

Ron Paul

**Opening Statement of Rep. Ron Paul
Hearings on Russian Money Laundering
House Committee on Banking and Financial Services
September 22, 1999**

Chairman Leach, ranking member LaFalce, thank you for holding a hearing so quickly in response to the reports of scandal regarding the Bank of New York and allegations of laundering of International Monetary Fund payments to Russia.

An examination of the objective facts illustrates clearly that our current approach regarding money laundering has failed. It also questions the wisdom of more unfunded government reporting requirements--and attacks on consumer privacy such as the Know Your Customer proposal (still required under the Federal Reserve's compliance manual of the Bank Secrecy Act despite overwhelming public opposition).

Overwhelmed with millions of bank forms required to detect money laundering, U.S. law enforcement officials did not act for months on British leads (initiated by a kidnapping charge) of money laundering at the Bank of New York. The bank did not file any Suspicious Activity Reports on the questionable accounts until after they were notified that the accounts were under law enforcement investigation.

Given that the IMF claims not to know what happened to the money and admits that the Russian central bank lied to them, we should not allow the IMF to hide behind the shallow defense that there is no evidence of wrongdoing. When using taxpayer funds, we must demand a higher standard: IMF, World Bank and U.S. Treasury officials should provide evidence that no public funds were siphoned off and that no officials profited from the conversion of the high-yield Russian GKO bonds into dollars just days before the default or from other public funds.

When Allan Meltzer, head of the congressional commission on the IMF, asked recently whether the use of IMF funds could be traced, Joint Economic Committee staffer Chris Frenze replied that someone "would have to be rather an incompetent criminal to conduct their affairs in such a way that it could be traced." We cannot justify taxpayer money going to an organization with such a lack of accountability.

In the (Russian) *St. Petersburg Times* ("Skuratov Says IMF Billions Sold on the Sly," September 17, 1999), Russian Prosecutor General Yury Skuratov charged in an interview that the IMF money funded profitable insider trading. He quoted from a memo President Yelstin refused to accept, "An analysis of the Central Bank's use of the account where the IMF stabilization loan was deposited showed that \$4.4 billion was sold from that account between July 23, 1998 and August 17, 1998. Of that money, \$3.9 billion was sold directly to Russian and foreign banks, bypassing the trading session at the Moscow Interbank Currency Exchange." He claimed only \$571 million went to support the ruble.

I am concerned that Treasury Secretary Larry Summers cites Anders Åslund, senior associate at the Carnegie Endowment for International Peace, given his controversial views on the benefits of encouraging bribery! He clearly states in his article "Russia's Collapse" in the current issue of *Foreign Affairs*, "As Andrei Shleifer of Harvard and Robert W. Vishny of the University of Chicago have observed, **the best way of fighting corruption is encouraging competition in bribery** [emphasis added]. August's financial crisis was a logical outcome of the oligarchs' war, as they tried to maintain their high and dubious incomes by any means. In the end, the Russian state could no longer deliver enough cash to satisfy their ravenous appetites. The crash radically reduced the amount of money that could be made on the state--and thus the power of the corrupt businessmen."

George Washington University professor Janine Wedel has warned about the appearance of corruption surrounding Andrei Shleifer heading the Harvard Institute for International Development ("The Harvard Boys Do Russia," *the Nation*, June 1, 1998) and the effects of collusion in her book Collision and Collusion: The Strange Case of Western Aid to Eastern Europe 1989-1998. It seems the best course for avoiding any perception problems would be more transparency of the activities of U.S. officials.

Our IMF/Treasury policies are not only a waste of taxpayer dollars, they are often counterproductive. "German officials both in and out of office are infuriated by the manner in which the U.S. Treasury rewrites history to paper over its own colossal blunders mainly to service financial interests on Wall Street," writes Klaus C. Engelen, "American Arrogance" in the current issue of *The International Economy*. He quotes Jürgen Stark, deputy to the Bundesbank president, as confronting IMF Managing Director Michel Camdessus, "I do not concur with the argument that exceptionally high IMF financing is justified in financial crisis situations with systemic or contagion risks...Starting with the Mexican crisis in 1994/95, [IMF financing policy] might have contributed to moral hazard and encouraged reckless financial behavior, both by the private sector and by governments."

Economists Kurt Schuler and George A. Selgin ("Replacing Potemkin Capitalism: Russia's Need for a Free-Market Financial System, *Cato Institute Policy Analysis No. 348*, June 7, 1999) point out, "Approaches that do not eliminate Russia's socialist monetary institutions are unlikely to put the monetary system on a sound basis for the long term" and explain that the Russian central bank, one of the world's oldest, directs credit to particular favored firms through the banking system and that past loans to the government served as a drug helping to maintain an unhealthy system. We need to stop funding socialist institutions impeding economic growth and not "encourage competition in bribery."

