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The Kleptocracy Curse: Rethinking Containment

Ben Judah
Kleptocracy Initiative

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Table of Contents

Preface

The United States needs to start paying attention to what has happened to the world economy. Gigantic sums of money are now traveling the world incognito. This has turned globalization into the golden age of money laundering. Nestling in Western economies are offshore financial structures (and their professional enablers) which allow funds to instantaneously and anonymously jump between countries, empowering authoritarians and corrupting Western institutions. This now presents a growing national security threat.

Across the world, money laundering on an epidemic scale is undermining American foreign policy: crippling development, threatening democracy, damaging Western soft power and fueling state collapse. Across the West, this staggering flow of illicit funds has turned authoritarian kleptocrats into powerful players increasingly able to wield power inside Western institutions and game them to their own ends. There is only one way to block the illicit flows that empower kleptocrats and undermine democracy: Ending anonymous shell companies must become a national security priority for the U.S.

The Kleptocrats Are Coming

Until recently, most experts in the White House and the Kremlin believed that globalization was undermining authoritarianism. Frenetic travel and instantaneous, at-a-click global finance–which allowed every moneyed actor to become a cross-border operator if they chose to be–seemed to be eroding the autocrats' institutions. Dictators, single parties, secret police chiefs, and embezzling kleptocrats appeared to be globalizing badly. The United States and the European Union believed that the openness of the new century generated an advantage for emerging middle classes, online-dissidents, NGOs, and democratic movements.

The assumption that globalization's deep, structural motor undermines authoritarianism and furthers Western values and power underwrites much of the Obama administration's strategic thinking. Russia is viewed as a brittle power, whose institutions and actions "belong to the nineteenth century."[1] America, the current administration believes, must approach Russia, China, and many other authoritarian states with "a strategic patience."[2] When Obama says Russia "is on the wrong side of history" or that the U.S. is on the "right side of history," this is much what he means.[3]

Panglossian confidence has underestimated 21st century authoritarianism. Rather than retreat, democratize, and reform towards the rule of law, the autocratic ruling classes of Russia, China, Central Asia, the Arabian Gulf, and beyond have globalized with great success. The openness of the new century, the U.S. and the EU are now finding, is in fact rather well suited to the kleptocratic dictator–with a coterie of American lawyers, French bankers, German accountants, and British public relations teams in tow.

This is because globalization has created the golden age of money laundering. Today, according to the International Monetary Fund, up to 5 percent of the world's GDP is laundered money–and only 1 percent of it ever gets spotted.[4] It has never been simpler or safer to be a kleptocrat. Globalization's deep, structural motors are in fact enabling authoritarians. Not only can capital now mask itself and disappear without any trace, but gigantic sums of money are now traveling the world in a concealed manner. Little by little, this has made the Western financial system hospitable to kleptocrats.

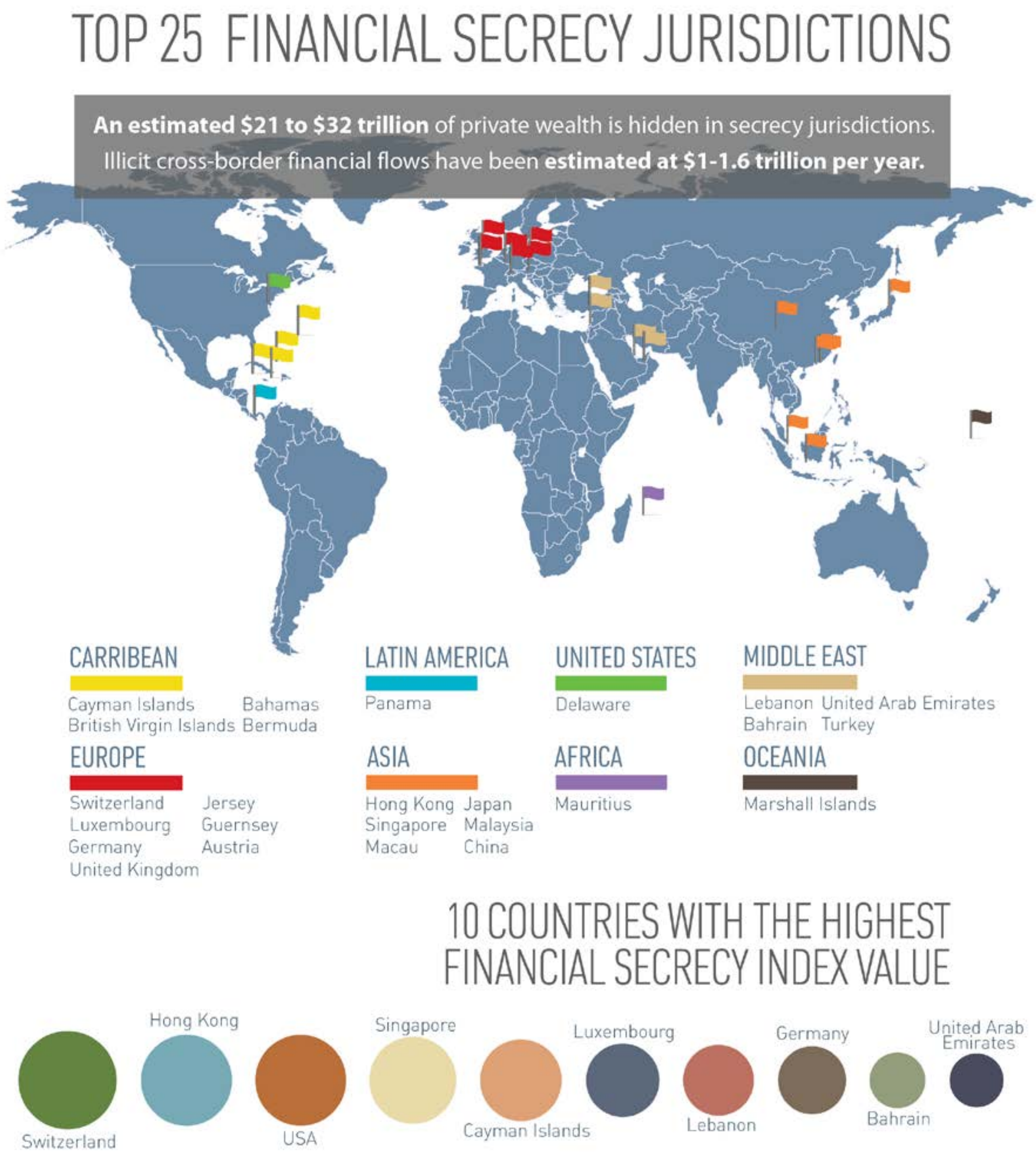
Why is anonymity so important? This is the successful criminal's dilemma. Once you are successfully stealing, your problem becomes not simply the ability to steal more, but the ability to launder these ill-gotten gains effectively. The successful criminal is accumulating dirty black cash that he cannot easily use or secure, and needs to convert it into clean white cash: this is why money laundering is so important. The easier it is to launder money, the richer, more powerful, and more influential criminals become, and the quicker it becomes for the proceeds of crime to turn into new sources of power and activity. This is why nothing is more beautiful for a corrupt dictator than the ability to anonymously and untraceably move enormous sums electronically around the world. This empowers him, both at home and abroad.

