



Journal of Money Laundering Control

Emerald Article: Political factors affecting AML/CFT efforts in post-communist Eurasia: The case of Georgia

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Article information:

To cite this document: Elias Götz, Michael Jonsson, (2009), "Political factors affecting AML/CFT efforts in post-communist Eurasia: The case of Georgia", Journal of Money Laundering Control, Vol. 12 Iss: 1 pp. 59 - 73

Permanent link to this document:

<http://dx.doi.org/10.1108/13685200910922651>

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Political factors affecting AML/CFT efforts in post-communist Eurasia

The case of Georgia

AML/CFT
efforts

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Abstract

Purpose – The purpose of this paper is to provide an overview of anti-money laundering (AML) efforts and high-risk sectors in Georgia, and explain changes in this field over time.

Design/methodology/approach – This case-study draws on a political economy-approach, based on the argument that “political will” provides the best explanation for the quality of AML efforts in transitional economies, as opposed to “technical assistance” or the sophistication of the domestic financial system.

Findings – The study finds that AML efforts have drastically improved in Georgia following the Rose Revolution, even though significant high-risk sectors remain and a certain tendency towards “selective implementation” of AML regulations can be detected.

Research limitations/implications – Implies that the “political will” of the ruling elite and the promotion thereof should be increasingly incorporated into research on AML, especially as regards explaining the quality of implementation and enforcement of existing laws.

Practical implications – Implies that technical peer evaluations resulting in “naming and shaming” of jurisdictions that do not live up to international AML standards may not in and by themselves be enough to further efficient implementation, but need to be complemented by policies creating incentives for the domestic political elite to encourage *de facto* implementation of *de jure* regulations.

Originality/value – Provides the first comprehensive overview of AML efforts in Georgia and points to important explanatory factors underlying changes in this field.

Keywords Georgia, Money laundering, Law enforcement, Government policy

Paper type Case study

Introduction

During the past ten years, efforts to counter money laundering and terrorist financing have grown exponentially, driven largely by the US “War on Drugs” and later the so-called “War on Terror” (Biersteker *et al.*, 2008; Clunan, 2006). But, it is only during the past three or four years that such efforts have begun to yield any palpable results in terms of criminal investigations and convictions in post-communist Eurasia[1]. In this region, the process of designing new political and economic systems while simultaneously grappling with issues of national identity “triple transition” has provided fertile ground for corruption, profiteering, and money laundering (Karklins, 2005; World Bank, 2000). In this paper, the center of attention is not so much on money laundering *per se*, but rather on how the state is responding to it. As most countries in



post-communist Eurasia provide ripe ground for financial crime, it is critical to know more about the factors and dynamics that propel – or prevent – adoption and implementation of strong anti-money laundering and combating the financing of terrorism (AML/CFT) measures (Vaithilingam and Nair, 2007).

In a nutshell, the argument put forward here is that looking at political and economic factors is crucial for gaining a satisfactory understanding of how a country is coping with financial crime. To be more precise, the basic premise is that “political will” and institutional capacity have a key role to play in determining how a country is handling money laundering problems[2]. By contrast, looking at the letter of AML/CFT laws alone appears insufficient. Technical peer evaluations are able to identify vulnerabilities in countries’ AML/CFT regimes, but unable to provide explanations for why those soft spots arose. This paper seeks to tease out the political factors that impact on anti-money laundering policies in post-communist Eurasia by taking a closer look at Georgia. In addition to data availability, the case is chosen because the significant changes over time in Georgia’s AML/CFT efforts are likely to present excellent conditions to study underlying dynamics and root causes[3].

The riddle – Why did Georgia’s AML/CFT policy improve so swiftly?