I agree with the Investor's Business Daily editorial on September 1, 1999, "Get Rid Of The IMF." when they said, "The only way to stop [the IMF] from sucking up scarce resources to waste on favored nations is to end it. Some in Washington advocate reforming the IMF. But it's useless to reform an outfit with such a poor record. Abolish it now." Passage of HR 1147, the Bretton Woods Sunset act is important and urgently needed as the best way to prevent more corruption.

EDITORIALS

Get Rid Of The IMF

Word that cash from the International Monetary Fund's bailout might be part of the Russian money-laundering scheme has put fund officials on the defensive. They should be. The IMF has long outlived its usefulness and should be abolished.

It's hard to defend the IMF's record. It has wrecked economies. It's propped up thugs who get their hands on its loans. Its policies have toppled governments. All in the name of sound currency and fiscal policies.

We're now learning the IMF's economic analyses are anything but sound. In fact, it seems the IMF cooks the numbers when it wants to make loans.

A new report from the Heritage Foundation shows that the IMF has overestimated growth in developing nations for the last 27 straight years. Is the fund being optimistic because it presumes its interventions will help the economies in those countries?

The Heritage report concludes that it is. It notes that the size of the errors grows as the degree of IMF aid increases. For every additional \$1 billion in aid to a Western Hemisphere recipient, its forecast error increased by 0.17 percentage point.

Errors were similar in African and Asian forecasts.

Why would the IMF do that? Well, its forecasts have a large impact on its funding. As long as fund officials can convince lawmakers in its member nations that its bailouts will work, it can rake in the cash — \$18 billion last year from the U.S., the largest contributor. Indeed, why would any country fund a program that would have little to no beneficial effect?

And then what would those highly paid international bureaucrats do when their *raison d'être* ceases to exist? Yes, the IMF has a strong incentive to make promising forecasts.

For a real-time example, look at Russia. Just last Sunday the IMF said Russia's economy "is better than expected." The pronouncement came a month ahead of the next \$640 million payment of a \$4.5 billion IMF bailout of the Russian economy. Is the IMF embellishing for the sake of the next payment?

Surely, it is. The Russian economy has been repeatedly bailed out. The IMF alone has doled out \$20 billion to Russia over the last seven years.

Yet the economy has retreated every year of the last 10, except 1997, when it grew by 0.4%.

It doesn't look like it's going to get better. As much as \$10 billion illegally leaves the country every year. Though it has outwardly cast off communism, Russia hasn't made the transition to a market economy. It's crippled by mobsters, corrupt bureaucrats and an inept industrial sector still controlled by central planners.

Rep. Jim Leach, R-Iowa, chairman of the House Banking and Financial Services Committee, says Russia "appears to be an anarchist kleptocracy" that has "no hope of economic progress unless the social plundering is halted."

Russia isn't the only country charged with misappropriating IMF cash. Critics have long said large portions of the fund's bailouts are never used as intended. Instead, the aid ends up in the hands of criminals and the politically connected (in many countries, these two are synonymous).

So it's not surprising that the \$10

billion Russian laundering scandal that surfaced two weeks ago is said to include IMF bailout money.

Fund officials have — predictably — denied it. But their record elsewhere is abysmal. Ian Vasquez at the Cato Institute says dozens of countries have been receiving IMF aid for decades. Their economies never improve as they subsist year to year on one fund loan after another.

Loan addicts, Vasquez calls them.

The IMF was established in 1944 to police the international fixed exchange rate system. That collapsed in 1971 and was replaced with a floating-rate method. For nearly 25 years the IMF provided advice to its member countries and made relatively small loans to economically troubled countries.

By 1995, though, it had completed its transition to an international Santa Claus, its toy sack bulging with bailouts.

Clearly, the IMF has outlived its usefulness. It has little accountability. It deals in secret. Its bailouts tell cowboy investors that there's no risk involved in bad decisions. And its view of proper fiscal policies sends economies further on the path to ruin.

If the IMF were a private lender, it would have failed by now. The only way to stop it from sucking up scarce resources to waste on favored nations is to end it. Some in Washington advocate reforming the IMF. But it's useless to reform an outfit with such a poor record. Abolish it now.

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News from Russia in English -

BUSINESS

Skuratov Says IMF Billions Sold on the Sly

By Natalya Shulyakovskaya
STAFF WRITER
Photo by Igor Tabakov

MOSCOW - Almost \$4 billion of last year's IMF bailout went straight back out of Russia and into the now famous Bank of New York as the Central Bank sold dollars to banks eager to flee the doomed treasury bill market, Russia's suspended prosecutor general told The St. Petersburg Times.



And that money was sold directly to those banks, bypassing the currency markets, Prosecutor General Yury Skuratov said in an interview Monday.

Last July, the International Monetary Fund put together a \$22.6 billion bailout package aimed at restoring confidence in the Russian economy.