How did this become so simple? Agents working on this theme at the FBI take a long view. They believe that both technological and political changes have dovetailed. Since the 1970s the technology of moving money around has changed radically. The dismantling of capital controls and the creation of global capital markets, tied together with instantaneous money transfer and effective free movement for the mass affluent, has created an environment highly suited to kleptocracy. "Whereas in the 1970s you could only make off with a few million, in the 2010s these factors mean you can now make off with a few billion," said one FBI investigator charged with this dossier.[5]

This has coincided with political changes in Western countries that have made wealth easier both to hide and defend. Since the 1970s the complex of lawyers, bankers, lobbyists, accountants, and public relations experts (best described as the "wealth defense industry") have matured in power and skill.[6] Not only has it successfully defended its clients from taxation, it has created new legal tools for them to avoid it: for example, the ability to keep cash owned by foreign subsidiaries in U.S. banks, untaxed but controlled in all but name by the U.S. parent company.[7] At the same time, the wealth defense industry has continued to push for political change enabling an escalation of offshore tax avoidance: consider the 30 major U.S. corporations which, between 2008 and 2010, collectively paid more in lobbying fees related to promoting tax avoidance measures in Congress than they did in federal income taxes.[8]

Since the Cold War, the wealth defense industry has evolved from defending more or less solely Western clients into a global concern whose core clientele now includes Russian, Chinese, Central Asian, and Gulf autocrats. The nature of these kleptocratic elites' funds has seen a swathe of this sector evolve into a "corruption services industry," whose primary task is to launder the money of kleptocratic elites, all the while catering to their needs and promoting their interests within the West.

This is how dictators like Kazakhstani president Nursultan Nazarbayev, Azerbaijani president Ilham Aliyev, and Equatorial Guinea's president Teodoro Obiang became global authoritarians. The rise of the wealth defense industry has changed the balance in international finance between onshore and offshore; it has driven a huge growth in both the scale and ease of access to offshore finance. This has turned what was believed to be a small appendix of the financial system into a parallel system of enormous scale. As a result, offshore shares of both national and global wealth have risen steeply since the 1970s. The investigative economist James S. Henry estimates that $21 to $32 trillion was being held offshore in 2010, not including physical assets owned through anonymous companies. Henry also found that, since the 1970s, elites from 139 low-to-middle income countries collectively accumulated between $7.3 trillion and $9.3 trillion in private offshore wealth.[9] Gabriel Zucman, author of *The Hidden Wealth of Nations*, suggests that some 8 percent of American wealth is now held offshore, as is some 10 percent of European wealth.[10] The percentage of national wealth rises dramatically in the case of fragile or authoritarian states, especially ones in which finance capitalism has only recently been established. Zucman estimates that 30 percent of African wealth is held offshore, along with more than 50 percent of Russian wealth.[11]



Data from the Tax Justice Network's Financial Secrecy Index (2015)

Though unanticipated, the growth of opaque financial systems has become one of the key features of globalization: enormous amounts of money are now moving around the world covertly. Despite this proliferation, it would be wrong to consider the offshore financial system simply as a parallel, untaxed jurisdiction. This system is one in which onshore rules regarding corruption are neither largely present nor enforced. Not all funds held offshore, even from fragile states, stem from corruption. However, Transparency International has shown that nearly all cases of grand corruption pass offshore, therefore rendering access to this system a key component of the corruption services industry.[12]

The offshore boom has fueled the ease and scale of corruption to the extent that Global Financial Integrity estimates $1 trillion flows annually out of developing countries in illicit financial flows.[13] This figure is composed of hundreds of thousands of individual crimes whose proceeds have been moved out of the developing world to be secured in the Western financial system. From Russian bureaucrats extorting local businessmen, to Central Asian autocrats embezzling from national budgets, to Gulf monarchs profiteering from crooked contracts, the proceeds of these systematic acts of corruption are sequestered offshore–much of them in the West–on such a scale that they have become a central feature of globalized finance. What is empowering kleptocratic authoritarians is also empowering criminal gangs. The same system has allowed the finances of the Italian mafia, Mexican drugs cartels, and Burmese heroin producers to flourish.

This dark side of globalization has created its own financial system. Investigative journalist Tom Burgis brilliantly named this $1 trillion-per-year system of illicit wealth entering the West from developing countries "the Looting Machine," stemming from his book of the same name.[14] The key element in the Looting Machine is the anonymous or "shell" company, a company stripped to its legal essence that provides neither goods nor services. Shell companies are used to hold funds and conceal their owners' identities. Rather than be misled by the designation of "company," it is best to conceptualize these entities as something closer to secret codes. Shell companies are often mathematically generated legal formulas, a chain of interlocking companies and holding companies, created simply for the benefit of anonymity. This is, of course, exactly what a criminal or kleptocrat needs in order to avoid detection in either his own country or the West.

The World Bank has shown how frighteningly easy it is to launder money with complete anonymity.[15] Under international guidelines, incorporation agents are supposed to establish the identity of a beneficial owner. The purpose of this requirement is to prevent the ability of criminals to launder funds through the system, though in reality this flimsy stipulation has broken down in the contemporary offshore environment. A recent World Bank study found that 42 out of 102 incorporation agents surveyed failed to establish the identities of their clients.[16] This finding was further corroborated by the Global Shell Games project, an academic research project that posed as 21 aliases mimicking everything from terrorists to corrupt officials and contacted nearly 4,000 incorporation agents worldwide. This project revealed that one quarter of these agents were ready to create a shell company without any documentation, and half were ready to do so without meeting the requirements of the law.[17]

It is just as easy for this dark money to enter the West. Once established, these shell companies can freely acquire assets across the West with anonymity. Russian, Chinese, Central Asian, and Gulf ruling classes have shown a marked preference for laundering their wealth into prime real estate assets in Western capitals through these same anonymity devices. This is why the closest places to see the results of the Looting Machine are not in Africa or Central Asia but in downtown Manhattan and central London, where hundreds of "ghost apartments" now sit empty.[18] Their primary function is no longer as residences, but as deposit boxes for illicit, laundered wealth.

When a kleptocrat seeks to secure his illicitly gained and vulnerable assets, he is enabled at every step by Western bankers, lawyers, accountants, and other professionals. Recent corruption scandals have shown that major financial institutions such as HSBC,[19] Deutsche Bank,[20] UBS,[21] and BNP Paribas[22] have all participated in the Looting Machine. This has significantly altered the psychological perception and relationship between authoritarian and Western elites.

Whereas during the Cold War, the ruling classes of Russia, China, and Central Asia experienced the Western elite as diplomats, journalists, and military officials representing Western values, the ruling classes today experience the Western elite (and the Western capitals themselves) as their willing partners in baroque corruption. This personal experience of American, British, French, and German elites as bankers, lawyers, and accountants from the corruption services industry has fueled the overriding impression in Russia, China, and Central Asia that Western elites are relentlessly hypocritical and their values merely an instrumental charade.

