

IMPLEMENTATION OF THE HELSINKI ACCORDS

CRIME AND CORRUPTION IN RUSSIA



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**Briefing of the
Commission on Security and Cooperation in Europe
Washington, DC**

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Briefing on Crime and Corruption in Russia

Friday, June 10, 1994

Commission on Security and Cooperation in Europe

Washington, DC

The Commission met in room 2359, Rayburn House Office Building, at 10:34 a.m., Sam Wise, Staff Director, presiding.

Also present: Dr. Louise Shelley, Department of Justice, Law and Society of American University, Stephen Handelman, Associate Fellow at the Harriman Center of Columbia University and international affairs writer for The Toronto Star

Mr. Wise. I think we can begin now. There might be others who will come, but it's time to begin—get started, and I would welcome you all here, first, to another briefing of the Helsinki Commission.

Our Commission is part of the process of the CSCE—the Conference on Security and Cooperation in Europe. We are, from the United States side, the more or less congressional component of that effort, and our Commission is headed by two chairmen—Senator DeConcini of Arizona and Representative Hoyer of Maryland.

And our meeting today will be a briefing, which will be chaired by myself. I'm Sam Wise, the Staff Director of the Commission, and it will be on the subject of crime in Russia.

I think all of us here have noticed a marked increase in the attention paid to the subject of crime in Russia. Certainly, internally in Russia I think it has become the dominant subject, and for the outside world it is becoming increasingly important as we realize the international implications of what is happening inside Russia.

Perhaps even more important is the effect of crime on the viability of Russia as a country. President Yeltsin has called crime the gravest threat to the Russian state. And in an article some of you may have seen in The New York Times today, yet another article on crime in Russia, he is quoted as describing his country as a "superpower" of crime.

In other words, to the President I'd say, and others, "Will criminals take over the Russian government? Is that a possibility? Or will Russian citizens become so frustrated over crime and corruption throughout their society that they will vote into office authoritarian leaders who will turn back the clock to a safer but more repressive era?" All sorts of possibilities come up.

Today we have two panelists who are uniquely qualified to address this issue. After they have spoken, we will invite questions from the floor.

Our first speaker is Dr. Louise Shelley of American University, who is a specialist in Russian law and organized crime, serving as a rule of law advisor to the Agency for International Development on issues of crime and corruption in Russia and the newly-independent states.

Her book, *Policing Soviet Society*, will be published later this year. Dr. Shelley has testified in the past at congressional hearings for the Commission, and it is a pleasure to welcome her back.

Dr. Shelley?

Ms. Shelley. Thank you.

It's a pleasure to be here and discuss this very important issue with you, that's important not only for the development of Russia and the former states or republics of the Soviet Union now newly-independent countries, as well as for the United States, Europe, and other parts of the world, because the development of post-Soviet organized crime is not just a national or an internal phenomenon; it is a phenomenon that affects all parts of the world.

Organized crime has penetrated most of the newly-independent states of the former Soviet Union at all governmental levels. With such pervasiveness and with such infiltration into the society, it ceases to be a crime problem but a political phenomenon that could affect the future course of development of the Soviet successor states.

As Mr. Wise says, there is concern that it could prompt a political backlash from the right that wants more political order. It could also cause lasting and permanent discreditation of a market economy and a move towards a capitalist system.

Not only that concern, it may limit human rights, foreign investment, and open market economies. Its influence at this moment is particularly strong at the municipal and the regional level, but there are also ties to the National level as well.

Domination by the Communist party may be replaced by the controls of organized crime. Organized crime will limit and is already limiting aspects of civil society by intimidating journalists. It is reducing free elections, freedom of the press, and media.

Labor markets, once controlled by state planning and submissive trade unions, will instead be subject to the intimidation of organized crime which is already a major employer. As I will discuss more, organized crime now is estimated to control up to half of the privatized capital in Russia.

State ownership of the economy will be exchanged for control of the economy by organized crime groups and former party elites, which have a monopoly on existing capital. There is, as one knows, a symbiotic relationship that exists between the political elite and the members of these violent organized crime groups.

Therefore, our primary concern is that the collapse of communism may not lead to democratization and the transition to a competitive capitalism economy. Instead, it may lead to an alternative form of development, political clientalism, and controlled markets.