Skuratov's revelations make it clearer than ever that most of that money instead went to bail out a handful of well-connected banks as they fled Russia's ill-fated market for ruble-denominated short-term treasury bills, known as GKO's.

In a memo that Skuratov prepared for President Boris Yeltsin but was never able to submit to him, he detailed where much of the IMF's \$4.8 billion first installment - sent to Russia on July 23, 1998 - went during the hectic 25 days that were left before Moscow's financial armageddon.

"An analysis of the Central Bank's use of the account where the IMF stabilization loan was deposited showed that \$4.4 billion was sold from that account between July 23, 1998 and Aug. 17, 1998. Of that money, \$3.9 billion was sold directly to Russian and foreign banks, bypassing the trading session at the Moscow Interbank Currency Exchange. And only \$471 million went to support the ruble exchange rate on MICEX. Another \$100 million went for intervention on other [currency] exchanges."

That \$3.9 billion was used by 18 large banks to convert their GKO's into dollars just days before Russia defaulted on the short term bonds - which had been paying yields as high as 200 percent, he said.

The banks bought the dollars from the Central Bank with rubles they received from the sale of their GKO's.

And it seems it was shipped out of Russia with the help of the Bank of New York.

"These operations between the correspondent accounts of the Central Bank and these banks were done with the involvement of the Bank of New York," Skuratov said.

The bailout cash in fact never even made it to Russia, Skuratov said.

The money went from the IMF to the Central Bank's U.S. account and then to Russian

banks' Bank of New York accounts, with the Russian banks paying for the dollars by depositing rubles with the Central Bank in Moscow.

The money was sold through special arrangements that the Central Bank had already struck with major banks operating on the Russian market, under which they could purchase hard currency directly from the Central Bank.

"We got an explanation that the deal was justified because it was lifting the pressure from the ruble by satisfying the banks' dollar needs even before they turned to the exchange," Skuratov said.

However, he criticized the Central Bank for selling the IMF bailout cash through those deals.

"I cannot understand why only \$471 million went to support the ruble, and the rest - without even landing in Russia - was sold to commercial banks."

Skuratov was unable to say at what rate the dollars had been sold. However, the PricewaterhouseCoopers report into the Central Bank's use of the July bailout shows that banks were able to buy dollars from the Central Bank at an average rate of 6.33 during July and August 1998, while the average MICEX rate for the same period was 6.97.

"There was a list of 18 banks, nearly 20. All of our major banks were on that list, SBS-Agro was listed as was Uneximbank," Skuratov said. He said he could not reveal the entire list.

The Bank of New York is now the subject of a probe into whether or not some \$4.2 billion to \$10 billion that moved through its accounts between October 1998 and May 1999 included ill-gotten gains being "washed clean" by Russian mobsters.

Investigators' suspicions regarding money coming from Russia were reportedly fueled by a surge in capital flight from that country to the United States in the wake of last year's crash, according to a report by The New York Times last month.

The Bank of New York has denied any impropriety regarding its business dealings with Russia. The bank, one of America's oldest and largest, had built a dominant position in servicing Russian customers wanting to do business in or through the United States.

Skuratov opened an investigation last September into the Central Bank's role in the August financial crash. That investigation was one of several that have ground to a halt since the Kremlin succeeded in effectively pushing the Prosecutor General out of office earlier this year.

He first submitted his resignation Feb. 1, after a meeting with then-head of the presidential administration Nikolai Bordyuzha, Skuratov said.

Bordyuzha pressured him at that meeting to stop his investigations into Swiss-based contractor Mabetex, he added.

Mabetex has since become the center of a wave of allegations that top Kremlin figures - including Yeltsin, his two daughters, and the head of the presidential administration, Pavel Borodin - accepted bribes from the firm in return for lucrative contracts to help renovate the Kremlin palaces.

When he first began investigating Mabetex, Skuratov kept the probe secret. Only he and one other investigator at the Prosecutor General's Office knew about the probe. He declined to identify that investigator.

The first person that he informed outside of his own office was Yevgeny Primakov. Skuratov went to Primakov soon after he was appointed prime minister last fall. Soon after he was confirmed by the State Duma, Primakov had declared a tough stand on corruption.

Regarding the investigation into the IMF money, one major question left unanswered was whether or not the flood of cash he had traced as far as New York had been the result of insider trading on GKO's, Skuratov said.

"Some of those individuals who got rid of their GKO's right before the August financial crisis turned their GKO's into hard currency and funneled it to the Bank of New York," he said.

Earlier this month, Skuratov said that former First Deputy Prime Minister Anatoly Chubais was among 780 former and current officials under investigation on suspicion of insider trading in GKO's.

Chubais has denied ever using inside knowledge to trade GKO's. Furthermore, he has said that he only ever traded in the debt instruments when he was a private citizen and that he in fact lost money on his GKO holdings.

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