to create incentives for public

(accessed April 15, 2010) for additional insight into the how the state undermined a media company in the Media-MOST Group tax evasion allegations in 2000.

²¹⁶ Ibid., 3.

²¹⁷ Committee to Protect Journalists (CPJ), "Anatomy of Injustice," (September 2009), <http://cpj.org/reports/2009/09/anatomy-injustice-1-summary.php> (accessed May 27, 2009): 9. Some of these high profile killings include journalists such as Anna Politkovskaya and Paul Klebnikov among others who worked on sensitive issues such as politics, corruption, and organized crime.

²¹⁸ CPJ, 9-10.

²¹⁹ Orttung, 1.

²²⁰ Aslund and Kuchins, 38. Medvedev went as far as to appoint himself as head of the Russian Anti-Corruption Council to further his reform efforts. Some might construe this personal appointment as a means to control information and restrict reform initiatives behind closed doors; time will tell.

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officials to deter and prevent corruption, ensure that illegal acts do not escape punishment, and the necessity for an environment that is intolerant of the existence of corruption within Russian society.²²¹ Unlike his predecessors, President Medvedev pursued his anti-corruption platform even further by pressing for new laws governing legal procedures to curb this disease. In July 2008, President Medvedev approved the National Plan on Countering Corruption, which introduced a draft resolution for the passage of a new federal law “On Counteracting Corruption.” The drafting of this new law amended 24 previous laws aimed at clarifying what corruption is, how to prevent corruption, and ways to reduce corruption in the future.²²² A few highlights from the new plan include, “strengthening public control over public officials” by increasing transparency and accountability through independent media outlets; a requirement for public officials to disclose financial sources of income; and finally, the imposition of an assortment of punishments or sanctions for violators of the new law.²²³

²²¹ Man, 31-40. Six months after being sworn in, President Medvedev implemented his new anti-corruption initiatives. Despite the vigor from which the plan was implemented, little evidence existed that successful enforcement was occurring which led to the implementation of a new National Strategy in 2010.

²²² Vinson and Elkins, (V&E), “Russia: New Anti-Corruption Bills Going through the State Duma,” *V&E Russia/CIS Practice* (December 2, 2008), http://www.vinson-elkins.com/resources/pub_detail.aspx?id=12266 (accessed May 24, 2010).

²²³ *Ibid.* The new measures outlining President Medvedev’s initial Anti-Corruption Plan were adopted on December 30, 2008 and subsequently three new laws came into force on January 10, 2009. Federal Law No. 273-FZ On Counteraction to Corruption (establishes the general framework of anti-corruption legislation); Federal Law No. 274-FZ On Amendments to Certain Legislative Acts of the Russian Federation in Connection with the Adoption of the Federal Law On Counteraction to Corruption (develops provisions of the main law with respect to certain categories of government employees, such as judges and members of parliament, persons holding state and municipal offices not qualifying as state or municipal service offices); and Federal Law No. 280-FZ On Amendments to Certain Legislative Acts of the Russian Federation in Relation to Ratification of the UN Anti-bribery Convention dated October 31, 2003 and the Criminal Law Convention on Corruption dated January 27, 1999, and Adoption of the Federal Law On Counteraction to Corruption (develops the provisions of the main law with respect to state and municipal service and amends the Civil, Criminal and Administrative Codes), Baker and McKenzie, “Legal Alert: Russia” *Baker and McKenzie – CIS, Limited*, (February 2009), www.legal500.com/.../russia_adopts_new_anti-corruption_legislation.pdf - United Kingdom (accessed May 24, 2010).

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Despite instituting these new laws, by the end of 2009, President Medvedev was frustrated with the pervasiveness of corruption and the lack of progress in the fight against it. During his speech to the National Assembly, he began to air his frustration by stating:

Centuries of corruption have debilitated Russia from time immemorial. Until today, this corrosion has been due to the excessive government presence in many significant aspects of economic and other social activities. But it is not limited to governmental excess -- business is also not without fault. Many entrepreneurs are not worried about finding talented inventors, introducing unique technologies, creating and marketing new products, but rather with bribing officials for the sake of 'controlling the flows' of property redistribution.²²⁴

Much like the initial reform measures that Saakashvili proposed to former Georgian President Shevardnadze, Medvedev proposed on March 10, 2009, that as a part of the Federal Plan for the Reform of the Civil Service, public officials would be required to begin declaring their earnings. Unlike previous calls for asset declaration, Medvedev's new plan called for an expansion of the types of assets required to be listed, as well as requesting that the family members of public figures to declare their assets as well.²²⁵ As a significant setback to the plan, the decree did not articulate the enforcement of sanctions, or any form of punishment against those that do not disclose their assets.²²⁶ Perhaps the lack of reporting may invoke public dissatisfaction that would lead to the eventual removal of those political figures during the next election? This naïve approach to legal enforcement during asset declaration is doomed to failure, and with it continued

²²⁴ Dmitry Medvedev, "Go Russia," September 10, 2009.

²²⁵ Roland Oliphant, "What Hath the President? A True Battle against Corruption Presupposes a Smaller Number of Bureaucrats," *Russia Profile* (April 9, 2009), www.cdi.org/russia/johnson/2009-67-10.cfm (accessed May 28, 2010).

²²⁶ Evgeniya Chaykovskaya, "Defying Medvedev," *The Moscow News* (May 25, 2005), <http://www.mn.ru/politics/20100525/187843087.html> (accessed May 28, 2010). This article cites that 23 public officials, this year, have failed to disclose their assets in accordance with the most recent Presidential decree.

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corruption. Without legal repercussions for failure to declare their assets, there will continue to be individuals who do not follow the laws, as well as leaders who hide their assets in foreign accounts or within the accounts of family members that are removed from the public eye.

Ministry of Internal Affairs

Often cited as one of the most corrupt institutions inside Russia today, the Russian Police force accounts for approximately 14 percent of reported corruption cases. This further highlights the questionable practices of the Ministry of Internal Affairs, which accounted for 31 percent of the officials that were convicted of corruption-related charges in 2008 alone.²²⁷ Because of the associated improprieties with the country's law enforcement agencies, President Medvedev turned his focus towards combating corruption within the Police Force and Ministry of Internal Affairs.²²⁸ One of the interesting points here is that without a lawful legal apparatus to enforce anti-corruption laws, true reform would not likely occur. In the first steps of reforms within the Ministry of Interior in February 2010, President Medvedev eliminated almost half of the positions within the Interior Ministry (MVD), fired an estimated 16 officials from within the

²²⁷ Business Anti-Corruption Portal, "Corruption Levels: Police," <http://www.business-anti-corruption.com/country-profiles/europe-central-asia/russia/corruption-levels/police/> (accessed May 27, 2010).

²²⁸ Rianovosti, "Russia Police Whistleblower Dymovsky Says Released," *Rianovosti* (March 7, 2010), <http://en.rian.ru/russia/20100307/158123074.html> (accessed May 24, 2010) and Conor Humphries, "Russia Arrests YouTube Police Whistleblower," *Reuters* (January 22, 2010), <http://www.reuters.com/article/idUSTRE60L33W20100122> (accessed May 24, 2010). In 2009 alone, police officers committed over 5,000 crimes, with an overall increase of 17 percent in police-related offenses from 2008 according to reports gathered by the Interior Ministry's internal security department (USB). Some of the most high-profile incidents included the deadly shooting spree at a supermarket by a Moscow Police Chief, who was believed to be drunk at the time as well as the infamous YouTube Video by a former policeman, Major Alexei Dymovsky, who urged the President and Prime Minister to begin a national effort to eliminate corruption in the police force. Mr. Dymovsky was dismissed from the police force just days after the video posted and then arrested on charges of fraud and abuse of power.

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ministry, and placed tighter restrictions on the most often cited corrupt practices conducted by the Russian police, i.e., road inspections.²²⁹ This estimated reduction of almost 20 percent highlights certain critical steps to anti-corruption reform as discussed previously.

The first step includes reducing the overall bureaucracy within the Ministry, which frees up the budget to increase the salaries of the police officers, as a means to reduce the incentives for accepting and expecting bribes while performing their duties.²³⁰ While the efforts to ‘clean up’ law enforcement agencies inside Russia appear to be moving the country in the right direction, one key fact remains unanswered at this point; what was the true intention of President Medvedev in the removal of two deputy ministers? Did President Medvedev remove these two deputies because they were unable effectively to perform their duties to curb corruption within the MVD, or was the President putting people in key positions that are loyal to him as a means to protect himself in the future?²³¹ Unlike the success the Georgians had with a quick reformation in their police force, Russia efforts are still in their infancy, and their effectiveness cannot be assessed at this time.

²²⁹ Russia Monitor, “War on Corruption: The Great Purge at MVD” (February 19, 2010), <http://www.therussiamonitor.com/2010/02/war-on-corruption-great-purge-at-mvd.html> (accessed April 14, 2010) and Mark Galeotti, “Medvedev’s Police Reform is more About Control than Reform,” *Spero News* (January 7, 2010), <http://www.speroforum.com/a/25136/Medvedevs-Police-Reform-Is-More-About-Control-Than-Reform> (accessed April 14, 2010).

²³⁰ Galeotti emphasizes that there is still room for large amounts of improvement in the MVD alone, but the increased salaries would reduce the need for a supplemental income as well as increase and improve likely candidates for recruitment. Unlike the Georgian police reformation, no word on improving the antiquated equipment, training, and inefficient police procedure yet. See Galeotti, “Medvedev’s Police Reform is more About Control than Reform.”

²³¹ See the Russian Presidential Website, “Dmitry Medvedev Made Appointments in the Interior Ministry,” *Kremlin.ru* (February 18, 2010), <http://eng.news.kremlin.ru/news/309> (accessed April 15, 2010).

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Investing in Russia

Regarding corruption in its economy, Russia's bloated bureaucracy retains a tight grip on the state-controlled entities of high revenue producing markets like oil and gas. As a rentier state, Russia's economic dependence on items such as oil and natural gas places the country at risk of rising and falling prices in the energy markets.²³² In addition to its economic dependence and subsequent vulnerability to market fluctuations, Russia has done very little to upgrade its aging natural gas equipment, as well as moderating the "near-monopolistic domination"²³³ by Gazprom, the predominantly state-owned natural gas provider in Russia. Gazprom's control is characterized by three important factors: first are its holdings of over 25 percent of the world's natural gas reserves; second, it is the primary provider of over 90 percent of all natural gas that Russia consumes domestically; and third, it is the primary operator of the country's natural gas pipeline network.²³⁴ These three factors allow Gazprom to influence both domestic and foreign product availability, and pricing variations.