This becomes crystal clear when one observes how the autocratic clique that rules Kazakhstan experiences the West. This country has been ruled since 1988 (before its 1991 independence from the Soviet Union) by Nursultan Nazarbayev. This Central Asian dictator frequently jails and exiles his opponents and routinely rigs elections and persecutes Kazakhstan's opposition parties. While Western embassies in his new purpose-built capital of Astana speak about anti-corruption and democratic reform, Nazarbayev and his clique interact with the West through its enablers. The ruling elite has both done business with and entertained members of Britain's royal family.[23] Nazarbayev himself has employed both the former British prime minister, Tony Blair, and the former Austrian president, Alfred Gusenbauer, to promote his influence in the West.[24] Not only does Nazarbayev own a palatial mansion on London's Bishops Avenue, known as "Billionaires' Row," but his wealth and that of his clique has been funneled out of the country by exploiting offshore networks. In the 21st century Nazarbayev is not the exception, but the norm; he is paradigmatic of the new authoritarians for whom there is no containment.

We need to reevaluate authoritarians like Nazarbayev. When the U.S. diplomat George F. Kennan sat down to anonymously write the "Sources of Soviet Conduct" in 1947, he had no need to think either about Western professionals or offshore bank accounts.[25] A U.S. diplomat today who endeavors to clarify the sources of Russian, Chinese, Central Asian, or Gulf autocrats' conduct would find extensive discussion unavoidable. Extreme wealth is as essential to understanding 21st century authoritarianism as ideology was to grasping 20th century authoritarianism; this extreme wealth is now unprecedentedly globalized.

Nazarbayev is the new normal; contemporary authoritarians are mostly kleptocrats. This means corruption is not a feature of their regimes, but rather the invariable nature of their rule. An unforeseen consequence of globalization is that it has never been easier to be a kleptocrat. Corruption is used to create power bases, cement regimes, forge political alliances, and eliminate foes. Amassing extraordinary levels of wealth, as both a tool and a pleasure of power, was considerably riskier in a world of segregated, more independent national financial systems. Corrupt bureaucrats today can steal immense fortunes and then launder them immediately into offshore funds, from which they can then easily sequester these assets in the West. Their behavior is guided by a simple logic: amassing extreme wealth is fraught with risk in a political system without the rule of power, but this risk disappears if you can steal in a system without the rule of law and sequester assets safely in the West. Rather than a bloc challenging kleptocratic behavior, the West today is experienced by such elites as a welcoming financial system and professional class that exists to abet and enable them. Once Nazarbayev has hired a former prime minister and a former president as consultants, why should he take the British and the Austrian embassies seriously when they lecture his government on anti-corruption?

The West has been slow to grasp these new global kleptocrats. For at least a decade, both Russian and Chinese analysts have characterized their ruling class as an "offshore elite." This applies equally to junior officials and rulers themselves. What Vladimir Putin and Wen Jibao have in common is not only their authoritarianism, but that both have taken advantage of offshore anonymity to amass fortunes worth billions of dollars with the aid of Western enablers.

China's role in the Looting Machine, unlike that of Russia, is little appreciated but enormous in scale. In fact, the entire economic and social relationship between China's elites and the West is being warped by the dynamics of this shadow system.
China is bleeding billions in illegally transferred funds. Every Chinese citizen can only transfer $50,000 each year outside the country, but it is estimated that around $600 billion of the money that left China in 2015 was transferred in defiance of Beijing's banking controls.[26] Today some $1 trillion dollars leaves China annually.

This means that China's authoritarian officialdom, just like Russia's ruling elite, is driving Western offshore centers. In 2014 it was estimated that 40 percent of the British Virgin Islands' offshore business comes from China and other Asian nations.[27] The Chinese Looting Machine operates the same way it does for Russia, Kazakh or Egyptian elites: Funds gained by corruption are illegally transferred into an offshore financial center (simply an electronic transfer to a notional ledger) and packaged into an anonymous company, before often being laundered into property. Chinese buyers spent more than $52 billion on foreign property in 2014, and many of these transactions–often conducted in cash–went under the radar, making real estate investment a popular choice for concealing illegally obtained money.[28]

In fact, while many are still struggling to afford homes, Chinese nationals have been buying property in the most expensive cities, including New York, Los Angeles, San Francisco, and Seattle.[29] Many of these investors are a part of the growing middle class, but companies and individuals with ties to government corruption are thrown in the mix and not easily parsed out. Jianjun Qiao, a former Chinese official, fled from the U.S. after prosecutors indicted him for purchasing his $500,000 home in Washington state with funds laundered through a grain facility in China, where he served as the director.[30] Even more high-profile real estate transactions often go unnoticed. When China Sonagol, a company with ties to Sinopec, China's state-owned oil company, purchased the JPMorgan Chase building in Manhattan for $150 million in 2008, only one news outlet reported on the multimillion dollar deal.[31] The company–whose president, Sam Pa, was arrested on corruption charges in China in 2015–let the building sit vacant for years before selling it to JTRE Holdings this year for an undisclosed amount.[32]

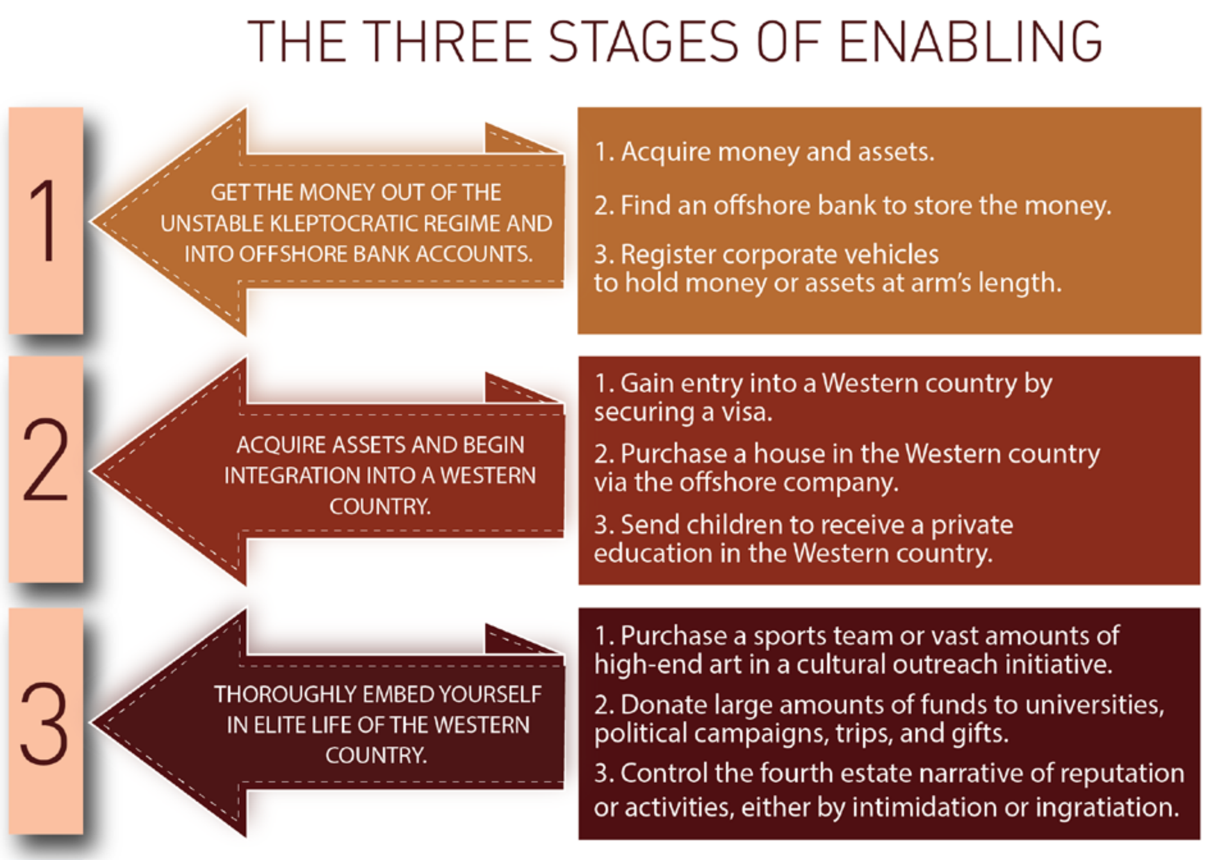
Chinese officials, just like Russian ones, find Western bankers their willing enablers. This informs the Chinese ruling class's psychological perception of Western values. The former Chinese premiere Wen Jibao saw his children build relationships with Western enablers whilst he was leading the country. The Swiss financial giant Credit Suisse helped Wen Jiabao's son create an offshore company in the British Virgin Islands while his father was leading the country,[33] whilst JPMorgan Chase & Co. was paying the consulting firm of Wen Jiabao's daughter $1.8 million annually to increase its influence in China.[34] Relationships like these with Western enablers have helped Wen Jiabao's relatives build an empire worth at least $2.7 billion, despite his modest official salary and frugal reputation.[35] It should come as little surprise that "Western values" are largely seen as hypocritical constructs used to bash China in Beijing.

