Repatriation of Russian Capital: Investment, Or More Looting?

by Rachel Douglas

It sounds like a great idea. Entice the past decade's (conservatively estimated) $300 billion in Russian flight capital back into the country to jump-start investment in the real sector of the economy. How could such a concept not be attractive to President Vladimir Putin, worried as he is about post-1998-crisis growth sputtering and wage arrears beginning to mount again? And Putin did announce a scheme in the works for the repatriation of offshore funds, when he addressed the Russian Chamber of Commerce and Industry on June 19.

Yevgeni Primakov, the former Prime Minister who now heads the Chamber, likewise endorsed "some form of amnesty" for capital exported abroad.

But, it is impossible to insulate a sound policy from an insane world financial system—especially if major players from the latter are involved. Russia's decisions on capital flows are intermeshed, first of all, with the pell-mell flight of international funds out of the crashing U.S. dollar. The chaos unleashed by that crash will swamp any national-sector initiatives, absent decisive action by several major nations to create a new, growth-oriented monetary system. Second, the promoters of large-scale repatriation of capital just now, overlap the promoters of the dubious scheme to make Russia the world's gas station, by directing foreign investment and repatriated flight capital, chiefly into the build-up of its oil sector for export. (See "What Did 'Energy Dialogue' at Bush-Putin Summit Mean?," *EIR,* June 7, 2002.)

Putin urged the Chamber of Commerce members and the government "to think about creating favorable conditions for investing Russian resources, including those placed in the West, in the Russian economy." His deputy chief of staff, Aleksei Violin, announced that the government would draft an amnesty law, under which Russian citizens could declare, repatriate, and pay taxes (at Russia's vaunted 13% flat income tax rate) on the funds they hold offshore, without facing prosecution. They would be allowed to leave 75% of their money abroad in its offshore havens.

Funds Abroad: Legal and Criminal

Putin's announcement was preceded by a campaign by domestic and foreign-based interests, with the theme that now is the time to make money in Russia. Economics Ministry official A. Ulyukayev, a member of the original liberal reform team around Yegor Gaidar in 1992, announced on June 13 that Russia had now shifted from net capital flight (of approximately $20 billion annually), to net capital inflow. Cyprus, a preferred offshore location for Russian banks and businesses, has become the top source of foreign investment in Russia. On June 15, Itar-TASS reported from Halifax, Canada that "halting of the exodus of capital from Russia was the main positive news" at Finance Minister Aleksei Kudrin's meeting with his Group of Eight counterparts. Kudrin, the report said, "stressed the importance of this news for the development of the Russian economy and its integration into the world economy."

Also in early June, the notoriously politicized international rating agencies in unison upgraded Russia's credit rating, or issued improved forecasts on the Russian economy. A World Bank report suggested that Russian economic growth could be predicated on large-scale repatriation of capital.

In 1996, *EIR* estimated that some 10% of the then approximately $1 trillion annual cash volume of "Dope, Inc." (half of it the proceeds of the narcotics trade, the rest from other types of illegal business, including weapons sales) was routed through Russia, the other former Soviet republics, and Eastern Europe. There are indications that some of these shadowy money flows are to be legitimized, through the partial Russian amnesty on flight capital, but also as a spinoff effect of crackdowns on money-laundering, stepped up in Western Europe in the name of "greater transparency" after Sept. 11.

Directly after his Chamber of Commerce address, Putin met for two hours with Sergei Pugachov, formerly president of Mezhkombank and now the representative of Tuva in the Russian Federation Council (the upper house of Parliament), who has been associated with Putin since they were both based in St. Petersburg. *Izvestiya* reported that their talk focussed on the nuts and bolts of repatriating capital from offshore companies, but speculated that another item was also likely on the agenda. It so happened that on the previous day, June 18, the Paris daily *Le Monde* wrote about an investigation of Pugachov by prosecutors in Nice, France, for suspicious cash transfers between his bank accounts in Monaco and his Star Limousine company in France.

At the beginning of June, Italian authorities coordinated 50 arrests in seven countries, of the Russian kingpins and their partners in a money-laundering operation involving as much as $9 billion. Analyst Leonid Bershidsky, writing on June 24 in *Vedomosti,* raised the question of how these "Operation Spiderweb" arrests tied in with the new policy on flight capital: like the plot of a spy story, in which a President with good intelligence community connections would demonstrate to key businessmen that their money-laundering can be caught and punished, while simultaneously offering them amnesty for returning funds to Russia.