Because of Gazprom's influence and stranglehold on the gas market, it is estimated that approximately 25 percent of Russian federal tax revenues are acquired through Gazprom tax payments.²³⁵ Despite its control of the natural gas market and current unyielding profitability, Gazprom is heavily regulated by Russian bureaucracy,

²³² Steven Woehrel, "Ukraine: Current Issues and U.S. Policy," *Congressional Research Service (CRS) Report for Congress* (March 5, 2009), www.fas.org/sgp/crs/row/RL33460.pdf (accessed December 22, 2009): 1.

²³³ Robert Pirog, "Russian Oil and Gas Challenges," *Congressional Research Service (CRS) Report for Congress* (June 20, 2007), italy.usembassy.gov/pdf/other/RL33212.pdf (accessed December 22, 2009): 83-84.

²³⁴ *Ibid.*, 84.

²³⁵ *Ibid.*, 84.

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which requires Gazprom to sell its natural gas at below-market prices, in order to heat and provide energy to Russia's domestic consumers.²³⁶ This government regulated price control encourages Gazprom to push exports to foreign consumers, while increasing prices to offset the loss of revenue from their domestic sales.²³⁷ In conjunction with the questionable activities of Gazprom, are two additional points of interest that should not be forgotten. One is Gazprom's role with the shadowy Florida-registered gas company, Itera. The other is the role the former chairman of the board of Gazprom, Dmitry Medvedev.

Regarding Itera, within the first few months of 2000, Gazprom's reserves were trading at approximately \$.10/barrel cents in comparison to \$13.80/barrel by Exxon Mobil.²³⁸ A subsequent investigation was conducted to determine why Gazprom reserves were so heavily undervalued; the investigation found that Gazprom had sold seven companies between 1997 and 2001, worth an estimated \$325 million, for a mere \$5,805 million.²³⁹ Further investigation revealed that Gazprom, in a joint venture with Itera, had placed 381 billion reserves into the Purgaz Company, for which Itera gained a 49% stake in Purgaz. A year later, Gazprom sold to Itera another 32% of Purgaz for a rock bottom price of \$1,200.²⁴⁰ While very little was done by former President Putin in regards to indictments against Gazprom, the fact that this information surfaced during the period when Putin was relentlessly hunting down the powerful oligarchs, such as Boris

²³⁶ Woehrel, 1.

²³⁷ Ibid., 1.

²³⁸ Caroline McGregor, "Gazprom and Itera: A Case Study in Russian Corporate Mis-Governance: Summary of Presentation by Mr. William Browder, CEO Hermitage Foundation" *Carnegie Endowment for International Peace* (March 18, 2002), <http://www.carnegieendowment.org/events/index.cfm?fa=eventDetail&id=468> (accessed May 24, 2010).

²³⁹ Ibid. The seven companies were - Purgaz, Rospan, Tarkosalenftegaz, Sibneftegaz, Achimneftegaz, Vostokgaz, and Severneftegazprom. The markets at this time perceived that nearly 99% of Gazprom's assets had been stolen, when only 10% really had been stolen.

²⁴⁰ Ibid.

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Berezovsky, Vladimir Gusinsky, and Mikhail Khodorkovsky, should induce further suspicion and questions of Putin. It was widely perceived prior to this indictment that the powerful oligarchs were setting up front companies in order to siphon off funds for their personal investment accounts.²⁴¹ Corruption and greed led these oligarchs to conduct nefarious and criminal activities, and now that the state controls many of the largest companies in Russia today, there is little doubt that this type of activity continues, as Putin and his closest associates are profiting heavily with little incentive or fear to reform the markets.²⁴²

The second questionable activity regarding Gazprom is the role of its former chairman, Dmitry Medvedev. From his appointment as chairman of the board of directors for Gazprom in 2000 until his election as President of Russia in 2008, Medvedev was involved in some of the most questionable and onerous activity in Gazprom's history. During his time as chairman, Medvedev steered the state-owned company through the acquisition of Vladimir Gusinsky's NTV television channel, the attempted merger of Rosneft Gas (the company that bought a large share of Khodorkovsky's Yukos Oil), and through the natural gas conflicts with Ukraine and Belarus in 2006 and 2008.²⁴³ The question that remains, is it possible to separate

²⁴¹ Todd Jatras, "Around the Globe: Russia Examines Gazprom, Itera," *Forbes.com* (December 11, 2000), <http://www.forbes.com/2000/12/11/1211atg.html> (accessed on May 28, 2010) and Paul Klebnikov's *Godfather of the Kremlin: Boris Berezovsky and the Looting of Russia* (New York: Houghton Mifflin Harcourt, 2000), for additional information.

²⁴² Gazprom Chief Executive Officer Alexei Miller defended Russia's control of a company like Gazprom, because of the government's assistance to help "secure the rights to develop new, strategic oil and gas reserves." *New York Times*, "Zubkov Replaces Medvedev as Gazprom Chairman," *New York Times*, (June 27, 2008), <http://www.nytimes.com/2008/06/27/business/worldbusiness/27iht-27gaz.14046892.html> (accessed May 28, 2010).

²⁴³ Russia Profile, "Who's Who? Medvedev, Dmitry Anatolyevich, President of the Russian Federation," *Russia Profile.Org* (2010), <http://www.russiaprofile.org/resources/whoiswho/alphabet/m/medvedev.wbp> (accessed May 28, 2010).

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President Medvedev's questionable past from his perceived anti-corruption reform efforts for the future?

A major negative economic aspect, aside from the monopoly that Gazprom has become, is the lack of competition within Russian industrial markets and the top-down driven policies, which inspire very few innovations and all but eliminates the creation of new business entities. The dwindling investment from domestic and foreign companies alike is the result of significant barriers to market entry, which include enormous start-up costs and delays in the onset of work, due to litany of licenses and permits that are required to conduct business.²⁴⁴ The investment climate inside Russia epitomizes some of the worst barriers to market entry as a result of corrupt practices. Interestingly, Russian reform efforts within investments have decreased in the last three to four years, but many investors cite policy unpredictability, quality of the legal system, and corruption as some of the highest concerns regarding the ability to enter the Russian market.²⁴⁵ The uncertainty associated with investing and developing a business limits the necessary level of competition that spurs economic growth.²⁴⁶

As a positive sign, the Economic Development Minister and the Duma have taken important steps towards limiting the effectiveness and detrimental impact that corruption has on the economy. At the beginning of 2010, the Economic Development Minister laid out four proposals to improve the country's investment climate and eliminate those barriers that limit economic growth. The first proposal was intended to reduce the

²⁴⁴ Raj M. Desai, "Improving the Investment Climate," *Can Russia Compete?* edited by Raj M. Desai and Itzhak Goldberg, (Washington, D.C.: Brookings Institution Press, 2008): 91-93. Desai provides an in-depth assessment of cross-national comparisons of the investment climate in Russia, China, Brazil, and India in Chapter Five of *Can Russia Compete?*

²⁴⁵ *Ibid.*, 93-94.

²⁴⁶ *Ibid.*, 97-109.

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number of government-induced reviews of projects. The second proposal intended to modernize the immigration law to bring in ‘highly-qualified’ personnel to jump start technological development. The third proposal included reducing the number of required documents that are associated with administrative barriers to market entry. Finally, the ministry proposed building a tax system that ensures the “budget doesn’t miss out on revenues...so the budget is balanced.”²⁴⁷ In a follow up to the proposals in March, the Duma approved a second reading of the draft changes to the federal law regarding the “protection of legal entities and individual businessmen during the process of state and municipal inspectorate.”²⁴⁸ While the first version was approved in December 2008, the new reform reduces the incentives for unplanned inspections by state authorities, a process that is ripe for inducing bribes and other corrupt practices.²⁴⁹

Unfortunately, the culture of corruption that is pervasive inside Russia decreases the availability of revenues that could be reinvested into a needed boost in production and transportation infrastructure, as well as development of a Russian Silicon Valley.²⁵⁰ While the acquisition of new market shares is the basic tenet of good business, Gazprom is facing increased production costs just to maintain a hold on the shares it currently possess. These increased costs and decreased revenues for reinvestments are

²⁴⁷ Interfax, “Economics Ministry to Offer Proposals for Improving Investment Climate” (January 28, 2010), https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CEP20100128964233?searchKey=1837720&rpp=10&index=2 (accessed May 24, 2010).

²⁴⁸ Business News Europe, “Government Steps to Reduce Administrative Barriers” (March 29, 2010), www.businessneweurope.eu (accessed May 20, 2010).

²⁴⁹ Ibid. While this appears to be a step in the right direction to limit corrupt practices and improve the overall investment climate in Russia, the extensive delays from December 2008 to March 2010 are indicative of a bloated bureaucracy that thrives on an environment that placates to the ebb and flow of anti-corruption rhetoric. Interestingly enough, just three weeks after this report surfaced, President Medvedev issued his new strategy to combat corruption.

²⁵⁰ Marshall Z. Blake, “The Russian Economy: Investment, Risk, and Integration,” *Russia Watch: Essays in Honor of George Kolt*, Edited by Eugene B. Rumer and Celeste A. Wallander, Significant Issues Series, Vol. 29, No. 6 (Washington, D.C.: Center for Strategic and International Studies, 2007): 55-58.

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confounding the necessary development of new fields that offset the loss of revenues from fields that have depleted their holdings.²⁵¹ Highlighted by budgetary constraints during 2009, Russia was able to sustain a high-level of social welfare spending that reduced political instability and public dissatisfaction by dipping heavily into the country's reserve fund.²⁵² Prime Minister Putin has called for "budget cuts and systemic reforms [that] will be required over the next three years," which spurred an internal debate between the Russian Finance Minister, Alexei Kudrin, and the Economic Development Minister, Elvira Nabiullina, over budgetary estimates, which are still heavily tied to oil revenues.²⁵³ Estimates between the two of them place the budgetary deficit next year somewhere between four and eight percent – with a call by Kudrin to reduce overall government spending by 20 percent in the next five years.²⁵⁴ With a reduction in spending and a loss of revenues to corruption, Russia's budgetary contraction could spell extreme trouble in efforts to reform the economy, fight corruption, and reduce the impact of the looming humanitarian crisis.

A New Plan?

In spite of the initial cheers for his Anti-Corruption Plan in 2008, President Medvedev has been criticized for not employing effective measures for providing a level

²⁵¹ Cooper, 15-20.

²⁵² Maria Antonova, "Putin Calls for Budget Reforms over 3 Years," *The Moscow Times* (May 17, 2010), <http://www.themoscowtimes.com/business/article/putin-calls-for-budget-reforms-over-3-years/406059.html> (accessed May 20, 2010).

²⁵³ Ibid.