Authoritarians' addiction to the Looting Machine applies not just to the great powers but also to authoritarian states of all sizes. The dozens of corruption scandals that have erupted recently from Ukraine to Egypt show just how addicted contemporary authoritarians are to moving illicit funds offshore. The scale of the political elites' involvement in this was laid starkly clear in the Panama Papers, a leak revealing many of the customers of law firm Mossack Fonseca. These very partial revelations implicated 140 politicians from 50 countries as exploiters of offshore finance, many as a means to sequester illicit funds.[36]

A look at the clients listed at some of London or New York's most successful banking, legal, and public relations firms makes it clear that globalization has profoundly changed what it means to be an authoritarian. Whereas Kennan's "The Sources of Soviet Conduct" identified a Kremlin ruling class both constrained and contained within its political borders, their behavior shaped by communist ideology and Russian circumstances, a U.S. diplomat in Moscow today faces changed actors and a new system. Russian elites today typically hold not only multiple bank accounts offshore, usually in Western jurisdictions, but also extensive assets—overwhelmingly, but not exclusively, property–in the West. They work closely with the Western wealth defense industry to further their personal aims. Russian elites' families are equally transnational, with most holding foreign residency or citizenship and using Western institutions to educate their children or secure

Western cities to house their families. Much the same can be said for the Chinese ruling class.

Authoritarian conduct is now shaped by the ease and ability to move both their money and their persons easily offshore and into the Western world. The modus operandi of the contemporary authoritarian is kleptocratic: steal in a zone without the rule of law, and then secure it in a state with the rule of law. This changes the psychology of contemporary authoritarians. They have much less to lose if they lose power, so they can rule more avariciously and engage in much less state building when in office. This mechanism has been clear to Western bankers, lawyers, accountants, and public relations specialists for over a decade. The White House, still with one foot in the Kennan paradigm, has been slower to catch on.



The Kleptocrats' Curse

Plenty of U.S. officials are entitled to feel exasperated. They would be right to point out that since the end of the Cold War, the U.S. has been active on anti-corruption, even making anti-corruption a central focus of the World Bank, IMF, and G-20. Successive secretaries of state, officials might add, have flagged anti-corruption as a priority.[37] But there is a paradox in America's campaign: as the U.S. has led a global campaign against corruption onshore, it has expanded offshore. As the U.S. pushed anti-bribery and transparency onshore, it allowed offshore to flourish. This produced an unexpected result. America was pushing states to reform themselves, making it more difficult for petty officials to be corrupt, while simultaneously doing very little to reform the very mechanisms that allowed ruling classes to function and flourish as kleptocrats.

This is what American strategic thinking has failed to appreciate. The 2015 U.S. National Security Strategy spells it out clearly. The Strategy highlights that globalization has made it easier for corrupt officials to sequester their assets abroad. Corruption is mentioned more than North Korea and identified as an ill arresting international development, aiding terrorist networks, and challenging the integrity of the global financial system.[38] However, the Strategy fails to join the dots and identify the unfortunate role that both Western professionals and financial institutions play. By situating corruption as a problem "over there," it fails to correctly identify the phenomenon; like all transnational problems it is also present and can only be fully tackled by efforts "over here."

As a result, the 31 pages of the U.S. National Security Strategy possess an oft-overlooked gap. The report covers the entire world, including the threats posed by Russia and China, terrorism, and fragile states, but is in denial about a crucial process that undermines ambitions for democracy: kleptocracy enabled by offshore and anonymous companies. This means that these 31 pages ignore the number one mechanism that empowers authoritarians at home and in Western capitals themselves.

In 1991, Russia's first post-Soviet Prime Minister Yegor Gaidar approached the CIA to ask them to help retrieve billions stolen from the country by KGB agents during the Soviet collapse. The response he received from the CIA, acting on instructions from the White House, was that the agency could locate the money but "capital flight is capital flight."[39] This attitude has seriously undermined American foreign policy. It should not be misunderstood as unfortunate and harmless theft. In the developing world corruption is a major killer, taking multitudinous forms, from stolen healthcare and infrastructure budgets, and turning them into deadly personal extortion. One estimate from the anti-poverty group One blames corruption for 3.6 million deaths per year.[40] This is because corruption is spectacularly connected to state failure, and modern offshore financial mechanisms allow ruling elites to pillage with impunity and invest securely in the West; the ease of this process has encouraged the plundering of national budgets, which has crippled development in the world's poorest societies, weakened fragile states, stymied democracy, and fostered violent extremism with choked life chances. A poignant counterfactual for foreign policy practitioners to ask themselves is, "how different would Russia look today if the CIA had blocked illicit capital flight?"

Just as kleptocracy has deformed Russian's transition, it has also deformed China's landscape. In 2007, it was estimated that corruption in the Chinese government cost at least 3 percent of GDP, or up to $86 billion per year.[41] Besides monetary losses, however, corruption has been documented as the root cause behind thousands of deaths in China. This is because it has led to dangerous work places, industrial explosions, toxic fallouts, devastating floods, pollution and ecological damage. Western enablers are enabling Chinese corruption patterns of criminal negligence.