For much of the last two decades, the relatively weak Georgian state lacked the technical and legal tools to effectively combat financial crime and money laundering. In recent years, however, the picture has changed – Georgia has evolved into a poster child of the South Caucasian region in terms of tackling financial crimes (Larson and Jonsson, 2007). The administration of President Mikhail Saakashvili has taken substantial steps to tackle the problem of financial crime and put into place the basic building blocks of a comprehensive AML system. Among other things, financial institutions now face a wide range of obligations and commitments, such as customer identification and record keeping requirements. In addition, a financial intelligence unit (FIU) has been established which is responsible for receiving, processing, analyzing, and disseminating information related to suspect financial transactions. Not least, the new set of regulations has created a better awareness among Georgian authorities of what exactly is involved in confronting money laundering (Moneyval, 2007). Some of the most obvious measures of the efficiency of a country’s AML/CFT system – number of investigations, prosecutions and convictions on money laundering charges – had grown from virtually zero in May 2003 to 91 investigations, 26 prosecutions and 15 convictions by April 2006, although autonomous money laundering charges had not yet been brought (Moneyval, 2005, 2007).

Clearly, the progress achieved has been substantial. Georgia is among the handful of post-communist countries in Eurasia that have made significant inroads towards fighting money laundering through providing an increasingly elaborate legal framework and implementing it (Larson and Jonsson, 2007). For example, as of their latest comprehensive evaluation following Financial Action Task Force (FATF) methodology, over 40 per cent of the countries in post-communist Eurasia had not achieved a single conviction on money laundering charges (Jonsson *et al.*, 2008)[4]. Georgia followed a similar trajectory until 2004, but has since changed dramatically, making it interesting to study as a “positively divergent case.” Nonetheless, there are still a number of loopholes and weaknesses in the Georgian regulatory system that continues to create problems. What is more, in the background looms the danger of slipping backwards. For instance, Georgian authorities have shown an inclination to politicize AML campaigns, thereby undermining

the credibility of their efforts and evoking practices of substantially less democratic countries in Central Asia (Jonsson and Larson, 2008).

The purpose of this paper is thus to describe the development of Georgia's AML policy and provide preliminary explanations for the course taken. It is a first attempt to fill a void of current research, thereby generating background knowledge critical to design effective and feasible AML strategies. In order to reveal relevant "push and pull factors" generating more stringent laws and better enforcement of AML/CFT rules, the analysis focuses on the political, economic, and historical context of Georgia's AML policy. Furthermore, although we do not explore this in as much detail, we suggest that the findings may also have some relevance to other countries in post-communist Eurasia and beyond.

Methodologically speaking, this paper is best described as a single-case study, focused on a "positively divergent case," that to a limited extent invokes both within-case comparisons over time and points to parallels in comparable jurisdictions. The main sources used are surveys and evaluations carried out by organizations such as the Financial Action Task Force (FATF), Moneyval, the World Bank, the International Monetary Fund (IMF), and the Transnational Crime and Corruption Center (TraCCC). In addition, we draw on insights from area-experts to build and substantiate our arguments.

The remainder of this paper unfolds as follows: The second section will set the scene of the study by describing scope and nature of money laundering activities in Georgia in general, and reviewing the development of Georgia's banking sector in particular. The Section 3 will take a closer look at legislation and implementation of Georgia's current AML regime. The Section 4 seeks to identify determinants for Georgia's strong stance on money laundering. The Section 5 attempts to clarify the causes of persisting problems and vulnerabilities in Georgia's AML efforts. The final section will conclude the paper by summarizing main findings and sketching out policy-relevant implications.

A bank for every purpose – money laundering in Georgia

In Georgia as elsewhere in post-communist Eurasia, many problems with financial crime have their roots in the transition process of the early 1990s. The challenge of simultaneously building new political and economic institutions amidst the massive redistribution of state-owned property provided fertile ground for corruption, profiteering, and money laundering. To put it more systematically, crony capitalism and murky dealings have been facilitated by at least three broad factors: first, the rewriting of an unprecedented number of laws and regulations; second, the virtual non-existence of institutions either within or external to the public sector that could effectively oversee and control the early stages of transition; and third, the extraordinary transfer of wealth from the state to the private sector (World Bank, 2000, p. 25). Opaque privatization created propitious conditions to accumulate enormous wealth of illicit origin, and at the same time provided superb opportunities to launder ill-gotten gains. This permissive "operating environment" for criminal actors was further aggravated by the rapid and somewhat disordered liberalization of Georgia's financial sector (Gogatadze, 2002). Similar processes have earlier been identified as contributing to the financial crises in the Baltics in general and Latvia especially, sometimes most probably involving sizable financial crime (Fleming and Talley, 1996; Fleming *et al.*, 1997).