²⁵⁴ Ibid. Here is a brief look into their budgetary projections: Kudrin estimates that if the price of oil is \$70/barrel then the budget deficit is projected at 4 percent, but if the price of oil falls to \$50/barrel, the deficit will be 8 percent. With continued spending of the Reserve Fund, the budget could be balanced if oil prices were at least \$95/barrel. Economic Development Minister Nabiullina cautioned the lofty projections and stated that her ministry was only predicting average oil prices of \$76/barrel through 2011.

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of checks and balances of the government by civil society.²⁵⁵ This lack of participation by the media and Russia citizens is indicative of the failures associated with previous anti-corruption reform efforts, resulting in cynicism towards more of the same political rhetoric. As a result, President Medvedev issued a new National Strategy for Countering Corruption in the fight against corruption on 15 April 2010, which provides a road map for the next two years on what steps must be accomplished during this phase of anti-corruption reform.²⁵⁶ The updated plan calls for a number of new and specific measures to be implemented during the course of the next two years. Some of the most important measures focus on bringing about fundamental changes to the way the country perceives corruption, in an effort to create an environment that rejects the mere practice of accepting and expecting bribes and other forms of corruption.²⁵⁷ The plan discusses the promotion of a new legal culture through radio and television ads, as well as the possible re-introduction of a law department at most colleges and universities. It also focuses on rotating individuals from positions within state and municipal organizations, to avoid long-term positioning that may breed complacency and corruption. Transparency in all actions is the ultimate goal of the plan.²⁵⁸

Despite continuous attempts by President Medvedev to root out corruption, civil sector oversight has been neglected. Government decisions and business deals remain

²⁵⁵ Nikolaus von Twickel, "Medvedev Redefines Anti-Corruption Drive," *Moscow Times* (April 15, 2010), <http://www.themoscowtimes.com/news/article/medvedev-redefines-anti-corruption-drive/403966.html> (accessed May 28, 2010).

²⁵⁶ *Ibid.*, This roadmap was not present in the original Anti-Corruption Plan and therefore made the original document incomplete by stating the right messages in the fight against corruption, but not having benchmarks for where the country should be at certain stages along the reform path.

²⁵⁷ Irina Granik, "Medvedev's Anticorruption Plan Outlined, Reliance on Civil Institutions Noted," *Kommersant* (April 15, 2010), https://www.opensource.gov/portal/server.pt/gateway/PTARG_S_0_0_200_203_121123_43/content/Display/CEP20100416379001?searchKey=1837758&rpp=10&index=1 (accessed April 25, 2010).

²⁵⁸ *Ibid.*

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behind closed doors and individuals who critique or become outspoken against corruption in Russia, end up in prison and sometimes die due to medical neglect, like Sergei Magnitsky.²⁵⁹ An environment that is not conducive to voicing opposition or free and fair media reporting will hinder any involvement of the public to enhance anti-corruption reform, and reduce the corruptibility of political and economic leaders. Critics argue that there are few differences in the fundamental construction of the plan and the mere introduction of a ‘new strategy’ hinges on showing a concerted effort in its fight against corruption, in order to prevent further negative light from the international community. In addition, the plan to limit the time an individual spends in a civil organization position neglects those elected officials inside the government. Gaps still remain in the equitable enforcement of this plan, which will further erode public trust in the government’s ability to defeat corruption.²⁶⁰

Insufficient time has passed to truly assess the effectiveness of the new laws. Within the past two decades, both Russia and Georgia have followed similar paths of weakened and vulnerable economies and political institutions resulting from the pervasiveness of corruption. To its credit, Georgia, under the leadership of President Saakasvili, has made significant improvements to its business and economic

²⁵⁹ Sergei Magnitsky, a Russia lawyer, recently died in a Moscow jail, after being charged with tax evasion, nearly a year ago while representing Hermitage Capital’s ongoing legal battles with Russia. See Gregory White, “U.S. Investor’s Lawyer Dies in Moscow Jail,” *Wall Street Journal*, (November 18, 2009), <http://online.wsj.com/article/SB125845597654851913.html>, (accessed May 24, 2010) for a full synopsis of events leading to the death of Mr. Magnitsky. Also reference Caroline McGregor’s “Gazprom and Itera: A Case Study in Russian Corporate Mis-Governance: Summary of Presentation by Mr. William Browder, CEO Hermitage Foundation” *Carnegie Endowment for International Peace* (March 18, 2002) for additional information providing linkages between Mr. Magnitsky, Mr. Browder, and Hermitage Foundation.

²⁶⁰ Lyudmila Alexandrova, “President Goes Ahead with War on Corruption, Society Skeptical,” *Itar-Tass* (April 15, 2010), https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CEP20100415950301?searchKey=1842086&rpp=10&index=1 (accessed May 24, 2010).

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environments. While some work remains with ensuring that its political practices remain transparent and accountable to its independent media sources, the grasp that corruption once had on Georgia is weakening. In stark contrast, Russian success against corruption remains to be seen. While significantly larger in sheer area and population, Russian attempts at anti-corruption reform during the same period have been marked by neglectful enforcement, incessant rhetoric, and greed. Will the Russian elite allow President Medvedev's reform efforts to continue, or will the reform message once again become more rhetorical following the upcoming presidential elections of 2012?

While understanding and patience is required by all, to see how this current reform will play itself, eroding the grasp that corruption has on a society takes time. Above all, it is a necessity to improve the economic and demographic infrastructure of a country as large as, and one as in need of drastic improvements, as Russia. Chapter 4 will explore several possibilities for the future of Russia, in its continued fight against corruption and its struggle against an aging infrastructure, a growing humanitarian crisis, and increased disparity between the rich and the poor.

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CHAPTER 4

Alternative Futures Analysis

*Corruption as a systemic challenge, as a threat to national security, as a problem which leads to a lack of faith among citizens in the ability of government to produce order and protect [citizens].
Dmitry Medvedev, President of Russia²⁶¹*

Predictions for the future of Russia have often been shortsighted and misaligned. Could anyone have foretold the collapse of the Soviet Union prior to its unhinging in the early 1990s? Did anyone predict that Russia would be able to recover from financial ruin after the disastrous years during the 1990s? What about the influence that Russia now wields as an extractively-based industrial powerhouse? All of these questions and more point to a very disjointed and polarizing issue amongst analysts from intelligence, economic, and political circles around the world, when addressing concerns for Russian behavior and involvement in international and domestic affairs. Below is a brief exploration of possible scenarios for the future of Russia that emphasize the complexity and diversity of Russia, through reviewing where Russia has come from, and where the future will likely take Russia to.

Following the collapse of the Soviet Union and the end of its Communist regime nearly twenty years ago, Russia has diminished in stature from the global power it once was. Within its borders, there is a growing demographic crisis that the government has yet to face. More pressing, there is a societal acceptance of corruption that is fueling the current economic crisis. Despite these nagging issues, Russia is committed to once again

²⁶¹ Janet McBride and Michael Stott, "Medvedev Says Poverty and Corruption Threaten Russia," *Reuters* (June 25, 2008), <http://uk.reuters.com/article/idUKNOA53311820080625> (accessed May 26, 2010).

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becoming a world power, “whose activities are directed at maintaining strategic stability and mutually beneficial partner relations under the conditions of a [multi-polar] world.”²⁶²

Nevertheless, the future of Russia will depend on its willingness to address domestic, economic, and demographic issues. This chapter will not only look at possible future scenarios for Russia, but will also provide an examination of the intelligence indicators that should be monitored to determine Russia’s commitment to and capability for ending corruption, which is a key determinant for 1) an expansion of its market economy and a greater commitment to democracy; 2) further erosion of democratic principles in order to preserve the current leadership; or 3) a future that is inextricably linked to the status quo. At present, while Russia’s status as a global power has declined since the collapse of the Soviet Union, it remains a regional economic and military power that influences global and regional markets, as well as various security interests. Russian de facto acceptance of corruption and its inability to tackle the challenges associated with its pervasiveness affects all facets of the government and society as a whole. It is important to examine and assess Russia’s domestic and regional economic activities, primarily focused on the impact of corruption and its impediment to foreign investment ventures, and Russia’s business reformation/transformation from an extractive-based economy to a market-based economy. Inability to address and manage these issues will contribute to further economic decline, in relation to potential economic gains by its

²⁶² Dmitri Medvedev, “Russian Federation National Security Strategy Until 2020,” *Russian Federation Presidential Edict No. 537* (May 12, 2009), https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CEP20090513557001?searchKey=1837972&rpp=10&index=3 (accessed April 24, 2010).

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Eurasian and European neighbors. Corruption also eats away at the possibilities for Russian democracy.

While Russian leaders claim they will attack corruption, Russia lacks the control measures, resources, and political capital from which to diversify their markets and end corruption in the midst of the current global economic downturn. The acceptance of corruption and the resultant decline in Russia's economy could have implications for its near-abroad neighbors as well as future policies of the United States government.

This chapter assesses three possible alternative futures. Russia appears positioned to maintain the status quo during the next ten years. This is based on the premise that the rich will continue to get richer, while the disparity between the rich and the poor is superficially addressed. The current political and economic environment will remain trapped in a continuous cycle where the impetus for change is viewed as too costly. Reform efforts are highlighted in speeches rather than through actions intended to end corrupt practices by removing those that seek personal gain at the expense of Russia's citizens. Today's political environment in Russia lacks a strong opposition party that is capable of challenging the current Putin/Medvedev regime. The minority reformists in that government today are unable to incorporate significant improvements and necessary reorganization into political and economic arenas, because their message is suppressed and unpopular to the ruling elite.

The Beginning

The beginning date for this assessment of possible alternative futures falls in the later half of 1991. This is the year when the former Communist state of the Union of

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Soviet Socialist Republics crumbled and the introduction of capitalism began to seep into all facets of society. The end date of this information is June 1, 2010.²⁶³ So why is 1991 such a poignant year for this former Communist state? At this time, President Yeltsin indicated that the country would move towards a market economy vice the failing state controlled market of the past.²⁶⁴ Corrupt practices within the government and business elites at this time cost the country billions of dollars, as state-owned assets were being sold for well less than they were worth during extensive privatization efforts. These privatization deals and corrupt practices ensured power among a group of wealthy elitists, called the oligarchs.²⁶⁵ The rise to power of the oligarchs allowed the system of corruption from the top to permeate to all other forms of small businesses in the country.²⁶⁶ Based on the prospect of increased wealth through bribes and extortion, little to no effort has been made by Russian politicians or businessmen alike to curb the pervasiveness of corruption inside Russia in the last twenty years.