What U.S. diplomats know personally from operating within these corrupt states has failed to be transformed into action by the State Department, Congress, or the White House. Almost all the major crises identified in the U.S. National Security Strategy have been worsened by corruption and anonymous companies. This is evident in the Greater Middle East where the U.S. is struggling with the civil wars and authoritarianism unleashed by the Arab Spring. Every country thrown into chaos and civil war since these social uprising began was ruled by elites violently detested for their use of corruption and illicit financial schemes to cement and strengthen their power. Characteristic of a view shared by U.S. diplomats in the region is what the *New York Times* correspondent and chronicler Robert F. Worth called "a rage for order" by a generation seeking the well-run environment that wealth sucked out of their countries could have built.[42] This is why the baroque scale of corruption practiced by Egyptian, Libyan, and Syrian ruling elites was a rallying cry for this revolution. The wealth of the family of the former Libyan dictator, Muammar Qadaffi, was estimated in 2011 to total $200 billion; [43] the wealth of the family of Egyptian dictator Hosni Mubarak was estimated at $700 billion;[44] the wealth of the family of the Syrian dictator Bashar al-Assad was estimated at $1.5 billion.[45] Further, all three families were exposed in the Panama Papers as extensive users of offshore accounts.

U.S. diplomats in Central and South America perceive the same dynamic when dealing with the ubiquitous narcotics trade. The U.S. "War On Drugs" is undermined daily by offshore networks. Since 2000, the U.S. military has conducted an extensive operation in Colombia attempting to stamp out the narco-trade and narco-terrorism. However, as this $20 billion intervention was staged, the Western financial system continued to operate as the enablers of these groups the American intervention sought to undermine. For U.S. diplomats in the region, a 2012 investigation by two Colombian economists Alejandro Gaviria and Daniel Mejía of the Universidad de los Andes makes for painful reading. Their study revealed that 97.4 percent of drug trafficking profits in Colombia are laundered through European and American banks and their affiliates.[46] For these cartels, as for any criminal, their power is directly proportional to the ease with which they can launder assets to fund new activities.

Likewise, American diplomats in Africa daily see their work furthering development constantly undermined. Any study of the continent's encyclopedia of corruption scandals, from Equatorial Guinea to Ethiopia, highlights elites' addiction to money laundering schemes and mechanisms. Western diplomats stationed in the continent are quick to point out this makes a mockery of the central plank of Western engagement with Africa: aid. Every year the continent receives some $30 billion in Western development aid, but research by a coalition of Western and African NGOs suggests every year over $35 billion leaves the region via illicit financial outflows.[47] The discrepancy between Western aid and Western enablers' collusion in corruption is widely known on the continent, where it has started to undermine American and European soft power. For example, at a 2016 anti-corruption conference hosted in London, the Nigerian President Muhammadu Buhari was able to turn a comment by then-Prime Minister David Cameron that his country was "fantastically corrupt" into a domestic publicity coup. "I am not demanding an apology," replied Buhari. "What I am demanding is the return of assets."[48] London's reputation as Nigeria's number one money launderer wholly undermined the authority the British prime minister's ability to criticize a deeply corrupt and failing government.

It is worth taking a step back and seeing where this sits in the sweep of political history. Clearly, without the necessary system these elites would not have been able to rob their societies so extensively. Perhaps, without the impunity offered by this Western system, they might have behaved less like kleptocrats and more like the 19th century ruling elites did in Britain, France, and the U.S., who had nowhere to keep their money but within their own borders. What this globalized financial system appears to have done is undermine a crucial process in democratic state building as seen in Western countries where elites, out of fear of losing their assets, attempted to win over more and more segments of the population by opening up society. Whereas the 19th century elites who extended the franchise in Britain, France, and America feared the fates of Louis XIV and the Bourbon dynasty, the rulers of authoritarian states today fear the fate of following their assets out of the country to a luxury penthouse in London and a bank account in the British Virgin Islands.

We see the kleptocrats' curse most clearly in Ukraine. The kleptocratic system was a precipitating factor in the most significant interstate war in Europe since 1945 and the starkest post-Cold War confrontation between Russia and the West. While Western diplomacy in Ukraine has, since 1991, sought to create a prosperous and independent democracy underwritten by the rule of law, Western enablers have in parallel been aiding and abetting a kleptocratic elite. Global Financial Integrity estimates that between 2004 and 2013 Ukraine lost over $116 billion in illicit financial flows.[49] Ukrainian GDP in 2013 was estimated at just over $181 billion.[50]

Because of the interference of these Western enablers, Ukraine not only never built a functioning market economy, but it also never built a functioning state. As a result, the anticipated wins of leaving the Soviet Union–a middle class and stable democracy–did not emerge. As Western diplomats struggled to impress on Ukrainian politicians the importance of the rule of law and responsible government, Western bankers, lawyers, accountants, real estate agents, and public relations consultants were laundering and sequestering illicitly extracted Ukrainian wealth in the West.

The 2014 "Maidan" Revolution was another "rage for order" like the Arab revolts. The Euro-Maidan protesters revolted against corruption and advocated for the modern state it denied them. Ukraine's state prosecutor, Oleh Makhnitsky, estimated the loss to Ukraine under Viktor Yanukovych's rule as "up to $100 billion."[51] Since the latter's fall and flight to Russia, dozens of corruption cases have exposed how his ruling clique pillaged Ukraine, funneling funds into Western countries like Austria, Cyprus, Latvia, and the UK. On the ground, Western diplomats are at pains to put an exact number on what Western enablers may have gained; Western diplomacy has had to pay the price. Kiev's implosion into violence, revolution, and the subsequent Russian invasion led the U.S. and the EU to support a Ukraine on the verge of state collapse, both diplomatically and financially. Despite decades of diplomatic efforts to encourage Ukrainian state building and democracy, the U.S. and the EU were forced to engage in a rearguard action to a stop a crippled state from collapsing completely.

Western diplomats on the ground perceive that not only has Western foreign policy in Kiev succumbed to the kleptocrats' curse, the Looting Machine is now also undermining Western soft power. Since Maidan there has been a growing trend among Ukrainian activists and politicians of pointing the finger towards the West as operating a system both hypocritical and harmful to Ukraine. This is how Mustafa Nayyem, the activist and journalist, whose call to protest triggered the Euro-Maidan uprising has come, exasperated, to view the Western elites operating the Looting Machine:

> Why do they only now investigate the hidden fortunes that were stolen and hidden in Austria and Switzerland? We told the Europeans and we told the embassies a hundred times this money was stolen and hidden in their countries. And nothing happened. Now that regime has fallen, they suddenly–in a matter of days–can reveal the stolen money. But why did they not do this before? They are guilty–guilty of leaving us alone with these thieves. They are guilty of allowing them to plunder us.[52]

This view of the West as hypocritical has come to be widely held by Ukrainian ministers, deputies, activists, and normal folk since the uprising. In Eastern Europe it is clear to see how money laundering is sinking Western soft power. This in turn fuels Russian propaganda, which claims that a deceitful West is indistinguishable from Russia–and just as corrupt. The former KGB agent and Russian oligarch Alexander Lebedev summed up the fallout of the Panama Papers, chiming exactly with Kremlin propaganda:

> What is most troubling about sensationally (and wrongly) placing Putin at the heart of a corrupt web is that we lose sight of the main issue these wonderful leaks expose so well: that the money-laundering and theft that is now so rife in countries such as Russia, China and Nigeria is only made possible by a huge machine operated by highly paid bankers, lawyers and accountants from the West. Officials and businessmen in developing countries may be bleeding their countries dry but it is the West that is teaching them how.[53]

Across the world, kleptocracy forces the White House, the State Department, and the U.S. military into the role of firemen struggling to put out the fires their fellow citizens have sold the kindling for. It would be a mistake, however, to believe the kleptocrats' curse ends at the border. This enormous flow of dark money is now also undermining Western institutions.