One of the most important things to remember is that the transition in the former Soviet Union is proceeding on both political lines and economic lines simultaneously. With the emergence of this organized crime, which is so visible and has such an impact on its citizens' daily lives, it is affecting their evaluation of democracy. It has affected their evaluation of a free market economy.

A symbiotic relationship exists between organized crime and national, local, and municipal governments. As the Italian and American experience has shown, once orga-

nized crime becomes intertwined with government the relationship cannot easily or rapidly be reversed.

But as the experiences of the United States and Italy have shown, constructive efforts through legislatures, through investigative journalism, through legal actions, through various kinds of economic measures that hit at the cause of organized crime, can be helpful in reducing the level of organized crime and its penetration into the government.

And I think that one of the things that the United States government should be thinking about now is that this effort can be introduced at this moment in Russia. There is now, in the last few months, serious planning by the Russians on the measures that they would like to introduce to curtail organized crime. There are efforts to and desire to cooperate with western governments, and I think it is very important for us to develop a complete and structured plan to be doing this.

We are looking at very serious problems in the political arena. Organized crime has undermined the electoral process, the emergence of a viable multi-party system, and the establishment of laws needed to move towards a legally regulated market economy. Organized crime has financed the election of candidates, and there are new members of Parliament with close links to organized crime.

The influence of corrupt officials and legislators has slowed the adoption of legislation outlawing corruption in the bureaucracy. It is not exclusively the fault of organized crime, but it has helped contribute to the confusion and the inability of the legislature to pass needed laws, including banking laws, regulation of securities markets, laws against money laundering, or a witness protection program.

Many of these legal measures have been adopted recently in eastern Europe. Hungary has taken the lead, and they are beginning to have a positive impact in these societies. Therefore, there is a concern among eastern European countries that Russia and the former Soviet states begin to take these measures, because if they don't it will undermine the developments and transformation process that is going on in eastern Europe at the moment.

Organized crime has supplanted many of the functions of a state. A coalition of organized crime and former party elites provides the ruling elites of many regions of Russia and the CIS states. Organized crime provides many of the services that citizens expect from the state—protection of commercial businesses, employment for citizens, mediation in disputes. Private security, often run by organized crime, is replacing state law enforcement.

Let me give you one anecdote that illustrates this. A businessman in Odessa, which is now in The Ukraine, had a deal with somebody in Novosibirsk. The man in Novosibirsk did not pay. There was no legal mechanisms for him to secure the repayment of his debt, which was about \$100,000.

So he called in his local godfather, to whom he paid protection money. That local godfather found the godfather of the businessman in Novosibirsk, a deal was worked out, and in six months repayment was paid. This would not be necessary if there were legal mechanisms working between the states and the judicial system legal mechanisms were functioning. But organized crime is replacing the functions of the state in the wake of the collapse of the Soviet Union.

Organized crime is facilitating the rise of regional powers in Russia. This is not the decentralization and federalism sought by American promoters of democracy. Instead, it

represents the rise of local fiefdoms, protected by armed bands, loyal to local leaders who seeks political and economic controls over their regions.

These local leaders may enjoy more power than in the Soviet period because they own rather than control property, and this time the law enforcers who are private bands work for them instead of the state.

With their control over the economy, over the privatization process, citizens may face serious troubles in the post-Soviet period in protecting their property rights and defending their labor rights because the new leaders are owners of businesses who are no more interested in the labor rights of the citizens than were their communist counterparts.

And I should add that for us as Americans we understand the importance of property rights. After all, Locke pointed out—and our society is based on the Lockean philosophy—that property rights are one of the basic defenses that citizens have against the state. If citizens do not have the right to acquire property, as I will be discussing a little bit more later, then they are jeopardizing their independence from the state.

International trade and investment is another area in which organized crime is affecting post-Soviet development. It is undermining foreign investment and trade by increasing the risks of capital investment. It is undermining American interest by making American investments and personnel less secure.

Furthermore, there are American businesses—some of them major—which have chosen not to enter the former Soviet Union because of the risks to their business. Capital is not being protected because of the absence of clear and permanent legal norms, reliable and honest parties with whom businesses can negotiate, trustworthy law enforcement, courts which are impartial arbiters of economic disputes, and the absence of insurance and banking laws. Therefore, there are other places that are just more much desirable for American businesses to invest.