Assumptions

Throughout this assessment, there are five assumptions that are paramount for understanding these claims:

1. The Russian economy will remain inextricably linked to oil and gas markets, as the country is unable to diversify or expand its economy due to inefficient usage of earned revenues.

²⁶³ This date was set arbitrarily as the mark of the end of the thesis research period. Additional information presented after this date may alter the presented scenarios.

²⁶⁴ Shevtsova and Olcott, "Russia Transformed," 1-25.

²⁶⁵ Aslund and Dmitriev, "Economic Reform Versus Rent Seeking," 96.

²⁶⁶ Ibid., 96.

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2. The Russian economy will remain vulnerable to internal and external price fluctuations within oil and natural gas markets over the next ten years.
3. Despite tough anti-corruption talk from President Medvedev, little evidence exists that corrupt practices are being reduced by increasing the identification and prosecution of corrupt individuals and/or businesses.
4. Russia will continue to downplay its current demographic crisis because of insufficient revenues available to improve its faltering health care system.
5. Rising and falling oil and natural gas prices will determine Russia's commitment to containing, neutralizing, and stabilizing areas of concern in the Middle East, the North Caucasus, and North Korea.²⁶⁷

In addition, this futures analysis is conditionally constructed because if any of the following events in the next section were to occur during the next 10 years, these alternative futures might not be realized.

Qualifiers

In addition to the assumptions presented above, it is important to identify any qualifiers that may alter the outcome for this futures-based assessment if these events were to occur:

²⁶⁷ Recent increased tensions between the two Koreas has heightened Russian concerns for stability and motivations to decrease the prospect of a nuclear war. See, for example, Patrick Goodenough, "Accused of Sinking South Korean Ship, North Korea Threatens 'All-Out War,'" *CNSNEWS.com* (May 20, 2010), <http://www.cnsnews.com/news/article/66317> (accessed May 24, 2010) and *The Nation*, "Russia Fears North Korea Conflict Could Go Nuclear," *The Nation*, (May 28, 2010), <http://www.nation.com.pk/pakistan-news-newspaper-daily-english-online/International/28-May-2009/Russia-fears-North-Korea-conflict-could-go-nuclear> (accessed May 28, 2010) for additional insight into this situation.

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1. The first qualifier is, if Russia was able to diversify its economy into new industries, such as computer technology (i.e., the development of a Russian Silicon Valley), therefore reducing its budgetary dependence on energy production, then Russia's economic growth would not be vulnerable to the volatility in oil and gas markets. This economic diversification could lead to new foreign and domestic investments, and improved efforts to modernize its deteriorating infrastructure.
2. The second qualifier is, if there were to be an increase in domestic terrorist attacks inside Russia, then Russia would likely be unable to address necessary market and political reforms, as more attention and funding would be allocated and utilized to increase military and security efforts to counter internal terrorist activity.²⁶⁸

Drivers

The following section highlights five drivers that influence Russian political, economic, and demographic issues that will help characterize Russia future objectives.

1. Corruption

²⁶⁸ To highlight this concern, during the morning commute on March 29, 2010, two suicide bomb attacks occurred aboard the Moscow Metro, at least 38 people were killed and 60 injured. See British Broadcasting Corporation News (BBC), "Moscow Metro Hit by Deadly Suicide Bombings" (March 29, 2010), <http://news.bbc.co.uk/2/hi/8592190.stm> (accessed May 28, 2010). Of note, according to the 2010 Annual Budget, only 3.5% (2008) of the annual budget is utilized by the Russians for their military, in comparison, the United States spends approximately 4.3% (2008), World Bank, "Military Expenditure (% of GDP)" (2010), <http://data.worldbank.org/indicator/MS.MIL.XPND.GD.ZS> (accessed May 27, 2010).

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The first and the key driver²⁶⁹ is the pervasiveness of corruption, which hinders and undermines economic reform and expansion efforts. Corruption remains a prevalent aspect that permeates all facets of Russian economics and politics. As a negative trend indicator and an associated taxation on a nation's GDP, corruption threatens economic stability, reduces the availability of resources, and it deprives the government of the ability to provide basic services to meet the needs of citizens within the country.²⁷⁰ In terms of investment, which helps build and/or expand business enterprises in countries, corruption raises the associated cost of doing business by adding a superfluous tax; it creates unfair competition and it encourages tax evasion, which limits the funds available to encourage investment from both foreign and domestic businesses.²⁷¹ Russia today is experiencing this additional burden on the economy, as corruption remains one of the primary impediments to improving the aging infrastructure and countering the current demographic crisis.

Russia receives large revenues from the sale of its oil and natural gas, but this profitability comes with great risk, as the Russian leadership continues its efforts to renationalize key elements of its private sector.²⁷² Unfortunately, this is a gamble that is solely based on the potential for continued high prices of both oil and natural gas products. By renationalizing large portions of the public sector, the Russian leadership is

²⁶⁹ As discussed in depth in Chapter 2, corruption remains the difference between economic and political revitalization and Russia's continued degeneration of world status.

²⁷⁰ Anti-Corruption Resource Centre, 6. The Anti-Corruption Resource Centre works in collaboration with Transparency International and is located at the Chr. Michelsen Institute (CMI) in Bergen, Norway.

²⁷¹ Ibid.

²⁷² United States Department of State, "Russia" (January 2006), <http://www.state.gov/p/eur/rls/rpt/63178.htm> (accessed May 27, 2010).

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reducing competition and the incentives for efficient market practices.²⁷³ The concern for many economists is that historically, there is little incentive to reform or improve the market when product prices are high.²⁷⁴ The subsequent failure to reform the market exacerbates declining economic conditions, because it prevents businesses from developing long-term investment projects such as offshore drilling in the Arctic Circle, where an undetermined quantity of hydrocarbons is assessed to be.²⁷⁵ This area remains unexploited due to rising costs to construct and secure necessary equipment, not to mention legal quandaries with neighboring countries inside the Arctic region.²⁷⁶ In addition, recent efforts by President Medvedev have emphasized the necessity of revitalizing a weakened technological industry inside Russia. The development of a Russian Silicon Valley has been derailed by insufficient funds, resulting from corrupt practices that strip companies of the necessary capital to develop the program.²⁷⁷

Since becoming the President in 2008, Dmitry Medvedev has championed anti-corruption efforts as a means to improve the Russian economy and the livelihood of its

²⁷³ Kuchins, Andrew C., "Alternative Futures for Russia to 2017: A Report of the Russia and Eurasia Program Center for Strategic and International Studies" (Washington, D.C.: Center for Strategic and International Studies, 2007): 8.

²⁷⁴ *Ibid.*, 8.

²⁷⁵ Pavel Baev, "Russia's Race for the Arctic and the New Geopolitics of the North Pole," *The Jamestown Foundation Occasional Papers*, Washington, D.C. (October 2007): 1-6.

²⁷⁶ *Ibid.*, 1-6.

²⁷⁷ Simon Shuster, "Can a Russian Silicon Valley Spur Tech Innovation?" *Time Magazine* (March 1, 2010), <http://www.time.com/time/world/article/0,8599,1967590,00.html> (accessed March 20, 2010). While the notion of developing an area where advances in technology meet the bright entrepreneurs of the future is a valuable goal for Russia, the growth of a Russian Silicon Valley is likely headed for a tumultuous and potentially unproductive future. Unlike the state directed Russian Silicon Valley in Skolkovo, Moscow, the Silicon Valley in California originated from a university's research and development venture to build upon Dr. Lee deForrest's audion tube, fused with young, energetic intellectuals and budding entrepreneurs. Without these budding intellectuals, abounding with determination and energy for technological entrepreneurial growth, and with the presence of corruption, Russian efforts will stumble. See Jim McCormick, "A Brief History of Silicon Valley," *Silicon Valley Economic Development Alliance*, (1995), http://people.seas.harvard.edu/~jones/shockley/sili_valley.html, (accessed May 27, 2010) and Maria Kiselyova and Michael Stott, "Kremlin Picks Site for Russian 'Silicon Valley,'" *Reuters* (March 18, 2010), <http://www.reuters.com/article/idUSTRE62H33S20100318> (accessed May 27, 2010).

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citizens. In a mere six-month period, President Medvedev was able to formulate an Anti-Corruption Legislative Bill and subsequently have it become law.²⁷⁸ The Anti-Corruption Plan defined corruption, called for transparency in government practices, provided an understanding for international cooperation and treaties as a basis for this plan, as well as measures for preventing future corruption.²⁷⁹ Nevertheless, in spite of the tough anti-corruption talk from President Medvedev, little evidence exists to date that translates this talk into identification and prosecution of corrupt individuals and/or businesses. In a quasi-admission of the lack of progress in the fight against corruption, President Medvedev recently signed a new national strategy for countering corruption, and an updated National Anti-Corruption Plan for 2010-2011.²⁸⁰ While current prosecutorial evidence is lacking, some international organizations are giving Russia the benefit of the doubt when it comes to combating corruption.²⁸¹ What is paramount in the development of not only these futures-based scenarios, but in the economic and political development of Russia in the future, is an understanding that the pervasiveness of corruption, in both the economic and political arenas, will remain the single key driver, which will affect the progress of this once great nation.

²⁷⁸ Dmitry Medvedev, "Russian National Anti-Corruption Plan," <http://eng.kremlin.ru/articles/corruption1.shtml> (accessed November 15, 2009). President Medvedev signed this bill into law in January 2009.

²⁷⁹ Ibid.

²⁸⁰ President Medvedev signed an executive order approving the new strategy for countering corruption and an updated draft of the Russian anti-corruption plan for 2010-2011 on April 14, 2010. In his article and subsequent speech entitled, "Go Russia," President Medvedev articulated his concern for the grasp corruption has on the Russian society and all its business and law enforcement endeavors. He called for a united Russia to create a new Russia, free of corruption. This speech was the first indication that his previous plan to curb corruption was either not implemented correctly or lacked verifiable measures to ensure its success. Dmitry Medvedev, Dmitri, "Dmitry Medvedev Signed an Executive Order Approving the National Strategy for Countering Corruption and a New Draft of the National Anti-Corruption Plan for 2010-2011" (April 14, 2010), <http://eng.kremlin.ru/acts/87> (accessed May 27, 2010).

²⁸¹ Alexander Bratersky, "Anti-Graft Drive Mostly Talk," *The Moscow Times* (November 18, 2009), <http://www.themoscowtimes.com/news/article/389777.html> (accessed November 18, 2009).