The primary sources of dirty money in Georgia are considered to be illegal proceeds generated through misappropriation, embezzlement, tax evasion, and abuse of power by public servants. Since the early 1990s, the South Caucasian republic has been plagued by widespread and pervasive corruption, ranging from petty acts like bribing policemen to administrative extortion, asset stripping, and illicit procurement deals. At times, self-serving officials were able to transform entire public institutions into private fiefdoms, which among other things lead the USA to curtail certain aid programs (Black Sea Press, 2003). Corruption was also seen as a central cause of the profound unpopularity of president Eduard Shevardnadze that led to the so-called “Rose Revolution” following parliamentary elections in 2003 (Mydans, 2003). The immense profits generated by organized crime and smuggling are regarded as another important source of illicit wealth (Moneyval, 2007).

Throughout the last decade, Georgia has witnessed a high level of organized crime activity, such as kidnapping, extortion, and racketeering. Above all, however, the country has come to play an important role in the international trafficking game. Georgia has developed into a turntable for illicit goods due to several reasons. First, as part of the wider Caucasus region, Georgia is located in the periphery of the “Northern” and “Balkan” smuggling routes on which opiates from Afghanistan and further east are carried to Europe (Cornell *et al.*, 2005). A second factor is the internal weakness of the state. Weak law enforcement, widespread corruption, and low-living standards have all contributed to making Georgia an ideal transiting point for drugs as well as other illicit commodities (Zaitseva, 2002). Third, the existence of uncontrolled territories has created propitious conditions for all kind of illicit trading activities. In particular, the breakaway regions of Abkhazia and South Ossetia have become smuggling hubs. But, central authority also is weak throughout other parts of the country, for example in Ajaria, Javakheti, and Pankisi (Cornell *et al.*, 2005; Galeotti, 2007).

As smuggling and organized crime rapidly increased throughout the 1990s, the demand for money laundering grew. Given the fact that the Georgian economy has been – and continues to be – heavily based on cash, it is relatively easy to launder money (Esadze, 2004; Moneyval, 2007). People can transfer assets or transform their riches without leaving financial transaction records. This makes it very difficult for law enforcement agencies to trace the proceeds of crime and corruption. However, when sums are becoming larger, the laundering process is likely to involve banking institutions. For long, with little and lax oversight mechanisms in place, the Georgian banking sector has been extremely vulnerable to money laundering activities (Moneyval, 2005).

After the break-up of the Soviet Union, Georgia developed an independent and two-tiered banking system, comprising the National Bank and commercial banks. Throughout the early 1990s, the number of banks rapidly increased as a result of incomplete legislation and weak licensing management. In 1994, a staggering 229 commercial banks were registered in Georgia. There can be little doubt that a good number of them were founded simply to serve a narrow range of individuals and their particular interests, becoming so-called “pocket banks.” Circumstantial evidence suggests that some of these banks were involved in money laundering schemes, though it is impossible to pinpoint extent and scope of such activities (Gogatadze, 2002). The total absence of convictions on money laundering charges until 2004 was consequently more likely related to the dire state of Georgia’s AML system, than with any absence of banking machinations.

In the period that followed, the Georgian National Bank began implementing a reform of the banking system with aid of the IMF, World Bank, and other international institutions. Licenses for many banks were liquidated due to inaction and insufficient assets. As a result, the number of operating banks sharply decreased to about 20 – for a people of some five million still a quite significant number, but nonetheless a consolidation process that eliminated more than 90 percent of the banks. At the same time, accidentally or not, some of the financial institutions in Georgia became closely tied to offshore companies (Gogatadze, 2002). According to TraCCC expert Khotenashvili (2003), this pattern is best explained as an attempt by individuals to gain controlling stakes in banks. Since the above-mentioned banking reform, Georgian legislation had prohibited any single shareholder or group of shareholders operating jointly to hold a share exceeding 25 percent. Thus, actors keen on gaining full control of a bank could do so by purchasing additional stock through an offshore company. As of mid-2003, offshore companies had shares in 5 commercial banks operating in Georgia (Khotenashvili, 2003).