The alliance of corrupt officials in organized crime prevents the emergence of long-term trade agreements because they are not in their financial interest. New Mafiosi preferred to sell state resources for their own rather than open trade with multi-national companies.

For example, an official who is in charge of valuable timber resources may choose just to log the timber, sell the timber, pocket the money, export the profits abroad, and not develop a relationship with a Weyerhaeuser or another international company because that will establish limits on how much timber they can cut.

It will establish a long-term relationship, which is not in this person's interest because most of these organized crime figures and corrupt officials are looking for short-term profits and not long-term gain. Therefore, the situation makes it very difficult for foreign businesses to invest.

What will happen is that organized crime will encourage trade in illicit, rather than legitimate, markets. It doesn't mean that the economy isn't going to grow; it is just going to grow more in the illicit sector.

At present, this illicit trade exists in goods which can be illegally exported for quick profit, such as diverted oil. A large share of the oil exports of the former Soviet Union are now being illegally exported, there is also illicit trade in metals, timber, and military equipment. And this export of military equipment is alarming because it is helping to supply armed conflicts within the former Soviet Union and worldwide.

Other illicit trade occurs in areas that are universally recognized as criminal, including nuclear materials, drugs, prostitution, and smuggling of people. These are not just former Soviet citizens that are being smuggled but people from all parts of the Third World. These commodities now dominate the CIS nations' participation in international markets.

The dependence of post-Soviet economies on illicit commerce is one of the major economic risks to their future development. It is impeding the development of commercial infrastructure for sustainable international trade. As we know, economies that are too dependent on a limited range of goods have trouble when there is a sudden decline in production or in demand.

While the post-Soviet economy is diversified in many types of illicit goods and services, the problem is that many of these are not renewable, and it is providing a problem in developing long-term international trade. Furthermore, much of the profit from this international trade is residing in foreign banks and is not being invested in the economies of the successor states.

Foreign businesses interested in international trade in oil and raw materials cannot avoid the profound corruption. International businesses often have to bribe officials to obtain the licenses that they need to export oil and valuable minerals. Therefore, United States' firms are frequently forced to violate U.S. legal norms if they seek to enter the Russian market. There is one estimate that 80 percent of all American businesses have had to violate the Foreign Corrupt Practices Act at least once.

To move on to the discussion of the nuclear security area. There were hearings within the last two weeks on the Hill on the problem of the risks of the smuggling of radioactive materials.

At least at this moment there has not been export of major nuclear weapons, though there is increasing trade in radioactive materials, which is dangerous both for the possible uses of this radioactive material, as well as the environmental risks of transporting radioactive materials without appropriate protections.

Recently, a well-known Russian investigative reporter published an article in The Bulletin of the Atomic Scientist suggesting that some of the risk that has been attributed to organized crime's infiltration into the nuclear arsenal is exaggerated, but I think we need to make sure that vigilance is maintained in this area.

Looking at tourism and foreign presence in the former Soviet Union, there is a serious problem of crime, especially in areas where tourists frequent, which are hotels, restaurants, casinos, which are owned by organized crime.

There are certain hotels which are just sites where organized crime figures gather. But even some western management hotels have been infiltrated by organized crime, and there have been 180 American victims in Russia last year, the crimes against them are mostly property crimes but there also have been cases of violence and cases of homicide.

Let me point to the area which I think is most alarming from a question of the transformation of the former Soviet Union, and that is the impact of organized crime on daily life.

From our international concerns, the nuclear threat is certainly very important. But the possibility that Russia will revert back to some kind of authoritarian government depends very much on the way citizens appraise the transition that is currently underway

in their society. And the impact of organized crime on their daily lives is very severe, and it is a very shocking transition.

Remember that only a decade ago it was safe to walk the streets in most Soviet cities. In fact, one of the benefits that Soviet citizens felt that they had from the Soviet system was a great sense of security, and Gorbachev, when he promised them perestroika, promised them democratization with order. What they've had now is democratization with disorder.