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2. Oil and Gas Markets

The next driver to address concerning the future of Russia is the price and production capacity of oil and natural gas.²⁸² With a narrow economic base that is primarily dependent on its extractive industries, such as natural gas and petroleum, Russia is in desperate need of expanding its economy into other profit-producing markets. In recent years, Russia's dependence on energy-based products allows its economy to remain vulnerable to foreign consumer demand for energy, and leaves the country hostage to rising and falling prices in the energy markets.²⁸³ Estimates are that Russia has access to more than 1,700 trillion cubic feet (tcf) of natural gas, which means that it not only has the world's largest natural gas reserves, but that it is also an influential exporter of gas.²⁸⁴ The potential for increased projections of power and influence, not only domestically, but internationally as well, is highlighted by the fact that the consumption of natural gas is currently on an upward trend, that many economists anticipate will more than double in the next 20-30 years.²⁸⁵

Estimates by the World Bank project that oil prices will remain stable through 2010 and into 2011, with prices at \$80 and \$85 USD/barrel, respectively – this increase

²⁸² Sergei Aleksashenko, "Russia's Budget Dilemma," *Carnegie Endowment for International Peace International Economic Bulletin* (May 19, 2010), <http://www.carnegieendowment.org/publications/index.cfm?fa=view&id=40817> (accessed May 27, 2010). Russia's oil and gas revenues accounted for 10 percent of its GDP in the 1st Quarter, 2010 – an increase in oil prices to \$75-\$80/barrel ensured this growth. This was an increase in pricing from \$36/barrel at the beginning of 2009. PRNewswire, "Oil Refineries Announces Results for Fourth Quarter and Full Year 2009" (March 21, 2010), <http://www.prnewswire.com/news-releases/oil-refineries-announces-results-for-fourth-quarter-and-full-year-2009-88759837.html> (accessed June 1, 2010).

²⁸³ Woehrel, "Ukraine: Current Issues and U.S. Policy," 1.

²⁸⁴ Pirog, "Russian Oil and Gas Challenges," 82.

²⁸⁵ Nadejda Victor, "Russian Geopolitical Geometry Through a Gas Prism" in Rumer and Wallander, 59. Natural Gas is assessed as the fuel of choice by many consumers due to its relatively low environmental impact. Estimates in 2006 indicate that European countries import a quarter of what they consume from Russia alone; this share of the market and higher pricing produces nearly 60 percent of Gazprom's annual revenues.

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and subsequent stabilization of prices is a positive sign since a high of \$96.99/barrel in 2008 and a low of \$36/barrel in 2009.²⁸⁶

The importance of energy rents for Russia has a downside. Some economic analysis indicates that countries, which receive large shares of profits from higher oil prices, have economies that are have faster growth, but are also countries that have also been more assertive in foreign policy as well as having a more monolithic political system.²⁸⁷ A growing assertiveness in foreign policy in fact has been the trend most recently associated with Russia, as a result of higher global market prices for oil and natural gas. Conversely, during periods of lower oil prices, trends indicate that countries are more willing to have a stronger pro-western foreign policy and a more pluralistic political system.²⁸⁸

3. Political Structure

The next driver to assess is Russia's political ideology as espoused by the current Russian leadership. Russia today cannot be defined as totalitarian because the state does not control every aspect of life. But it also cannot be called a democracy because it does not possess the traditional notions of a democracy either, it lacks transparency and governmental accountability, an independent and open media, and multiple political

²⁸⁶ Canadian Imperial Bank of Commerce (CIBC), "Oil Prices Likely to Hold Steady Through 2011, Despite Supply Worries," *CIBC World Markets Inc.* (May 12, 2010), <http://finance.yahoo.com/news/Oil-prices-likely-to-hold-cnw-484074944.html?x=0&.v=1> (accessed May 26, 2010).

²⁸⁷ Kuchins, "Alternative Futures for Russia to 2017," 5. In Russia's case, revenues received from both their oil and natural gas markets are large enough to reduce initiatives for market reform and induce domestic as well as foreign investment opportunities.

²⁸⁸ *Ibid.*, 5.

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parties that have a realistic chance of challenging the controlling party.²⁸⁹ With these limitations in mind, Russia remains a traditional patrimonial authoritarian system, where the power of the country lies within the centralized authority inside Moscow.²⁹⁰ The inherent strength inside Moscow is not realized by political institutions outside the Kremlin - those institutions are highlighted by weakened political parties and an ineffective legal system, which prevents competition and/or accountability to anyone at the domestic level, but also in the international arena as well.²⁹¹ As revenues continue on an upward climb, typical patrimonial authoritarian states like Russia become more defiant and are able to intimidate or "purchase" potential competitors, as a means to control and improve market shares.²⁹²

To complement this authoritarianism, the personality of the leader is an essential part of the process. Russia possesses a long history of strong and vibrant leaders who have controlled many aspects of the State, some with an iron fist through fear and others, like former President Vladimir Putin, who controls through intimidation and persuasion.²⁹³ Through Putin, a resurgence of nationalism has been the cornerstone to his efforts to realize Russian power and greatness; nationalistic efforts in the form of anti-western rhetoric and violent crimes perpetrated against non-ethnic Russian minorities inside Russia, were paramount during his tenure.²⁹⁴ These efforts were meant to control

²⁸⁹ Celeste Wallander, "Russian Transimperialism and Its Implications," *The Washington Quarterly*, Vol. 30, No. 2 (Spring 2007): 115-116.

²⁹⁰ Ibid., 115-116. Wallander defines this situation as a 'patron-client' relationship that is "dependent on [the] control and distribution of 'rents,' (graft, bribes, etc) created not by productive economic activity but by the political manipulation of economic exchange."

²⁹¹ Kuchins, 9 and Wallander, 115-116.

²⁹² Kuchins, 9.

²⁹³ Ashland and Kuchins, *The Russia Balance Sheet*, 37 and Kuchins, 10.

²⁹⁴ Kuchins, 12-19. Youth groups such as *Nashi* (Youth Movement) emerged during this period. *Nashi* claims to be a democratic, anti-fascist movement with support from senior members of Putin's Administration. The initial focus of the group centered on eliminating the 'regime of oligarch capitalism,

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and intimidate the population into compliance, as well as through strong economic gains. Putin was able to provide increased monetary freedoms to Russian citizens, while controlling access to contrary information.²⁹⁵

Despite Putin's yielding of the Presidency in 2008 to President Medvedev, Putin conveniently had himself appointed Prime Minister, allowing him to retain access to governmental decisions.²⁹⁶ Questions remain as Russia moves towards the Presidential elections of 2012, as to whether Putin will split from Medvedev, his appointed successor, and run for another term as President of Russia. A return to power and continued economic gains will likely embolden Putin to further push towards centralized control of the state and its economy, in order to secure his rule.

4. Demographics

Further underscored by an inefficient use of the state budget is the current demographic or de-population crisis inside Russia, which is assessed as the fourth driver. It is estimated that since 1992, the Russian population has been on a steady decline as a result of low fertility rates and high mortality rates, due to alcoholism and the spreading of communicable diseases such as HIV/AIDS and tuberculosis (TB), just to name just a few of the issues.²⁹⁷ With regard to alcohol abuse, it is estimated that approximately six

when President Putin championed the cause against the oligarchs. Interfax, "Russia: New Youth Movement Intends to Eliminate 'Regime of Oligarchic Capitalism'," *Interfax* (April 15, 2007), <http://www.cdi.org/russia/johnson/9122-14.cfm> (accessed May 24, 2010).

²⁹⁵ Michael McFaul and Kathryn Stoner-Weiss, "The Myth of the Authoritarian Model: How Putin's Crackdown Holds Russia Back," *Carnegie Endowment for International Peace* (January/February 2008), <http://www.carnegieendowment.org/publications/index.cfm?fa=view&id=19808&prog=zru> (accessed May 24, 2010).

²⁹⁶ Aslund and Kuchins, *The Russia Balance Sheet*, 37. Aslund emphasizes that there appears to be some questions regarding the configuration of power, specifically who is in control of Russia, Medvedev or Putin; this is a question that is echoed throughout many economic and political circles as well.

²⁹⁷ Eberstadt, "Drunken Nation: Russia's Depopulation Bomb," 51-62.

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percent of the adult Russian population are classified as heavy drinkers.²⁹⁸ This figure was further emphasized in the findings from a city in the Urals, which indicated that over 40 percent of young males that died, had “probably been alcohol-impaired or severely intoxicated at the time of death – including one quarter of the deaths from heart disease and over half of those from accidents or injuries.”²⁹⁹ These staggering figures are troublesome for a country in which women of childbearing age are not conceiving at rates observed during Soviet rule. In addition to the high death rate, the fertility rate is down, complicated by the fall in Russian health care due to economic factors. One alarming statistic from 2005 indicates that the risk of death during childbirth was over six times higher for women in Russia than in countries such as Germany and Switzerland.³⁰⁰

The final consideration for the demographic crisis in Russia relates to the spread of infectious disease. Estimates indicate that over one million Russians are currently afflicted with HIV/AIDS, and an additional 150,000 new cases of TB are identified each year.³⁰¹ These figures will likely continue to rise as acceptance of local drug use and prostitution continue to develop along with the spread of TB infections resistant to drug treatment.³⁰² This demographic crisis brings concern for the future of Russia, and its diminishing prospects for economic development resulting from a dwindling population available to enter the workforce, as well as the potential for rising health care costs to

²⁹⁸ Ibid., 60. Eberstadt did not specifically define what constitutes a ‘heavy drinker,’ but the article did emphasize the issue with extreme binge drinking and a correlation with a 2003 World Health Organization Study that indicated “Russia was Europe’s heaviest per capita spirits consumer.” The report went on to articulate that Russian hard liquor consumption was well over other countries such as Germany, France, and Portugal.

²⁹⁹ Ibid., 60.

³⁰⁰ Ibid., 54. This study was conducted by the World Health Organization in 2005. Of interest Russian Health Expenditures accounted for approximately 5.3% of GDP; compared to 15.5% for US, 8.4% for Georgia

³⁰¹ Ibid., 60-61.

³⁰² Ibid., 58-59. The World Health Organization indicated that as of 2008, almost half of the new 150,000 cases of TB each year are known as extreme drug-resistant Tuberculosis (XDR-TB).

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treat and care for those afflicted with severe diseases and other associated cardiovascular ailments.³⁰³

5. Diplomacy

The final driver is in the diplomatic arena. Russia's ability to maintain strong international economic ties intertwines explicitly with remaining a viable strategic partner in containing, neutralizing, and stabilizing areas of concern around the world.³⁰⁴ Without strong diplomatic ties to not only the United States and other influential areas around the world, Russia could invite terrorism and the proliferation of nuclear weapons inside its territorial boundaries, as well as undermine international non-proliferation and anti-terrorism efforts. It is estimated that over 95 percent of all nuclear weapons are controlled by the United States and Russia, and as a result, the enormous responsibility in strengthening and enhancing an international non-proliferation system is of the utmost importance.³⁰⁵ With that in mind, Russia maintains strong ties to Middle Eastern countries like Iran; this strategic partnership between Russia and Iran could be utilized to contain and stabilize the Middle East Peace Process, as well as defuse a growing nuclear crisis between the West and Iran.³⁰⁶

Another area for diplomatic concern is the relationship that Russia has with the rest of the former Soviet States. The 2008 conflict between Russia and Georgia undermined the sovereign territory of a smaller country and discredited Russian peaceful

³⁰³ Ibid., 51.