The 25 percent limitation was lifted in 2006. Still, operating through offshore companies continues to provide at least one major advantage, namely that the identity of the beneficial owner, as a rule, remains strictly confidential. Only the names of nominal owners are disclosed to the public. Needless to say, covert ownership of banking institutions presents would-be criminals with ample opportunities to allocate cash to bank accounts and transfer black money abroad to corresponding accounts. Against this background, it should not come as a surprise that most of the money laundering cases investigated in Georgia during the past three years have involved banking transfers by offshore companies (Moneyval, 2007, pp. 25-6, 42).

To sum up, there is arguably a substantial “demand” for money laundering in Georgia due to the vast proceeds generated by murky privatization deals, organized crime, and smuggling. At the same time, the largely cash-based nature of economic transactions, the poorly regulated financial market, and widespread corruption for a long time opened up wide avenues for such activities. For the better part of the last decade, Georgian authorities showed little enthusiasm for combating financial crime. It was only in early 2004 that Georgia U-turned and massively stepped up its efforts to tackle the problem of money laundering in earnest, resulting in 15 convictions up until April 2006 (Moneyval, 2007).

Georgia’s AML/CFT policy – a success story?

The Georgian AML/CFT regime has been scrutinized by the Council of Europe’s experts on money laundering, or short Moneyval, three times in recent years. On-site visits were carried out in October 2000, May 2003, and April 2006. Based on their reports, a clear trend is discernable: Georgia’s legislation on AML/CFT has advanced from virtually non-existent to a fairly acceptable level. This positive trend has been further confirmed by Moneyval’s Progress Report on Georgia of July 2008.

In 2000, Moneyval noted that Georgia had “very serious deficits in the anti-money laundering system in all sectors – legal, financial, and law enforcement” (Moneyval, 2001, p. 2). The examiners had the impression that there was a general lack of awareness of the money laundering issue by the Georgian authorities. At the time of the second on-site visit in mid-2003 (report published in 2005), little had changed. There was a criminal offence of money laundering, but it had never been used. Neither did the law even elaborate on what was meant by “money laundering.” A preventive law was

not in place, and there was no suspicious transaction regime. Anonymous accounts could still be opened, and little practical guidance was given to banks and other institutions of how to confront money laundering (Moneyval, 2005). Notably, at the time of the second on-site visit, President Shevardnadze was still in power.

In the aftermath of the second round evaluation, the Georgian Government took substantial steps to remedy the above-mentioned shortfalls. On June 6, 2003, the Law of Georgia on Facilitating the Prevention of Illicit Income Legislation – hereafter the AML Law – was signed. Its provisions went into effect in January 2004; the law was amended in February of the same year. Based on the AML Law, legal provisions were established to define important principles and rules in the sphere of preventing money laundering and terrorist financing. Although these regulations were by no means perfect, they nevertheless presented a vast improvement in Georgia’s attempt at combating money laundering. In April 2006, Moneyval observed that the “basic building blocks of an AML/CFT system are now broadly in place” (Moneyval, 2007, p. 7).

FIU

Based on the AML Law, a FIU was created – the Financial Monitoring Service (FMS) – which began to function in January 2004. It has the legal responsibility for reviewing the status and enforcement of the AML Law and preparation of further legislative proposals. In mid-2004, roughly half a year after the so-called “Rose Revolution” brought Saakashvili to office, the FMS became a member of the Egmont Group, implying the willingness to actively cooperate with other FIU around the world. Also, the special service on prevention of legislation of illicit income (SSPLII) was created at the General Prosecutor’s Office, which is responsible for the investigation of money laundering cases received from the FMS and other sources (Moneyval, 2007, pp. 63-76).

Monitoring entities

The AML Law covers a wide range of financial institutions as well as a number of non-financial businesses that are designated monitoring entities. These entities are obliged to verify the identity of customers “know your customer”, keep records of transactions, establish an internal control system, and report any transactions in excess of 30,000 Georgian Lari (corresponds to some 13,300 Euro) as well as transactions which evoke suspicion (Moneyval, 2007, pp. 85-6, 147-50).

Confiscation

The legal framework covering provisional measures and confiscation has been significantly developed in recent years, and now there is a legal structure in place for freezing, seizing, and forfeiture of objects and criminally acquired assets (Moneyval, 2007, pp. 49-54).