The London Laundromat

To understand what has happened to the world economy we need to answer this question: What is the most corrupt city in the world? Is it Moscow? Mexico City? Or perhaps Kabul? The answer may surprise you. Speaking in the British parliament, the leading authority on organized crime, Roberto Saviano, is adamant that London is the most corrupt city in the world. “It’s not UK bureaucracy, police, or politics, but what is corrupt is the finance capital. Ninety percent of the owners of capital in London have their headquarters offshore. Jersey and the Caymans are the access gates to criminal capital in Europe and the UK is the country that allows it.”[54]

London is not just a city; London is also a financial system. The City of London offers not only the world’s most sophisticated financial services, it also sits at the heart of a network of offshore jurisdictions under British sovereignty whose names are synonymous with offshore finance: such as the Cayman Islands, Jersey, and the British Virgin Islands. Electronic funds only notionally in these jurisdictions are then pushed towards London. More importantly, their operators–bankers, lawyers, and accountants–are in the British capital. In the Tax Justice Network’s Financial Secrecy Index, which ranks countries according to secrecy levels and their scale of offshore financial activities, Switzerland comes first. However, the report explains: “Overall the City of London and these offshore satellites constitute by far the most important part of the global offshore world of secrecy jurisdictions. Had we lumped them together, the British network would be at the top of the list, above Switzerland.”[55]

Two powerful trends meet in London: the rise of the offshore financial system and the rise of globalized authoritarians. In the London financial system, which extends from the small offices in the Cayman Islands where billions are nominally stored to the skyscrapers of Canary Wharf, legal and illegal practices blur. British authorities estimate that more than £100 billion is laundered in the United Kingdom every year, and the Financial Services Authority, before its dissolution, estimated that money laundering accounted for 3.6 percent of British GDP.[56] London has become an offshore city. Real estate serves as the primary asset through which offshore companies launder dirty money in London. As a result, anonymous offshore companies now own more than 37,000 properties in the capital–over 2.25 square miles. This breaks down into nearly 10 percent of all properties in Westminster, 7.3 percent in Kensington and Chelsea, and 4.5 percent in the City of London.[57] Britain’s National Crime Agency believes that this has permitted “hundreds of billions” to be laundered in the capital’s property market each year.[58] (Analysis from the Land Registry shows that 75 percent of properties whose owners were under investigation for corruption used offshore secrecy tools.)[59] Across Britain, ownership in the most expensive areas is slipping offshore. Companies in the British Virgin Islands now own more of Britain than the entire land area of the British Virgin Islands themselves.[60]

The basic premise of globalization is that is creates interdependence, and that as two states globalize with each other they are both changed by the process. To cut through the language of political science we might update an old proverb: Be careful whom you globalize with. London has globalized hugely with Moscow which has led to significant unintended consequences. Russia today is undoubtedly a kleptocracy, where corruption is both a tool and a privilege of power. Vladimir Putin has turned his closest associates into a ruling oligarchy. If one adds up the assets of Putin's partners in his 1990s St. Petersburg dacha collective, friends and a few former KGB agents he served with, the sum is over $180 billion.[61] This is an elite bound together by ties to criminality and money laundering. The European Police Office has estimated that 20 percent of members of the Russian parliament, 40 percent of decision makers in private enterprise, 50 percent of bank directors, and 60 percent of directors and managers of state owned companies had criminal ties.[62] These are the elites who are today some of the most important clients of London's financial system.

The rise of this new London has turned the British foreign office's expectations about globalization topsy-turvy. Until the 2010s, both the Russian Embassy in London and the British Embassy in Moscow agreed: London was coming to Moscow. Both of the embassies believed that globalization was empowering London's allies in Moscow: the emerging middle class, online dissidents, NGOs, and democratic movements. Today however, they believe that globalization is in fact empowering Moscow's allies in London.

Moscow's allies in London are the Russian superrich, a mixture of politically exposed officials and oligarchs, who, supported by the British wealth defense industry, have turned their fortunes into considerable influence. The Russian superrich find direct influence by acquiring media outlets, funding politicians, employing lobbyists, and forging close business ties with members of the House of Commons, the House of Lords, the royal family, and others in the political establishment. The Russian superrich find indirect influence as the owners of football clubs and other institutions with social cachet, as the employers of the wealth defense industry, and as prime customers of elite legal, financial, educational, and other services whose practitioners are politically influential. They are also leading patrons of the "valet class" of elite professions such as real estate agents, art collectors, and speech-writers with social influence. Kleptocrats from Azerbaijan, Kazakhstan, Qatar, or China operate the same way.

Contrary to the expectations of the Russian Embassy in London and the British Embassy in Moscow in the early 2000s, the influence of the Russian elite in Britain is now far greater than it was at any point in the Cold War. Russia's financial power is buttressed by its traditional hard power in the British capital. According to British intelligence, Moscow has more spies deployed in London than even at the height of the Cold War.[63] Meanwhile, Britain's allies in Russia find themselves weakened, discredited, and encircled. Pressure from the emerging middle classes for political representation has effectively been silenced, Twitter-dissidents are caged in with surveillance and trolling, NGOs are been discredited as "foreign agents" and crippled with legislation, and democratic movements are demonized, intimidated, legally hamstrung, and *de facto* barred from participating in politics. British influence in Moscow is now at a historic low.