³⁰⁴ Chuck Hagel and Gary Hart, "The Right Direction for U.S. Policy Toward Russia," The Commission on U.S. Policy Toward Russia, (Washington, D.C.: The Nixon Center, March 2009): i-ii.

³⁰⁵ Ibid., 7.

³⁰⁶ Ibid., 5.

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intentions with its neighbors, by invading Georgian territory.³⁰⁷ With regard for the Six-Party Talks with North Korea, Russia remains a strong ally to cease North Korean nuclear aspirations, and currently is attempting to diffuse rising tensions between the two Korea's after the sinking of South Korean naval vessel.³⁰⁸ Russia's primary concerns for the talks include keeping a destabilizing actor from using devastating weapons of mass destruction; reasserting Russian influence in Northeast Asia; as well, as possible humanitarian concerns with the flow of refugees from North Korea, if it fails.³⁰⁹

In an effort to assess the viability of the aforementioned drivers, a detailed list of scenarios and indicators will need further elaboration. Following the explanation of scenarios and their specific indicators, potential gaps in intelligence will also be highlighted. During the conduct of this analysis, all five intelligence disciplines need to be employed, to identify and verify the validity of information obtained.

Future Scenarios

With an accurate assessment of the current situation and the drivers of future intentions, we can now move forward with building future scenarios that highlight potential outcomes, indicators, and intelligence gaps.

Future Scenario 1: The Status Quo

³⁰⁷ Shoemaker, 226. This statement was given in 2007, by Russian Foreign Minister Sergei Lavrov.

³⁰⁸ Blaine Harden and June Lee, "Explosion Sinks South Korean Naval Ship Near Disputed Sea Border with North," *Washington Post* (March 27, 2010), <http://www.washingtonpost.com/wp-dyn/content/article/2010/03/26/AR2010032602026.html> (accessed on May 27, 2010).

³⁰⁹ Jayshree Bajoria, "The Six-Party Talks on North Korea's Nuclear Program," *Council on Foreign Relations* (July 2009), <http://www.cfr.org/publication/13593/> (accessed March 20, 2009).

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In the first alternative future scenario, it is assessed with high probability that Russia will maintain the status quo for the next ten years; for this to occur, little would need to change inside the country. From a political lens, Putin and those allied with him retain power following the presidential elections in 2012. By maintaining his political presence and overall leadership of the country, Putin would ensure that his control over Russia would be secure for at least the better part of the next decade or so (the presidential term recently was lengthened to six years), thereby limiting the necessary political and economic reformation the country so desperately needs. As this path is followed, the coffers of the ruling elite are continuously filled by corruption at the expense of the nation as a whole. From a foreign policy perspective, Russia will continue its clandestine/covert efforts to reestablish its sphere of influence in former Soviet states, much as we have witnessed during the conflict with the Republic of Georgia in 2008. With the looming de-population of Russia and its problems in fielding a conventional army, Russia will continue its defense spending on Nuclear Force development as a deterrent.³¹⁰ Again, highlighting the projected high international price of oil and gas, there is little impetus to expand or reform domestic markets beyond oil and gas into other arenas such as high technology, broader industrial production, and civil nuclear power. Further corrupt practice will limit attempts to improve the quality of life for many that suffer from infectious diseases such as HIV/AIDS and TB, as well as staving off the

³¹⁰ Following the Russian-Georgian Conflict of 2008, pundits began to highlight the aging Russian military equipment and the subsequent National Security Strategy highlighted the necessity to modernize its military force and improve its strategic deterrence force. For additional information, see Murray Feshbach, "Behind the Bluster, Russia is Collapsing," *Washington Post* (October 5, 2008), <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/03/AR2008100301976.html> (accessed on May 15, 2010) and Dmitry Medvedev, "Russian Federation National Security Strategy Until 2020," *Russian Federation Presidential Edict No. 537* (May 12, 2009).

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detrimental effects of alcoholism and alcohol-related fatalities that reduce the availability of manpower for future generations.

Future Scenario 1 Indicators:

Inside Scenario 1, various indicators need to be monitored to determine if this is the path Russia will take in the near future:

- Although President Medvedev has recently issued his new strategy and plans to combat corruption during the next two years, one indicator will be if his efforts will be undermined by a lack of political will and follow-through by his administration. Will Medvedev's very public anti-corruption reform remain merely rhetoric that is used to discredit opponents of the current ruling elite, as the national election approaches in 2012? The platform from which President Medvedev has built his presidency upon could be used against him, if Prime Minister Putin remains an important and influential figure inside the country.
- Another key indicator is if one of two things could occur in the run-up to the national elections; both involve Putin becoming the president of Russia again. The first possibility would entail a role-reversal between Putin and Medvedev; the other would occur through clandestine attempts to destroy Medvedev's credibility by undermining his anti-corruption platform. Regardless of which possibility occurs, the key is if Putin continues to appoint individuals that are loyal to him and his policies – further denying the country of new blood to institute meaningful and necessary reforms in the country.

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- Also important as sign of the status quo would be if governmental appointees continue to be the norm, rather than the development of general elections at regional and local levels of government. How much will local government be stifled?
- Other indicators include the beginning of further reversals of western-leaning ideals, in the so-called former Russian sphere of influence. Recent success in gaining pro-Russian governments in Ukraine and Kyrgyzstan may be only the beginning of continued meddling in the foreign affairs of the Near Abroad countries by Russia. To highlight this concern would be the rise of a viable (pro-Russian) opposition party in the Republic of Georgia.
- Another indicator is the depth of reform within civil society. Will it remain stagnant? This stagnation would be emphasized by the continued control of print and television media by the state and those friendly to the Kremlin. An important issue to monitor is if those journalists that speak out against the Kremlin and corruption will remain targets of attacks and possibly murdered.
- Other indicators include constraints on the national budget, because of a loss of revenues resulting from corruption. These indicators could include no meaningful and practical investment in public infrastructure, i.e., the roads, railways, pipelines remain old and deteriorating. The role of health care services and programs will also provide information, if they are further reduced because of budgetary constraints. These constraints would further be highlighted by the continuing decay and depopulation of the Russian populace – no long-term population growth will be realized.

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Future Scenario 2: Market Expansion and Functioning Anti-Corruption Reform³¹¹

The second alternative future scenario could be considered the Market Expansion Option, which would be highlighted by a change in the political apparatus in 2012. By 2012, a strong opposition party is formed that could wrestle elections and political control away from Putin and his cronies as a result of increased and verifiable anti-corruption reform efforts that begin to take shape within the country. In this scenario, Medvedev's reforms have gotten traction and Russians have witnessed an increase in the rule of law, which leads to increased transparent legal enforcement and prosecution in targeting corrupt individuals and businesses alike. These necessary reforms would allow for market expansion beyond the extractive industries of oil and gas, towards new developmental areas, industries, and businesses. Despite security concerns regarding the West, Russia would become more willing to extend a more cooperative and less belligerent tone that diminishes reliance on First Strike Option, especially with nuclear weapons. There would also be a concerted effort for strengthening sanctions against aspiring nuclear states such as Iran and North Korea. This scenario would see the beginning of an increased public awareness, as well as increased funding, intended to combat social problems and a serious effort to resolve further demographic issues, as the negative effects of corruption are eroded. Unfortunately, this scenario is assessed to have a low probability of success at this time – Putin's grasp over the country has not weakened despite the problems highlighted during the recent economic downturn,

³¹¹ This scenario of market expansion could be discussed into two distinct futures: one as highlighted above and one where market growth inspired a more belligerent tone and overt foreign policy influence, much like what is portrayed in Scenario 3.

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therefore opposition parties will continue to have their voice and message suppressed much as they have in recent years.

Future Scenario 2 Indicators:

The indicators in Scenario 2 are much more positive not only for the state of Russia, but for its neighbors and partners around the world. Indicators that will foretell the likelihood of Scenario 2 surround the success of President Medvedev's anti-corruption reform efforts:

- The prime indicator would be how much Medvedev's new strategy and an updated, anti-corruption plan within the next two years begins to take control of business and political transactions.
- A corollary indicator to the anti-corruption plan would be the institution of a verifiable rule of law across the country, as well as an increase in the number of arrests and prosecution of corrupt individuals. These actions would increase the public's perception of the national and local governments.
- Another indicator would be the diminishment of Putin's roles, control, and responsibilities with the re-election of President Medvedev, based on his record of reform and continued efforts to improve the country.
- With the beginning of real and meaningful anti-corruption reform, another indicator would be a steep increase in domestic investment to improve the aging public infrastructure; i.e., construction on the roads, railways, pipelines, and health care services, and programs that receive more attention and funding.

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- Vastly increased foreign investment would be another key data point. Allowing for improved perceptions of Russians and international companies that corruption will not disrupt trade and future investment opportunities, Russia could become the recipient of increased foreign investment opportunities that will enhance the growth of new Russian markets and reduce reliance on and subsequent vulnerability to oil and gas markets.
- Along with foreign investment, another indicator would be how much relaxation of state-controlled enterprises, both economic and media-related, will occur. Combined with this will be the measurement of the depth of increased transparency and civil sector feedback.

Future Scenario 3: Return to an Authoritarian State³¹²

To realize a return to an authoritarian state during this period, no substantial reform would occur. Corrupt practices would continue to undermine reform efforts. During the elections in 2012, corruption and bribery would ensure the return of Putin to the presidency. As a result of his return to power and a referendum on his popularity and his policies, Putin would become further emboldened to openly exert his influence and power in domestic and foreign areas. Recent pro-Russian gains in Ukraine and Kyrgyzstan would allow more open influence to expand Russia's perceived sphere of influence towards Western European countries again. Corruption would remain and deepen as an impediment to reform, allowing the rich to continue to get richer. No

³¹² Another area of concern would be a hostile take over of the country by ultra-nationalists as markets collapse and the power of Putinism impoverishes the country to a point where a rival power overthrows the current government. Can this scenario be realized with Medvedev still in power?