And it is this impact of organized crime that is so alarming to the Soviet citizens because there is almost no aspect of their lives that is untouched by organized crime. It is penetrating not only the problems of their personal security, but it is affecting the press, the formation of civil society, and as I mentioned earlier their ability to obtain property and, hence, their future financial security.

The violence and insecurity in emerging markets is a threat to their lives and financial security. The privatization process has resulted in a variety of criminal acts against citizens. Individuals with choice apartments have been threatened or even killed to acquire their apartments.

Individuals who have right to acquire shares as employees of present businesses or retirees of existing businesses have been visited by the thugs of organized crime and been forced to surrender their property rights. Citizens who have used or acquired vouchers, which are their way of acquiring property that's being sold off by the former Soviet state, have been intimidated at auctions. Or if they've given their funds over to voucher funds, these unregulated funds have in some cases just totally disappeared with all of the resources of the citizens.

So many Soviet citizens, observing this privatization process, it is the great grab of organized crime and the party elite that is leaving them totally in the cold without any property or any chances of obtaining it.

At this moment, the discrepancy between the top 10 percent of the Soviet-Russian population and the bottom 10 percent is 12-fold, and as this privatization process proceeds this discrepancy is going to grow larger and larger. Organized crime results in increased violence, street crime, property crime, and more visible deviance.

Not only do we hear about the explosion of car bombs in the street, but there are increasing numbers of burglaries, and the vast majority of the population has said that they are changing their lifestyles in response to the crime threat. We know what that means in this society, but it is particularly alarming to former Soviet citizens who once had such security in their lives.

Organized crime has contributed to significant increases in drug trafficking and drug use, prostitution, and gambling, and prostitution has spread both abroad and within Russia. Gambling casinos are sponsored by organized crime groups in hotels, and so forth.

Another major problem is the inflation and high cost of goods that is leading to an increased number of citizens living below the poverty level. The monopoly on goods and services is increasing prices for Soviet-Russian citizens by 20 to 30 percent. So this is an extremely important factor in their lives and the fact that they are not able to buy the food that they need or the clothing that they need for their family members.

Furthermore, industry is increasingly controlled by organized crime, and individuals are not going to be able to establish free trade unions. As we have watched what has happened in this country as organized crime has entered into trade unions, this is something

that we must watch with vigilance in the former Soviet Union, because labor rights once violated by the communist party will now be violated by members of organized crime.

The emergence of organized crime as a political and social force is also affecting the creation of a civil society. We have read about the intimidation of journalists, but there are other ways that this is happening as well. Organized crime is helping to fill this vacuum in society. It is an impediment to the development of civil society, and it has been infiltrating the hundreds of charitable organizations that are existing in Russia.

The last problem that I think is also very important to consider is the way in which organized crime helps exacerbate interethnic tensions. The active participation of different ethnic groups in organized crime is leading to increased ethnic conflict and hostility.

We must remember that after the storming of the Parliament in October, non-Russians were expelled from Moscow because of their alleged involvement in organized crime. And this problem of interethnic conflict is not just one in Russia; it exists because of the diverse ethnic groups' participation in organized crime in all parts of the former Soviet Union.

What are the policy implications for the United States government? First, the United States government should carefully scrutinize our ongoing and soon-to-be-launched massive privatization program to ensure that attention is paid to the serious threats to this process from corruption and organized crime. Grant guidelines for this last round of proposals currently ignore this problem, or these problems.

The United States should pay very careful attention to the aid-sponsored privatization program and those of other international organizations in which we participate. A recent article in *The Atlantic* pointed out that U.S. government officials are aware of this problem.

If we are contributing to the infiltration of organized crime into the privatization process, we are contributing to the exacerbation of a problem that is going to affect future generations of post-Soviet citizens who are being deprived of their property rights and their chance for financial security and a prosperous future in a market economy.

Therefore, it is imperative that our aid effort not only promote a positive distribution of resources, but we must be very careful that we do not worsen the process.

Second, all law enforcement assistance should be targeted. A massive aid program would only serve to aggravate the problems of corruption and benefit the law enforcers sponsored by organized crime. Remember, there is a very high rate of turnover in the police at this moment. Individuals spend a few years there and then join the private security forces run by organized crime.