The Oil Scenario

Quick to welcome Putin's announcement was Anatoli Chubais, a key figure in the ransacking of Russia through privatization and asset-stripping during the 1990s. Now head

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of United Energy Systems, the national electricity company, Chubais said that for too long the attitude toward illegal capital flows had been "ban and interdict." Now there would be a "more professional" approach to offshore accounts.

On June 21, Mikhail Khodorkovsky's Yukos oil company became the first big Russian firm to publicize its ownership structure of nested offshore holding companies, based in Gibraltar and the Isle of Man. Formally, the action by Yukos was preparation for being listed on the New York Stock Exchange, but Russian media were quick to call it a sign that "our offshore capital is ready to come home." Khodorkovsky himself continues his vociferous campaign to boost Russia to the status of the world's top oil supplier, announcing that his first tanker of oil for sale in the United States is already at sea.

The *Times* of London puffed Khodorkovsky in a June 23 profile, as having "gone from being a shadowy figure associated with the alleged plunder of Russia, to the country's richest and most famous business leader." His "unusual disclosure" of Yukos ownership, the *Times* wrote, "could set a trend that would make Russia far more attractive to investors."

In case these maneuvers did not attract enough foreign investment for Russian raw materials exporters' needs, another Russian-born intimate of London financial circles has a wilder idea. Earlier this year, Mark Garber, formerly a Russian psychiatrist and now a partner in the exclusive British investment house Fleming Family & Partners (and a person who was named, then cleared in yet another Italian investigation of the illegal arms trade), presented in the weekly *Ekspert* his "five-year plan" for Russian firms to raise capital through international acquisitions. Russian companies should "become transnational not by selling themselves, but by merging with others," analogous to how Flemings shepherded the South African mining company Glencore (now BHP Billiton) to its eventual acquisition of Australia's largest mining company, BHP. The first step was to raise $8 billion through stock issues, after getting listed on the London exchange. Garber proposed that Russia's giant natural gas company, Gazprom, "not sell stocks to [the German gas company] Ruhrgas. On the contrary, Gazprom should purchase Ruhrgas. Then, Gazprom would become a transnational company, which would be traded quite differently."

On a smaller scale, the Russian oil company TNK, owned by Alpha Group, is trying to wiggle out of a serious debt crisis by "transnationalizing." Last September, it created TNK International, subsuming almost all of TNK's industrial assets. Its chairman, American citizen Simon Kukes, announced on June 13 that TNK International now has a board of trustees with two members: Sir Peter Walters, former chairman of British Petroleum, and Sir William Purvis, head of Hongkong and Shanghai Banking Corp., the famous "Dope, Inc." bank. Kukes told the Russian press that by inviting such "highly respected persons," the company will become more efficient and transparent for investors, which will "increase our capitalization."

False Axioms Blow Out California's Budget

by Mary Jane Freeman

If you build your house upon quicksand, you can be sure it will sink. Yet, this is exactly what nearly two-thirds of the states and the District of Columbia did since the mid-1990s in building their budgets on revenue streams from the speculative high-tech, Internet, housing, and stock market bubble economy. The recently declared, enormous California budget shortfall of $23.6 billion, epitomizes just how wrong the deluded assumption of relying on the bubble has been.

State budgets across the country, built on quicksand revenue from the "New Economy" and the stock market, now find "the outlook is painful, with serious problems likely ahead," as one state budget official put it. But the "problems ahead" loom larger than any leading figure, with the exception of Lyndon LaRouche, is willing to admit.

Rather than address the 30-year-long false premise embedded in the post-industrial paradigm-shift which led policymakers to assume they could take their revenues from speculation, governors and legislators across the nation are instead frantically fine-tuning budget cuts, going deeper into debt, and using accounting tricks now denounced when used on Wall Street, to survive until a "recovery" appears. They deny the underlying reason for their sudden larger revenue shortfalls, with deadly consequences for their citizens, as basic health, education, and welfare programs begin to vanish and infrastructure crumbles.

Tax Cuts Plus Depression Really Hurt

While California—the nation's most populous state with nearly 34 million people, biggest U.S. state economy, and world's fifth-largest economy—has a budget crisis of the largest magnitude, a recent national survey shows that out of 41 states and the District of Columbia responding, 32 have rapidly sinking revenues and attribute a big part of this collapse to a "drop-off in capital-gains- and stock-options-related income."

The survey, conducted by the Rockefeller Institute, the National Governors Association, the National Conference of State Legislatures, the Federation of Tax Administrators, and the National Association of State Budget Officers, also shows that April—tax month—personal income tax (PIT) revenues for all states, fell 21.4% from the April 2001 level. For the four months of January-April, PIT collections "were down an average of 14% nationwide" from the same period of 2001. Although the first quarter PIT decline averaged 14%, the sur-