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substantive effort to enrich social programs, or curb the looming health crisis are employed, as revenues from oil and gas markets are utilized to secure the longevity of ruling elite at expense of the population. This scenario is characterized as the worst possibility for the people of Russia and for the international community. A rich Russia, that is determined to rollback democratic gains within its borders and its sphere of influence is potentially destabilizing to nearby European and Asian countries. This scenario is assessed as having a 'likely' chance of occurring in the future, with an increased negative impact on not only internal Russian policies, but for the stability of Russia's regional neighbors as well. Little information is available regarding the power-sharing agreement between Putin and Medvedev, but within the next 12-months, the intelligence community should begin to see some indicators regarding the plans of Putin and Medvedev.

Future Scenario 3 Indicators:

With the two previous scenarios in mind, Scenario 3 is made possible by many different activities, but none more important than Putin's return to Presidency and an increase in the price of oil and gas to well over \$95/barrel:

- A key indicator would be clear public displays of differences between Medvedev and Putin, with Putin undermining Medvedev's policies and statements. Through this effort, Putin shows the country 'a new path' for the future.
- Despite these claims of progress and improvement promised by Putin, there would be no discernible improvements to the aging infrastructure.

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- Budgetary allocations would be an interesting indicator, especially if the depopulation boom accelerates as a result of budgetary allocations being placed into other revenue producing markets like oil and gas.
- One indicator of increased authoritarianism would be the government's unwillingness to tackle rising inflation rates and skyrocketing unemployment, as revenues are siphoned off because of corruption.
- President Putin's taking formal measures to eliminate general elections at all levels of government, thereby ensuring his placement as the head of Russia for many years to come, would be a clear indicator of this scenario.
- Foreign affairs would take a major detour even from recent years. One measurement would be how much the influx of monetary gain from oil and gas would embolden Putin to become much more involved in the affairs of neighboring countries, as he attempts to build once again a buffer between Russia and the West.
- An increase in the state security services would likely occur as well as a return to increased FSB activities similar to the Cold War. This would be done to ensure Putin's continued rule.

Intelligence Gaps

It is important to address possible gaps in intelligence that will assist in identifying the most likely future scenarios for Russia. While collecting relevant information, it is of extreme importance that all five intelligence disciplines be employed to identify and verify the validity of information obtained. This intelligence will fall into

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one of four categories; political, economic/anti-corruption reform, military, and civil sector (including media and health care reform).

Political

From a political aspect, the intelligence community needs to assess the disposition and composition of political leadership, as well as new opposition parties. This would include the presence of both more moderate and neo-nationalistic candidates. This assessment will help identify intentions, motivation, coordination, and levels of popular support for the ruling party, and identify if there are any indications that politicians are shifting strategies/policies away from or towards Putin. This effort will also identify if rival political parties and figures are becoming targets of anti-corruption reform rhetoric meant to discredit competing parties.

In addition, the intelligence community will need to monitor reporting to identify if there is an increase in more open anti-Western rhetoric, as well as attempts to influence foreign markets and governments. This is a likely indicator of further provocative efforts to influence former spheres of influence and the status of internal political power.

Economic/Anti-Corruption Reform

With corruption placing a strain on economic growth and development, it is of extreme importance to identify the business and politically based initiatives that will likely determine the overall success of President Medvedev's anti-corruption reform effort. Focus on the gaps in intelligence here should be centered on public sentiment towards corruption's presence within Russian society. This can be accomplished through

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monitoring polls, blogs, and articles that originate from Russia. Further monitoring of arrests and prosecutions of corrupt individuals and businesses is important, as well as determining increased/decreased allocation into revenue producing markets other than energy and extractive industries. Reporting will also need to be obtained to determine if there is an increase/decrease in foreign investment within Russia. An increase in foreign investment is indicative of a relaxation in the concerns by foreign investors regarding the presence of corruption and the impediments it would likely have on their economic successes.

Military

As Russia's population figures continue to decrease because of inefficient reform efforts in the civil/health infrastructure, so does Russia's military might. It is important within the confines of the military to monitor for changes in military force structure, especially if there is a return of military units to cantonment areas or to outlying border regions indicating possible incursions across international boundaries. Other areas of military force structure that need to be identified include the continuation of the movement toward a volunteer force and the possibility of relaxing of military standards to allow non-Russian citizens to join the military. With the possibility of constraints on the conventional military force, it will be necessary to identify if there is an increase in the Russian Nuclear Force structure, as well as determining the disposition, composition, and intentions of that force.

Civil Society

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First, information must be identified that assesses the transparency of Russian political and economic decision-making, and the appropriate level of feedback from the civil sector. Are media outlets, both print and television, controlled under the auspices of the state or those friendly to it? What is the status of non-governmental organizations (NGO) inside Russia? Who are they, what is their mission, and are they effectively employed to assist and help develop Russian civil society? In terms of health care, information regarding the state of infectious diseases to include an increase or decrease in areas with a large concentration of infected persons is important to monitor. This information will allow the Intelligence Community to assess levels of commitment to civil sector reform that results in increased social efforts to improve quality of life for the Russian population. The required information includes the status of the economy and revenue sharing to enhance internal markets beyond oil and gas, as well as information regarding the state's efforts to prevent a looming humanitarian crisis.

Scenario Summary

With all the information presented, it is this thesis' assessment that a continuation of the status quo is the most likely scenario during the next ten years. First, there is at present no political will to reform. The current system ensures the continued political presence of those in power, and further undermines the establishment of any viable political opponents. Second, the current leadership remains committed to fattening its own pockets, i.e., anti-corruption efforts are words rather than action-based and have become impotent for years. Third, the popularity of Putin and those closely tied to him remains high as a result of the improvement in the standard of living of the average

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Russian (largely due to the trickle-down of energy revenues), especially urban Russians, and the perceived economic stability. Fourth, there is currently no voice to challenge those in power, because the information presented by the media is controlled by the ruling elite within the government. Finally, if the price of oil and natural gas remains high, it will diminish the impetus for political and economic reform and decrease investment in an aging and deteriorating infrastructure. Under these conditions, the future for Russia is bleak, and raises the level of concern for its economic placement in the global economy, as well as for its deteriorating social conditions that are inducing the current depopulation of Russia. Reform within Russia is a necessity, but little impetus for that change exists within the Russian elite.

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CHAPTER 5

The Destabilization of Russia

...this year, more than ever before, we know that our physical security and our economic security are indivisible. We are all confronting a serious threat to our economic security that could further spread instability and erode the progress we've made in improving the lives of all our citizens.

Joseph R. Biden, Vice President of the United States³¹³

As addressed throughout this paper, Russian prospects for future gains, prosperity, and a peaceful existence are inhibited by the pervasiveness of corruption in all sectors of civil society, politics, and the economy. Serious challenges are facing Russia and its future, such as a growing demographic crisis, a vulnerable economy, and a lack of legal enforcement of laws to protect citizens and potential investors alike. Russia needs international assistance to incorporate fundamental and realistic change. Chapter 2 highlighted corruption's grasp on Russia and Chapter 3 focused on Russia's incomplete and sometime incomprehensible anti-corruption reform efforts, in comparison to the relative success of Georgian reform efforts. While Chapter 4 focused on several possibilities for the future of Russia, the bottom line remains that there is and should be concern on the part of the United States about the future success or failure of Russia. By sheer geographical size, Russia is the largest country in the world, with an economy inextricably linked to the global economy. Any minor hiccup or change in Russia's ability to provide energy services to its foreign and domestic customers can have rippling effects that are felt around the world. This chapter will explore some of the impacts

³¹³ Joseph R. Biden, "Remarks by Vice President Biden at the 45th Munich Security Conference," (February 7, 2009), Munich, Germany, <http://germany.usembassy.gov/events/2009/feb-biden-security/> (accessed May 28, 2010).

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concerning Russia's current political and economic endeavors on U.S. national security, as well as a few areas where the United States and our European partners can work together to facilitate true, genuine, reform in a country that so desperately is in need of change.

The failure of the Russian system would likely have a serious effect on U.S. national security. Concern for Russia should not be over- or under-assessed at any given time, but the sheer magnitude of Russia should be considered in all policy debates. As the world emerges from the recent global economic crisis, no country was left unscathed. The volatility of all industrial markets, especially those with a large majority of their economies tied to oil and natural gas, should give warning of the increased risks associated with not diversifying economies. With the concerns highlighted, there should be no question to why Russia is so important to the United States and its national security.

The Impact of Russian Failure

Russian success is extremely important to the United States because of its role in four significant areas of concern. The first area is the role of Russia in countering the proliferation of weapons of mass destruction (WMD) and their associated materials. The second area is its influence in the Middle East. Energy security is the third area of concern for the United States. The fourth area of concern is strengthening of international norms against corruption. The primary concern for all four areas surrounds Russia's inability to develop and enhance domestic reform initiatives and diminished

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international influence, as a result of lost revenues associated with the strain corruption places on the Russian economy and its annual budget allocations.

Proliferation

As the second largest nuclear power in the world today, Russia possesses a vast stockpile of plutonium, enriched uranium, and knowledge and experience with the development and manufacturing of technology to create nuclear weapons.³¹⁴ Of grave concern to the United States is Russia's ability to provide the necessary security and control measures to protect WMD material and their delivery systems, as well as the knowledge necessary to construct a delivery system necessary to employ such a weapon. Not only is it of extreme importance to ensure that Russia can secure its WMD materials from terrorist organizations and rogue regimes around the world, but Russia must also possess the means to address the inconceivable destruction associated if and when a weapon were to be utilized somewhere in the world.³¹⁵

Diminished Influence in Middle East and Southwest Asia

As security challenges in both the Middle East and Southwest Asia move into the second decade of the 21st Century for the United States, the importance of having a strong and influential partner like Russia should be of importance to this and future administrations. As the US works tirelessly to secure peace in this area of increased tensions in the world, by ending conflicts with Israel and Palestine, strengthening the fledgling governments in Iraq and Afghanistan, and preventing Iran from developing a

³¹⁴ Thomas Graham, *Resurgent Russia and U.S. Purpose*, *The Century Foundation*, (2009), www.tcf.org/publications/internationalaffairs/Graham.pdf (accessed April 15, 2010): 6.

³¹⁵ *Ibid.*, 6.