We, therefore, should focus our law enforcement assistance in ways that focus on U.S. interests. This can be done through enhanced cooperation, as well as the development of legislation. There is currently a legislative agenda that the Russians are developing on extradition, money laundering, witness protection programs.

All of these should be encouraged, and we should be helping them to develop legislation that is in conformity with Vienna Convention and other agreements, so that the Russian legislation can be used in a cooperative way with our counterparts, or with their counterparts in the United States.

Third, emphasis must be placed on establishing a legal infrastructure, not only by providing technical assistance through the Aid Rule of Law Program but by emphasizing the importance of this in discussions with high-level governmental personnel and legisla-

tors. This should be done not only in talks by Americans but also through our participation in international organizations and the CSCE process.

Fourth, we should educate American businesses on the problems of crime and corruption. Many of them are not aware of the dangers and problems that face them in investing in Russia and the former Soviet states. We should penalize American businesses who are violating the Foreign Corrupt Practices Act.

Fifth, we should broaden the concept of human rights violations to include acts committed by organized crime groups and corrupt officials. This can include violations of labor rights, freedom of the press, and the fomentation of ethnic conflict.

For so many years we have thought of this in terms of violations by the government and focused on human rights violations in those areas. Now we need to broaden our thinking and think in other terms as well.

And lastly, the United States should pay close attention to the impact of post-Soviet organized crime on American business interests, on security, on the crime problem within the United States, and the financial integrity of our aid process.

We must remember that this post-Soviet organized crime has developed very rapidly and is developing in an international arena. Therefore, as Russians will admit to us, it is not just our problem; it is your problem. And by being your problem, as they were saying, you have to focus on the consequences, and you have to cooperate.

Many Russians feel let down out by our failure to pay attention to this issue earlier. Many people that I know in Russia are welcoming the United States government's new interest in this area and our willingness to help them. And I think there are many fruitful areas of cooperation that are just beginning and should be continued in the next few years, in order that Russia and the other successor states can make a transition to more democratic societies with market economies.

Thank you.

Mr. Wise. Thank you, Dr. Shelley.

Our other panelist this morning is Stephen Handelman, who is presently an Associate Fellow at the Harriman Center of Columbia University. He was the Moscow Bureau Chief of The Toronto Star from 1987 until 1992. His articles on crime in Russia have appeared in Foreign Affairs, The New York Times Magazine, and other publications.

Mr. Handelman's book, Comrade Criminal: The Theft of the Second Russian Revolution, will be published this fall.

Mr. Handelman?

Mr. Handelman. Thank you.

It's a little unusual as a journalist for me to be on this side of the table.

[Laughter.]

But I appreciate the opportunity to talk about an issue that, as Dr. Shelley said, is probably the most important single issue in the—to consider when we're talking about the transition of the Soviet Union and the successor states into the post-communist era, or whatever we want to call it.

And I don't really want to repeat a lot of the—a lot of the points that Dr. Shelley made so ably. But I'd like to begin with a story about a man named Aleksei Kochetov. He is the manager of probably Moscow's largest brewery which is located in the northern neighborhood of the capital.

He is in his late 40's, he has two children, and he managed this brewery for about 10 years, but until the beginning of 1992 he was a state employee, a bureaucrat, since all of the breweries were owned by the state at that point. And with the first rush of privatization he was allowed to sell his beer to private distributors. So he jumped at the chance to become what he said was a capitalist.

Within a few months he was doing a pretty good business. Trucks would come in every morning from retail outlets around the capital; he had hopes of returning—of turning his company into a completely private operation. But he began to notice something strange in the mornings when the beer trucks would leave the gates of his company. There were groups of men congregating around the gates, talking to the drivers, whispering to them.

He sent somebody downstairs to inquire what was going on, and he found out they were members of a local gang who were demanding payment from the drivers for each load of beer that they were shipping out or, alternatively, a cut of the actual beer that they were bringing out.

Now, Kochetov was still an innocent then in the world of new Russia. He knew the local police captain so he complained, and a few days after his complaint, while Kochetov was on a business trip and his wife and children were at home, an explosion ripped apart the door of his apartment. No one was injured. Kochetov got the message.