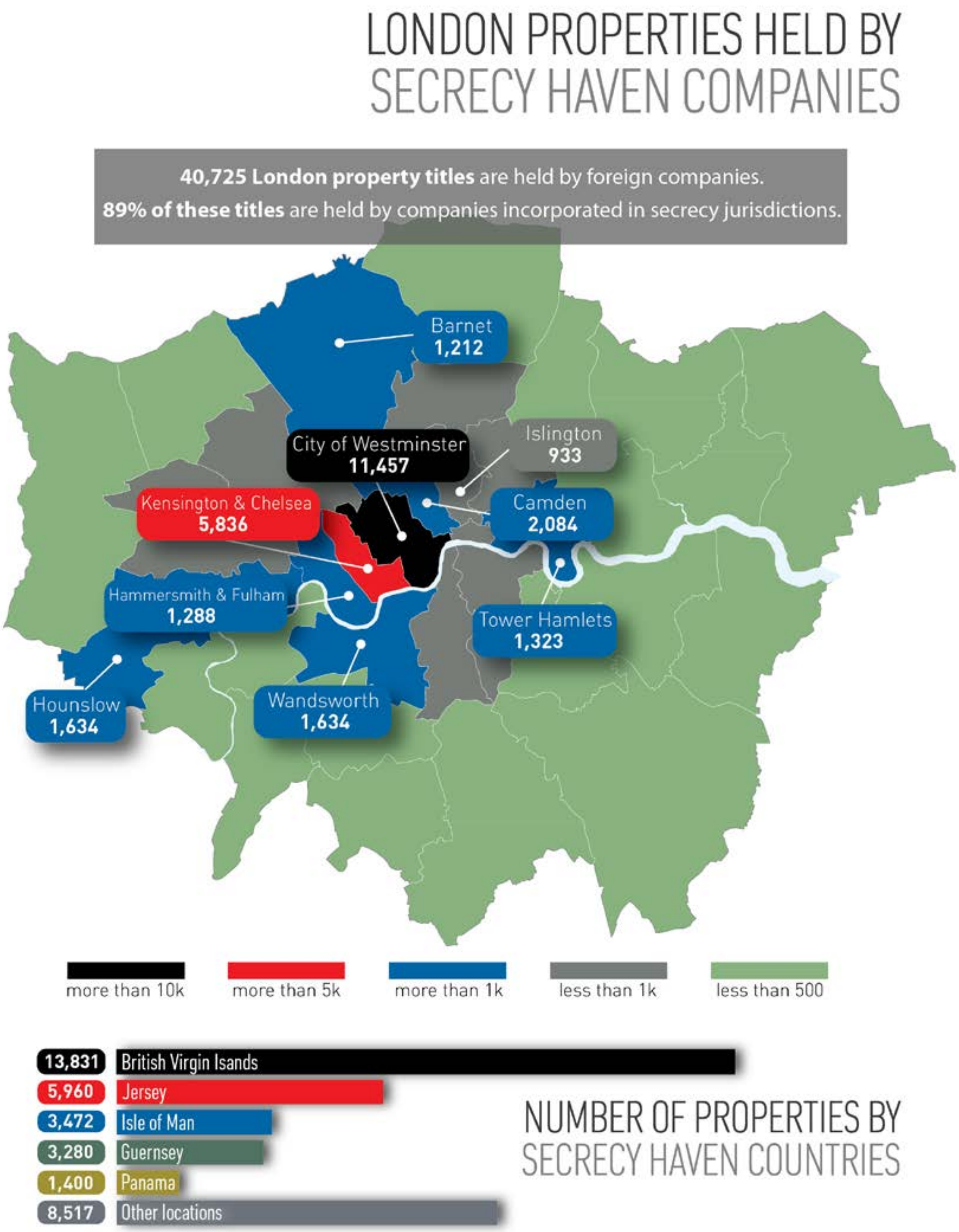
London has failed to come to Moscow in the way Moscow has come to London because globalization did not "socialize" Russian elites in the way it was expected to. Until the early 2010s, Western thinkers and diplomats believed that exposure, trade, and the education of foreign elites would align them with Western norms. Russian elites establishing themselves and their families in London was therefore naively welcomed as a harbinger of their inevitable transformation into agents of Western values. This optimism, bordering on hubris, in the transformative power of Western residence, exposure, and education has subsequently been proved wanting. Rather than try to operate Western rules in a lawless jurisdiction, they continued to operate lawlessly in Western jurisdictions despite their new degrees, mansions, and aides.

Instead of making Moscow elites more amenable to British foreign policy, globalization has instead made London elites more amenable to Russian foreign policy. During the 2014 Ukraine crisis, one of the reasons that the British government held back from imposing sanctions on London-based oligarchs and officials was that they feared this could be legally challenged and overturned in British courts. Secret documents showed that British officials were briefing the Prime Minister not to "support, for now, trade sanctions ... or close London's financial centre to Russians."[64]

The London financial system has become not just a capital of Russian money laundering, but the capital of global money laundering: Central Asian despots,[65] the Italian mafia,[66] corrupt Chinese officials,[67] and Central American cartels[68] are all using the London Laundromat. Russia is better known but China is fast emerging as the lead London buyer. Real estate acquisitions in London accounted for 52 percent of total Chinese commercial real estate investment flows to Europe in 2014.[69] China's most powerful families are purchasing iconic sites in the city of London. In 2013, Ping An Insurance purchased Lloyd's Building in London (the original site of the colonial East India Company) for $387 million,[70] and the Dalian Wanda Group is moving forward with plans to develop a five-star hotel and apartment complex next to the River Thames.[71] The Ping An Insurance Group has been tied to Wen Jiabao's family,[72] and the chairman of Dalian Wanda, the son of a Red Army hero, has ties to relatives of some of China's most powerful politicians and their business associates.[73]

Britain's elite refuses to accept there are consequences to this wealth. Meanwhile, as these ultra-powerful Chinese companies have been snatching up real estate in London, the average price of a London home has almost doubled since 2009.[74] Britain's elite needs to wake up to the consequences of this wealth. Not only their tax base and professional revenue, but role in the world is increasingly built on financial services. They do not own the London financial system but are owned by it. The more that this system feeds off corruption, the more vulnerable it makes the country. The National Crime Agency has warned that the scale of money laundering in London constitutes "a strategic threat to the UK's economy and reputation."[75] Roberto Saviano goes beyond this warning in the British parliament:

> There aren't dead bodies on the streets, or shootings but the UK cannot pretend nothing is happening. It has the data; it has the results of research; it has received warnings signals from authorities are experts. Now is the moment to take action, to do something before criminal money buys up the world of the UK. London is in danger of being eaten up by dirty money.[76]



Data from "Corruption on Your Doorstep: How Corrupt Capital is Used to Buy Property in the UK," Transparency International UK, February 2015, p.12.

Kleptocratic Takeover

London may be at risk of falling under kleptocratic influence, but other Western institutions have already succumbed. Globalization was expected to open up autocratic institutions to the probing lights of Western diplomats, Twitter-activists, and NGOs. Instead, globalization has seen Western democratic institutions capitulate far more easily to authoritarians' transnational lobbyists, revolving doors, and outright corruption. This is not by accident. Autocrats have skillfully developed a new globalization strategy which penetrates, undermines, and in the worst case captures Western democratic institutions in partnership with enablers, both politicians and professionals.

The most extreme and successful case of kleptocratic takeover to date was undertaken by Azerbaijani president Ilham Aliyev, the head of a dictatorship that has ruled the country since 2003. In 1950, the Council of Europe and its Parliamentary Assembly were founded to guard both the European Convention on Human Rights and the European Court of Human Rights. Winston Churchill viewed these institutions as critical for post-war democratization. Until the end of the Cold War, only established democracies were allowed to join. Azerbaijan, then–as now–an autocratic kleptocracy, was admitted to the Council of Europe in 2000 in the hope that membership could transform its political culture.[77]

Instead, it has transformed the Council of Europe in its very image. A kleptocratic takeover has not paralyzed the Council's ability to criticize Azerbaijan but manipulated this venerable institutions' official bodies into denying the existence of political prisoners, systematic ballot fraud, and entrenched autocracy in the country. Baku, rather than suffer criticism from the Council of Europe, chaired the institution in 2014, and hosted the president of the European Court of Human Rights and a series of international conferences including one on the application of the European Charter on Human Rights. Many members of the Parliamentary Assembly, lawmakers in their own country, have been won over to Baku's view that there are no human rights issues there worth examining.