Implementation

The risk involved in speedily launching an AML regime is that it becomes insufficiently implemented. This was, for example, exactly what happened in the Baltic countries in the late 1990s, where the AML efforts looked fairly acceptable on paper, but proved far less so on the ground (Kärstrand and Jonsson, 2007). To be sure, the situation in Georgia is by no means perfect. Nonetheless, the country has largely escaped the implementation trap. In the words of the latest Moneyval report: “. . . money laundering prosecution is being taken seriously” (Moneyval, 2007, p. 42).

Given the legal responsibilities now imposed on Georgian banks, a new reporting culture is gradually creating a more watchful banking industry. Since 2004, the number of suspicious transaction reports (STRs) has been steadily increasing. With regard to non-banking financial institutions, however, the pattern is mixed. While brokerage companies and security registrars have begun reporting, it is notable that exchange houses and insurance companies have made no STRs at all since inception of the FMS (Moneyval, 2007, p. 12).

Between January 2004 and April 2006, the Georgian FIU received 43,053 reports from monitoring entities, of which 1,313 were either sent or categorized as suspicious. Of these, 91 cases were opened by the FMS. After analyses, the FMS forwarded in total 26 cases to SSPLII at the General Prosecutor’s Office. The cases sent to SSPLII were subject of investigations and 15 defendants were convicted of money laundering. As of today, it seems fair to say that Georgia’s AML/CFT regime fulfils international minimum standards (Moneyval, 2007, pp. 9-10, 40-2). The major developments in Georgia’s AML/CFT regime are shown schematically in Figure 1.

Based on consecutive Moneyval reports, we have evaluated Georgia’s efforts to counter money laundering over time by looking at different aspects of its AML/CFT regime, namely:

- whether money laundering has been criminalized;
- whether a functioning FIU is in place;
- whether the financial sector and designated non-financial businesses and professions (DNFBPs) provide an appropriate number of STRs;
- whether there are any prosecutions related to the money laundering offence; and
- whether there are any convictions related to the money laundering offence.

Each of these aspects (and the overall score) is coded on a scale 1-3, whereby 1 means not compliant, 2 partly compliant, and 3 largely compliant with the FATFs 40 + 9 criteria[5]. A quick glance at Figure 1 immediately shows that Georgia has substantially strengthened its AML/CFT regime from 2003 to 2006. This begets the broader question of how this swift and sweeping progress can be explained.

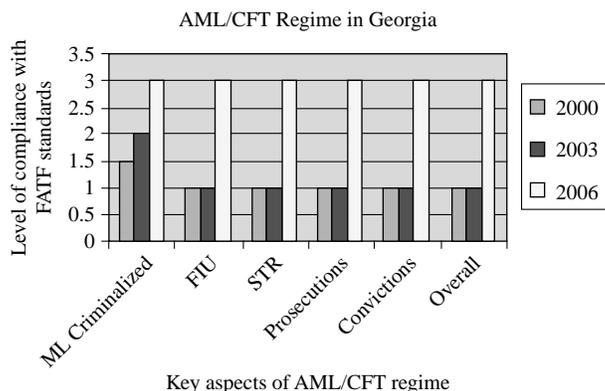


Figure 1.
Development of Georgia’s
AML/CFT regime

Explaining the improvement in Georgia's AML/CFT Policy

In the South Caucasian context, Georgia is doing exceptionally well with regard to countering money laundering and financial crime (Larson and Jonsson, 2007). This impression is further reinforced when considering the Georgian case against the backdrop of the rest of the post-communist Eurasian countries – Georgia is one of the few non-EU member countries in these regions having such robust AML/CFT regulations and enforcement, and stands out as the only one having achieved those improvements in a very short period of time (Jonsson *et al.*, 2008). This is mirrored by the fact that Georgia made improvements in transparency international ratings – Georgia were to improve its score on the corruption perception index from 2.0 (2004) to 3.4 (2007) – and has been mentioned as a “top reformer” by the World Bank (Transparency International 2004, 2008; World Bank, 2008). All this is indicating that the AML/CFT changes are not isolated phenomena.