He didn't call back the local police. It took him a few weeks to summon up the courage to find help in Moscow's new and relatively small, organized crime squad. And a friendly detective told him what he had already guessed, that he was foolish to have gone to the local police because they were already in the pay of the local racketeers.

The detective offered to provide some of his men as bodyguards and station them at the gate of his brewery, which he did, and it worked—for the first couple of weeks the gangsters stayed away. But the detective had to tell Mr. Kochetov that he couldn't guarantee that these men would stay at his brewery forever. After all, they didn't have a very big budget, Moscow was a very big city, and there were a lot more of these things going on.

This, obviously, helped Kochetov decide to change some of his plans about expanding the operation of his brewery. He told me when I saw him that he was waiting for the atmosphere to change. But I could tell that he doubted that it would. He had a different attitude towards capitalism, and obviously he wasn't alone, because there are thousands of would-be Russian businessmen, would-be Russian capitalists, who have gone through very many similar experiences.

I think Kochetov's story is significant because his fear of success, his failure to go further on the road to capitalism, is really our failure as well. If Russia's transition to democracy and free enterprise is cut short or reversed, we are going to feel the impact, again, as Dr. Shelley has said.

That's really, in my opinion, the real issue behind the crime problem, the crime story in Russia. There is obviously plenty of sensational aspects to it—car bombs in the streets of Moscow, mafya lords being gunned down in Chicago-style shootouts, a 43 percent increase in the murder rate in the last—first 5 months of this year in Moscow alone, stories of nuclear smuggling, increasing drug trade. Crime was the first post-Soviet growth industry.

But the central question about crime, really, is its affect on Russian attitudes towards the revolutionary transformations in their own country. It is going to determine their future stability, and by implication our own. The irony is that until recently we have given the issue of post-Soviet crime so little attention.

The transition out of communism is probably the most dramatic and crucial story of our time, but it is hidden in the cloud of rhetoric that accompanied the fall of the Soviet Union, and the euphoria about our victory in the Cold War, and our relief of being able to concentrate on our own backyard.

We made three assumptions, all of which allowed us to close our eyes to Russian reality. We believe that the communist establishment was gone or at least too weak to have any impact. We believed Russians were eager to grasp democracy, and we believed the free market will be the engine of development in a new Russia.

Crime, and particularly organized crime, have confounded all of these assumptions. But it is really not the corpses in the streets that should worry us. It is the impact of disorder and illegality, as Dr. Shelley said, on the individual Russian as well as the individual Ukrainian, the individual Belarussian, because the problem is not just a Russian problem; it is extended to all of the former republics of the Soviet Union.

And another point, a very key point to remember, is that crime didn't begin with the fall of the communist regime. In fact, crime was a—rising crime was a problem throughout the final decade of the Soviet Union's existence. It was something that Gorbachev made a point of talking about. Many police have told me that they feel perestroika was the reason for the development of organized crime in Russia.

But the key question still to ask—and I'll come back to that point because there's a lot of truth in that—is that people ask is—whether crime in Russia is a cause of the current chaos that we see in the streets of Moscow and St. Petersburg and other parts of the country, or an effect. Because if it were merely an effect we might be able to breathe easier.

After all, most societies including our own, have experienced violent disorder during periods of rapid economic and political change. The crime, bribery, and financial wheeling and dealing of today's Russia look very similar to the American frontier and the period that ended with the robber barons and the rise of the big city corrupt political machines.

Some Russians use that very same analogy to shrug off what is happening in their society. They say that all of this will eventually blow over, and perhaps some of their own robber barons will turn into decent citizens honored for their charities and their civic pride.

The funny thing is that some of the mobsters I've talked to in Russia made the same argument. They say, "We have no choice" except to act the way they do. "We live in a lawless society. But our children," they say, "are going to be honest." The question is, will they?

The problem is that in post-communist Russia crime is not just a by-product of free-wheeling frontier capitalism. It is its direct rival. Organized crime in particular has choked off natural economic development of Russia, of whatever type, whether it's a capitalist type, quasi-socialist type, whatever we want to call it. It has corrupted politics, and just as importantly it has transformed public opinion about the new society.

This is what a man who was at that point the director, the head of the Supreme Soviet Parliamentary Committee on Law and Order said to me in the summer of 1992—