How has Azerbaijan achieved such a whitewash? Since the mid-2000s the Azeri dictatorship has been systematically lobbying, gifting, and bribing members of the Parliamentary Assembly of the Council of Europe (PACE). The kleptocratic takeover of the Council of Europe was brought to public attention almost singlehandedly in the 2013 report "Caviar Diplomacy" by the Austrian researcher Gerald Knaus, director of the European Stability Initiative, a think-tank. One senior official boasted to Knaus in Baku:

> During visits to Baku many things are given as well. Many deputies are regularly invited to Azerbaijan and generously paid. In a normal year, at least 30 to 40 would be invited, some of them repeatedly. People are invited to conferences, events, sometimes for summer vacations. These are real vacations and sometimes there are many expensive gifts. Gifts are mostly expensive silk carpets, gold and silver items, drinks, caviar and money.[78]

Who has been won over by such caviar diplomacy? Knaus documents how European lawmakers as diverse as British Liberal Democrats, Greek leftists, Polish ex-Communists, German Social Democrats, and Spanish social conservatives willingly made themselves the mouthpieces of Baku. Since retiring, German lawmakers from both the left-wing Social Democrats and the right-wing Christian Social Union have gone on to work as official lobbyists for Azerbaijan.[79] Germany's "revolving door" is building up Baku's power in Berlin.

Knaus highlights that such extensive courting came to a head in 2009 when the non-compromised German Social Democrat, Christoph Straesser, saw his resolution on political prisoners in Azerbaijan voted down. This marked the end of a long campaign by Straesser to actually make the Council of Europe do its job and to hold Azerbaijan accountable for its human rights failures. As official rapporteur, he had been blocked from visiting Azerbaijan, a move unprecedented in the history of the Council, and subject to a smear campaign by Azeri officials and lobbyists many of his fellow lawmakers chose to bandwagon with. "The Council of Europe belongs to Azerbaijan," said Samad Seyidov, the head of the Azeri delegation to PACE.[80]

Europe has never had more human rights treaties, employed more human rights professionals, awarded more human rights prizes, or been home to more human rights organizations at any point in its history. Despite this, Gerald Knaus has identified how Azerbaijan tactically paralyzed the Council of Europe through its Parliamentary Assembly. Azerbaijan thereby evaded sanctions from both the European Charter of Human Rights and the European Court of Human Rights it guards, instead attempting "to neutralize the core strategy of the human rights movement: 'naming and shaming.'"[81]

This "caviar diplomacy" with Parliamentary Assembly members means the Council of Europe now finds itself unable to label Azeri human rights for what they are. This collaboration both permits Azerbaijan to claim it has "no political prisoners" and to rebrand them as "hooligans" in official documents.[82] No wonder that by May 2015 Azerbaijan's president Aliyev declared that international treaties are "only a piece of paper that aren't worth anything.... We see it and everybody else can see it too. We see this throughout the world–might is right."[83]

What happened to the Council of Europe could one day happen to Britain's House of Lords, leading French political parties, or committees of the European Parliament. But why are Western institutions proving so vulnerable to kleptocratic advances? The answer is that these institutions are not firewalled for globalization. This is because these are historic institutions first erected in their modern forms when only the West was a major exporter of capital. They were not designed for a reality where capital is mobile and funds linked to a hostile power can taken many forms. Attempts to firewall these institutions during the Cold War were successful, but laws and spy agencies designed to trap KGB spies do not stop mercurial kleptocratic cash. Azerbaijan's kleptocratic takeover of the Council of Europe is a warning of what could happen to other unguarded Western institutions should the influence and acceptance of kleptocrats as players inside Western political systems continue.

Containment for Kleptocrats

The U.S. is not that different from the UK. There is an all-American "Looting Machine." The jurisdiction of Delaware operates as an international tax haven. The banks of Wall Street have operated in just the same manner as the banks of the City of London; American bankers, accountants, and lawyers are also operating as enablers. Extensive luxury American property has also been used to launder money and big banks exposed to laundering include Bank of America,[84] Wells Fargo,[85] and Standard Chartered.[86] Kleptocrats from Kazakhstan, Nigeria, Thailand, Uzbekistan, Ukraine, and Equatorial Guinea have been exposed as sequestering assets inside the U.S. Meanwhile many others including from Russia, China, and the Gulf continue to do so with impunity.

The next administration needs to choose between two policy options. Currently, both a positive and a negative trend are at work in the U.S., and which of them is stronger will be determined by political choices. As it stands, the U.S. is simultaneously becoming an activist, seizing assets of international kleptocrats laundering their wealth inside the country (especially in property), and evolving into one of the world's largest tax havens. The Boston Consulting Group estimates that there is $800 billion of offshore wealth housed in the U.S., nearly half of which comes from Latin America; this is growing at 6 percent per year.[87]

The U.S. has its own Cayman and British Virgin Islands, and individual states are booming. South Dakota is emerging as a major destination for trusts: assets held in South Dakota's trusts have grown from $32.8 billion in 2006 to more than $226 billion in 2014, while the number of trust companies has jumped from 20 in 2006 to 86 in 2016.[88] Nevada and Wyoming are joining Delaware as large-scale tax havens. This boom in offshore in America is partially driven by the U.S. lagging behind on mild international reforms in reporting standards. The U.S. has long encouraged foreigners to place their money in the country by exempting them from taxes and reporting, which has in turn transformed this into a competitive advantage by not implementing new OECD standards–along with the Bahamas, Nauru, and Bahrain. The U.S. has also made it easier to launder money in property in the country by exempting the real estate sector from reporting requirements of the USA Patriot Act. The rise of ghost properties has facilitated the rise of "ghost apartments," which have mushroomed across the most expensive districts of New York, Miami, and Los Angeles. Many experts now think the U.S. may already effectively have replaced Switzerland (but not the greater London system) as the world's largest tax haven.

However, there is also a positive direction of travel. The Department of Justice is now moving to seize assets that have traveled into the U.S. through opaque and antiquated financial systems. The Department of Justice has managed to freeze $2.8 billion in 28 cases and returned $145 million to the intended recipients of these funds.[89] In January 2016, the U.S. launched measures to block grey funds landing in Miami-Dade county and Manhattan, requiring all real estate deals over $1 million in Miami and $3 million in Manhattan to report their owners and waive offshore anonymity.[90] The program has since been expanded to other key counties in New York, Texas, California, and Florida.[91] Meanwhile overseas, the U.S. sanctions program targeting the assets and travel rights of the Russian political and military elite and its henchmen in Ukraine has turned their activities as globalized kleptocrats into a source of leverage. The simple step of blocking access to their Western-based assets is being used as foreign policy punishment and deterrence. However, these measures do not come anywhere near close to ameliorating larger systemic problems of corruption, looting, and the protection of illicit funds in offshore entities.

What can the U.S. do about this? Unlike the UK, the U.S. can overhaul the system. The same way that George F. Kennan developed a policy of containment for the Soviet Union to stop authoritarian communism spreading, it is urgently in the interest of the U.S. today to develop containment for kleptocrats. Kleptocratic containment will be about disarming authoritarian elites, reasserting Western law, reaffirming Western values, firewalling Western institutions, and closing down Western hypocrisy. The Looting Machine is doing more damage to the West than its enemies, undermining democracy and development worldwide, and empowering authoritarians both in their countries and in Western capitals. This is why kleptocratic containment is so important. It is about reasserting control over globalization. This can be done with two simple objectives: committing the U.S. to ending anonymity in global finance and enforcing strict U.S. anti-money laundering laws against Western enablers. Developing both the right legislation and the right enforcement mechanisms to achieve these clear goals must be one of the next administration's highest priorities–if it is serious about standing for democracy.

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