In the case of Georgia, at least four factors can be identified that have facilitated the adoption of a strong AML/CFT regime: state-building efforts, anti-corruption campaign, foreign policy orientation, and international pressure.

First of all, Georgia's AML initiative can be seen as part and parcel of its larger state-building endeavor. After the Rose Revolution of late 2003, the new leadership inherited from former President Eduard Shevardnadze a weak, enfeebled, and deeply corrupt state. In many ways, politics and economics resembled a form of “modern feudalism” (Lynch, 2006, pp. 17-22). Thus, the Saakashvili administration faced the significant challenge of setting the state on its feet. More than anything else, this entailed developing the capacity of the state to deliver public goods, such as order and stability, social protection and health care, and simply systems of public revenue management and money lending (Lynch, 2006, p. 34). In order to create some sort of stability that is required for the functioning of a modern market-based economy, the banking sector became much more regulated (IMF, 2006, pp. 4-20).

A second and related factor is the fight against corruption[6]. Since the early 1990s, Georgia has suffered from widespread and endemic corruption. Corruption undermined the functioning of state institutions; plus, it was a major obstacle to private sector development as well as cause and consequence of organized crime (Ampratwum, 2008; Biagioli, 2008). Little wonder, therefore, that the new government embarked on a decisive anti-corruption campaign (IMF, 2006, pp. 30-40; World Bank, 2006, p. 19). The adoption of a comprehensive AML/CFT regime can be read in this light. Strong AML/CFT measures became a central element in the Georgian authorities' campaign to curb the abuse of power. On the ground, the new leadership took some quite drastic steps to shake up some of the most stagnant institutions – such as the Ministry of Defense and the traffic police. In addition, numerous high-ranking officials and businessmen were prosecuted on money laundering and corruption charges. However, it should also be noted here that these prosecutions and arrests have been criticized for including mainly political opponents. Indeed, as will be discussed below in more detail, selectively applying the law threatens to undermine the credibility of Georgia's AML policy (Dadiani, 2005, pp. 148-9; Lynch, 2006, p. 26).

Third, Georgia's efforts to establish a comprehensive AML regime may well also be seen as a function of its foreign policy posture. It is no secret that Georgia has very complicated relations with neighboring Russia, marked by a high degree of mutual distrust and sometimes bordering on open hostility[7]. On the other hand, Tbilisi has

developed ever-closer relations with the Euro-Atlantic community – Georgia is a prospective NATO country and a self-perceived potential EU member (Cornell, 2005, pp. 56-58; Cornell, 2007; Lynch, 2006, pp. 29-31). In a way, the staunchly westward orientation of the Saakashvili government can be seen as a major driving factor for the adoption and implementation of strong AML measures. Simply put, Tbilisi's foreign policy orientation implies a need to bring its legal framework in line with international standards set by the Euro-Atlantic community. In a way, the dramatic if imperfect improvements of Georgia's anti-money laundering legislation are comparable to those achieved in the Baltics or more recently in Romania and Bulgaria as those countries struggled to become EU members.

Lastly, in the wake of the 9/11 attacks, the international momentum to combat money laundering and the financing of terrorism increased dramatically. More than 100 jurisdictions passed new AML/CFT laws and nearly every country has introduced, amended, or strengthened its AML legislation since 2001 (Lilley, 2003, pp. 143-9). Especially, in light of its interest to strengthen relations with the USA, Tbilisi proved to be an eager partner in the war against terrorism. Terrorist financing was criminalized in July 2006, but the legal framework did not cover the financing of individual terrorists. After amendments in March 2008 to the Criminal Code of Georgia, such flaws were rectified (Moneyval, 2008, p. 7).

Weaknesses and vulnerabilities in Georgia's AML/CFT policy

Although things are going in the right direction, Georgia's AML/CFT legislation and implementation thereof is not flawless – and there are reasons for this. Roughly speaking, weaknesses and vulnerabilities are related to privatization, politicization, and ethno-territorial conflict.

In the aftermath of the Rose Revolution, the Saakashvili Government carried out a sweeping privatization process and created new licensing laws to improve the climate for business investments. This set of structural reforms has helped to jumpstart the Georgian economy, resulting in double-digit growth rates (Lynch, 2006, pp. 28-29; World Bank, 2008). In some sectors, however, the measures taken have created favorable conditions for money laundering and penetration by organized crime (Bokeria, 2006; Tbieli, 2006).

