OPINION

Putinism Thrives on Dirty Money

Western leaders ignored Putin's bad behavior as long as Russian money flowed in. Flight 17 changes all that.

By OLIVER BULLOUGH
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This year's most important Russian financial indicator will be how much money flees abroad. Central-bank data released on July 9 put capital flight so far this year at $75 billion, almost 4% of gross domestic product, and rising by the day. And that was before last Thursday's murderous downing of Malaysia Airlines Flight 17 over eastern Ukraine.

Westerners marvel at Vladimir Putin’s high domestic approval ratings, above 80% in Gallup's most recent poll, which comes after this year's invasion of neighboring Ukraine and annexation of Crimea. But those with the wherewithal to let their money do the talking say different. More money has fled Russia in the first half of 2014 than in the whole of 2013. If Mr. Putin were really doing a good job, capital flight would not be an issue.

Popularity and capital flight are rarely considered together, but they hold the key to Putinism: He gives ordinary Russians stability and television (heavy with propaganda), while their rulers get the right to strong-arm their way to riches and keep the money safely abroad. For the Romans, it was bread and circuses; for Mr. Putin, it is bread, circuses and offshore bank accounts.

Mr. Putin is often credited with rebuilding Russia, but that has been as much aided by $100-a-barrel oil as by anything he has done. Hundreds of billions of dollars have poured out of Russia since he took power in 2000, while corruption has spread to encompass every element of the economy.

He has done nothing about this, since doing so would cost him the support of the Russian elite. These are the people that Nikolai Patrushev, former head of Russia's FSB domestic-intelligence agency and now Mr. Putin's Security Council secretary, calls "the new nobility." Without them Mr. Putin would be nothing, and it is their money and their channels to the West that the U.S. and the European Union should target.

To succeed, Western authorities need to follow the assets: the yachts, the mansions, the estates, the professional sports teams—most owned via Western shell companies and funded via Western banks. It is here that the West has the leverage it needs, if it wants to solve the Putin problem before something even worse happens than the downing of Flight 17.

Mr. Putin has long acted like someone to whom international law means nothing. In 2004 a court in Qatar...
convicted two Russian agents of murdering the former president of Chechnya Zelimkhan Yandarbiyev with a car bomb in Doha. In late 2007 Andrei Lugovoi, the former KGB agent wanted for questioning by British authorities in the poisoning death of Kremlin critic Alexander Litvinenko with radioactive polonium-210 in London in 2006, was elected to the Russian parliament. (Mr. Lugovoi denies involvement.) Mr. Putin hived off two chunks of Georgia in 2008 and declared them independent.

Most Western governments were happy to ignore all of this—some even brushed off the annexation of Crimea—as long as the Russian money kept flowing into their economies. But the downing of Flight 17, killing 298 people, is different. There can be no justification for giving poorly disciplined guerrillas missiles powerful enough to bring down an airliner. This is rogue-state behavior, and the West needs to act.

Washington has already pioneered some bold and effective sanctions, including clever targeting of Russia’s crucial energy and arms industries the day before Flight 17 was shot down. Judging by Secretary of State John Kerry’s words on Sunday, tougher sanctions may be on the way.

Europe has been feeble in comparison, but the leaders of France, Germany and Britain backed sanctions on Sunday, and EU foreign ministers are discussing action on Tuesday. It will be a brave foreign minister who tells his Dutch, British, Belgian or German counterparts, after the bodies of their slain countrymen have been treated disgracefully by pro-Russia rebels, that Mr. Putin deserves the benefit of the doubt.

It seems certain that more Russian individuals and companies will have their dealings with Americans and Europeans curtailed by the end of the week. But that will not solve the problem. Thanks to the sly methods of offshore financiers, the Western financial system remains wide open.

According to Transparency International’s Corruption Perceptions Index, Russia is as corrupt as Pakistan. Precise details of the amount of corrupt money generated each year are not available, obviously, but it is clearly in the billions, and it has to go somewhere. We do not know all the routes it takes to get out of Russia, but thanks to Hermitage Capital CEO and co-founder William Browder, we do know one of them.

Hermitage Capital once managed the largest pool of foreign money invested in Russia. That was before Russian officials stole $300 million from Hermitage, imprisoned its auditor, Sergei Magnitsky, and watched him die in jail in 2009. Mr. Browder has deep pockets, and a long memory, and he has funded a forensic investigation into the fate of the stolen cash. It passed through Cyprus, Latvia, Moldova, Switzerland and the British Virgin Islands, and it ended up buying property in Manhattan, Dubai and elsewhere.

Those who allegedly laundered the Hermitage money (Latvian citizens acting as nominee directors of shell companies) also appeared as suspects in investigations by journalists and nongovernmental organizations into the fate of the billions stolen from Ukraine by ex-President Viktor Yanukovych, suggesting that their services are available to any post-Soviet kleptocrat who wants them.
Western banks are the gatekeepers to our financial system and are supposed to report suspicious transactions, obey U.S. and European financial laws and sanctions, and turn away illegal money. They have clearly been failing to fulfill this role.

Mr. Putin’s regime is a criminal one, and our banking system facilitates that crime. They steal it; we fence it. Changing the way we treat Russian money, making its owners prove its provenance before banks accept it, would at a stroke cut away one of the struts that support the Putin regime. It would encourage honest Russian businesses and penalize the dishonest.

It is up to Russians to improve their own country, but we can help by ceasing to accept the money their rulers steal. Sanctions treat the symptoms of the disease, not its cause, and the longer we put that off, the deeper the cancer of dirty money will penetrate our countries—and the harder cutting it out will become.

Mr. Bullough, a former Moscow correspondent for Reuters, is the author of “The Last Man in Russia: The Struggle to Save a Dying Nation” (Basic Books, 2013).