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nuclear weapons program, Russian historic trade and diplomatic relationships and influence in the region are critical to securing peace.³¹⁶

This influence is essential to persuading Iran from pursuing its nuclear aspirations. Unfortunately, Russia in recent years has undermined US attempts to deter Iranian development of nuclear arms, first by agreeing to a \$1 billion contract to construct the Bushehr Nuclear Plant for Iran, and then again in 2007, by promising to sell S-300 ground-to-air defense weapons to Iran. These missiles could be utilized to engage any threats, specifically from the United States or Israel.³¹⁷ In a surprising turn of events, Russia appears to be ready to support additional sanctions against Iran, which in the past it had been reluctant to support.³¹⁸ Revenues earned from other countries with specific interest in Russian military equipment will likely offset any loss of sales to Iran that Russia would have incurred as a result of supporting increased sanctions against Iran.³¹⁹

Energy Security

Natural gas conflicts between Russia and Ukraine, not only disrupted the flow of gas to consumers in Europe, but also displayed a significant amount of willful foreign intervention through the manipulation of energy resources.³²⁰ The disruption in services, if sustained could provide an impetus for regional destabilization and an unnecessary

³¹⁶ Graham, 7-8.

³¹⁷ Selcan Hacaoglu, "Iran: Fuel Swap Deal is One-Time Opportunity," Associated Press (June 8, 2010), This report cites Russian concern over the potential destabilizing effect the missiles may have in the Middle East, with that said, Russia has yet to deliver the missiles or officially cancel the deal with Iran.

³¹⁸ David Osborne, "UN Set to Give Approval for New Round of Iran Sanctions," *The Independent* (June 9, 2010), <http://www.independent.co.uk/news/world/politics/un-set-to-give-approval-for-new-round-of-iran-sanctions-1994948.html> (accessed June 9, 2010).

³¹⁹ Reuters, "Factbox: Russia's Relations with Iran," *Reuters* (May 26, 2010), <http://www.reuters.com/article/idUSLDE64P10N20100526> (accessed May 28, 2010).

³²⁰ Woehrel, "Ukraine: Current Issues and U.S. Policy," 1 and Pirog, "Russian Oil and Gas Challenges," 83-84.

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increase in global pricing.³²¹ While the energy the United States obtains from Russia is small, the impact that Russian energy policy has on our allies in Europe raises significant concerns. Increased revenues from higher oil and gas prices may appear to be an attractive venture for Russia, but as witnessed in the recent economic downturn, the pockets of the Russian elite are filled with riches, but little to no reform occurs. Necessary reform is neglected especially in the realm of bringing new energy fields online, or identifying alternate sources of energy that are cleaner for the environment.³²²

Strengthening of International Norms against Corruption

With a growing dependence and interoperability within international economies, it is important to ensure that corruption, terrorists, or other nefarious actors do not weaken US national security interests or capabilities. It is vital for the US and Russia to strengthen legitimate safeguards that will reduce economic vulnerability, and allow for the prosecution of corrupt agents who deprive the economic system the opportunity to expand and reform.³²³ As signatories to international agreements such as the United Nations Convention against Corruption, it is critical to ensure transparency and accountability in international and domestic practices, as well as reducing the barriers that impede the necessary institutional and market development required of nations.³²⁴ Recent Russian efforts in this area have been articulated with the right message, but little

³²¹ Ibid.

³²² Graham, 8. Aslund, and Kuchins, 157.

³²³ *The National Security Strategy of the United States of America*, (May 2010), 33. In the new National Security Strategy, President Obama highlights the concern over the threats related to the International Financial System and measures to protect these systems through enforcement of agreed upon principles, in accordance with international and domestic laws.

³²⁴ Ibid., 38.

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legal enforcement and identification has been realized. Legitimacy comes from accountability, something Russia lacks today.

Suggestions for Improving the Situation in Russia

What all analysts and decision makers alike must understand, is that the impetus to change in Russia will not occur because American policy drives it, but because the power of the global economy will encourage it to. The loss of revenues from foreign investment in Russia and the potential decrease in profitability, associated with oil and natural gas markets, will propel Russia towards necessary reform. As long as world oil and gas prices remain high enough (between \$85 and \$100/barrel), little reform will occur, and the necessary improvements to defeat the hold that corruption has on the country will continue to weigh Russia down, eroding its regional and world status, while eliminating any hopes of returning to super power status once again.

Unlike American assistance during the transition period following the end of the Communist state, which many Russians described as arrogant and demeaning, assistance today must be mutual and inclusive of not only American and Russian interests, but also the interests of the European Union (EU) as well.³²⁵ The West cannot isolate Russia and it cannot treat Russia with indifference. Russia must be incorporated into the world economic venues. Former Secretaries of State Kissinger and Shultz recently stated, “isolating Russia is not a sustainable long-range policy. It is neither feasible nor desirable to isolate a country adjoining Europe, Asia, and the Middle East and possessing

³²⁵ Graham, 12-15. Graham in his article writes that American policy towards Russia under President Clinton was pushed through by advisors who did not understand the intricacies of Russia and through the George W. Bush Administration, which was tied to the progression and incorporation of democratic values. Both fueled feelings of resentment and animosity between the two nations.

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a stockpile of nuclear weapons comparable to that of the United States.”³²⁶ Given Russian animosity and resentment towards the West and American perceived arrogance, any future cooperation must be built on shared interests and threats. Agreements on both sides must be constructed to emphasize that neither side will be in 100 percent agreement with the other all the time, but as long as the dialogue continues with respect for the others interests and incentives, progress will occur.

Yet there must be considerable improvements to the way Russia conducts its business. Russia cannot remain in the bottom 20 percent of countries in relation to perceived corruption.³²⁷ Russia has too much to offer to its own population and to the world as a whole, to allow the plague of corruption to prevent domestic and foreign investment into an aging production infrastructure. The US must work with Russia and our international partners to achieve Russian integration into the World Trade Organization, with the incentive to repeal the Jackson-Vanik Amendment when appropriate reform measures have successfully been implemented.³²⁸

Several issues must be addressed before Russia can become an influential partner, none larger than curbing the endemic and detrimental impact of corruption. First, Russia must begin to diversify its market economy and reduce its reliance and likely

³²⁶ Henry A. Kissinger and George P. Shultz, “Building on Common Ground with Russia,” *Washington Post* (October 8, 2009), <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/07/AR2008100702439.html> (accessed May 28, 2010).

³²⁷ Reference Transparency International Corruption Perception Index rating found in Chapter 3.

³²⁸ Julie Ginsburg, “Reassessing the Jackson-Vanik Amendment,” *Council on Foreign Relations* (July 2, 2009), <http://www.cfr.org/publication/19734/> (accessed May 28, 2010). The Jackson-Vanik amendment (Section 401, Title IV of the Trade Act of 1974, P.L. 93-618) affects U.S. trade relations with communist or former communist countries that restrict freedom of emigration and other human rights. It was a response to the Soviet Union's "diploma taxes" levied on Jews attempting to emigrate. It was signed into law on January 3, 1975 by President Gerald Ford following a unanimous Congressional vote and continues to influence trade relations with a number of states. Of note, as of March 2010, Secretary of State Hilary Clinton stated that the United States wants to repeal the Jackson-Vanik Amendment, but that she did not “know whether these plans can be implemented soon.” See also, Rianovosti, “Clinton Tells Putin U.S. Wants to Lift Jackson-Vanik Amendment,” *Rianovosti* (March 19, 2010), <http://en.rian.ru/business/20100319/158257197.html> (accessed May 28, 2010).

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vulnerability to energy price variations. The world could have hoped that through this recent economic downturn, amidst lower oil and gas prices, that an increased level of concern from Russia would have inspired Russia to develop alternate revenue producing markets that would relieve the over-dependence on extractive industries. Unfortunately, the most influential person on domestic policy within the Russian government is none other than Prime Minister Putin. Greed, control, intimidation, and corruption have been the cornerstones of Putin's legacy. Therefore, until Putin is no longer driving either the foreign or the domestic policies of Russia, change will not occur.

Diversification is possible with the assistance of the EU. The EU needs to continue to open its economy for investment into Russian industries, with the caveat that there must be strict enforcement to maintain European standards and rules of business. Germany alone has offered extensive cooperation opportunities to Russia to improve demographic issues, improve energy use, and give assistance with rule of law development.³²⁹ Through the development of a technological partnership with the EU, the hopes of creating a successful Russian version of the Silicon Valley would greatly benefit with the addition of Western ingenuity. While there is still apprehension over the stability and credibility of the investment climate in Russia, there are opportunities for future growth, with improvement in Russia's fight against corruption.

Aside from economic development, emphasis must be incorporated that would induce a shift in the values and interests of Russian society, to include increased transparency and accountability in business, political, and legal/judicial transactions. The

³²⁹ Niels Annen, "Fearing a Weak, Embracing a Strong Russia: There is No Alternative to Engagement with Moscow," *Brussels Forum Research Paper Is Russia Friend or Foe?* (March 2009), The German Marshall Fund of the United States, Washington, D.C., <http://www.gmfus.org/publications/index.cfm> (accessed May 24, 2010): 14. This partnership offer was issued by former German Foreign Minister Frank-Walter Steinmeier.

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fight against corruption should be open and assisted by all interested parties within Russia.³³⁰ The international community must work to ensure Russia does not revert to the autocratic system under the Soviets, or something even worse. Cooperation with America's European allies is critical to the success of ensuring Russian economic vitality and its democratic development, and to ensure that Russia does not become another failed state - a failed state that is inundated with rampant crime, poverty, and home to transnational terrorist organizations, as well as a breeding ground for the proliferation of materials utilized to construct weapons of mass destruction.

The long path that Russia must take towards reforming its political and economic ventures needs to begin with eliminating the incentives and sources of corruption. Ending corruption begins with transparency and a free press. Russia must also eliminate the state control of press and media services within the country, as well as ensuring the protection of those journalists who explore sensitive and potentially embarrassing topics.

Russia must also cease the practice of nationalizing its markets, specifically industrial giants such as Gazprom. While Gazprom is one of the largest revenue producing entities within Russia today, the mere control the state has over the company provides an environment ripe for corruption and abuse.

President Medvedev has initiated reform from within the Interior Ministry in an attempt to improve the legal and judicial process, but more reform in this area must occur. The courts must be allowed to rule on cases within the confines of the rule of law, not by state direction. The courts must also publish their rulings and become open and transparent.

³³⁰ Ibid., 18.

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All of the aforementioned changes are critical to the successful reformation of Russian society. Positive change inside Russia should not be considered a quick or inevitable endeavor. Political and economic reformation observed in the 1990s, allowed Russia to miss critical steps along the development process. The learning curve was steep and the driving forces behind this change pressed too hard, and resulted in missed opportunities. The United States has had over 200 years to work through all the issues that we expect Russia to do overnight. A weak, semi-democratic Russia is not in the best interest of the United States or the international community. The United States has a great deal to be concerned about with Russia's successful and prosperous integration into the international community. Time will tell whether President Medvedev has the political power and fortitude to endure the necessary reform process, or whether he is cast from the same cloth of all the previous leaders in Russian history.

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