In the financial sector, institutions are now subject to different licensing regimes. Among other things, the licensing requirements for money remittance services conducted outside the banking sector have been abolished, implying that virtually any person can open a money or value transfer service. Little imagination is required to see how this is creating wide opportunities for money laundering activities (Moneyval, 2007, p. 13).

In the non-financial sector, with the abolition of the Law on State Control, Analysis and Marketing Precious Metals and Stones in November 2004, the business of dealing in precious metals and stones is *de facto* no longer regulated or supervised. What is more, while the general requirements of the AML Law are applicable to dealers in precious metals and stones, including customer identification, record keeping, and the obligation to reveal and report suspicious transactions, these measures have not been fully implemented yet. In a similar vein, the construction industry is currently neither regulated nor supervised – real estate agents, for example, are not even designated monitoring entities under the AML law. Finally, Moneyval has pointed out that gambling houses and casinos are not licensed in a way ensuring that criminals do not hold controlling shares or perform management functions (Moneyval, 2007, p. 14, 28).

Briefly, put, the Saakashvili administration's liberalization and privatization policies have contributed to undermine supervision and monitoring of non-banking businesses. In the words of the 2006 Moneyval (2007, p. 14) report: "At present, the supervision and monitoring of DNFBP is very limited." This is particularly worrying because money launderers are likely to shift their focus of operations to other sectors (e.g. real estate and construction sectors, retail businesses, nightclubs and bars) as AML regulations in the financial sphere become increasingly more elaborate and effective – a fairly similar pattern to what happened in many OECD countries in the late 1990s (FATF, 1997, pp. 6-8; Lilley, 2003, pp. 67-92).

On the political level, two common problems frequently hinder efficient implementation of AML/CFT regimes in post-communist countries. The first is "selective implementation" – that is, using AML/CFT laws to target political opponents. The other problem is "political risk." This means, governments and individual decision-makers adopting strong AML/CFT measures take the risk of being forced out of office by actors who prefer to maintain the unregulated status quo. Certain cases in Central Asia may illustrate "selective implementation" (Jonsson and Larson, 2008), whereas the killing in 2006 of the head of the Russian Central Bank Andrei Kozlov (Baev, 2006) is illustrative of the perhaps most extreme form of "political risk" that ambitious reformers encounter: physical insecurity.

In Georgia, since the Rose Revolution, there have been numerous arrests of businessmen and high-ranking officials on corruption and money laundering charges, including one minister, two deputy ministers, 33 *gamgeblis* (heads of local administration), and five judges (Nodia, 2008, pp. 248-249). Without questioning the legality of these prosecutions, one can nonetheless note that political opponents of the current government have been over-represented among the defendants (Esadze, 2004, p. 4).

The most contentious and important example is the high-profile case of Irakli Okruashvili, who had served on various important posts in the government of President Saakashvili, including being the Minister of Defense from December 2004 until he was dismissed in November 2006. In September 2007, he announced the formation of an opposition party and unleashed sharp criticism on the sitting government. On September 27, 2007, Okruashvili was arrested on charges of money laundering, corruption, and abuse of office. Without speculating about the specifics of the case – since they are currently not known in sufficient detail – the Okruashvili case may illustrate either "selective implementation" or backlash against reformers – or perhaps both. On the one hand, some argue that the arrest was partly driven by political logic (Devdariana, 2007). Given the over-representation of political opponents on the bench of defendants in ML-cases, this allegation does not seem entirely unfeasible.

On the other hand, Okruashvili's arrest was one of the triggering factors behind the large-scale demonstrations of November 2007, resulting in a political crisis and leading to the decision to hold snap presidential elections in early 2008. In conjunction with this, some observers alleged that parts of the financing of the political opposition came from rather dubious sources (Asatiani, 2007). Pro-Saakashvili analysts, therefore, were quick to frame the events of November 2007 as an attempt by "rogue elements" within Georgia to overthrow the reformist and pro-Western leadership in Tbilisi. They argued that radical opposition and corrupt officials and businessman had forged an unholy alliance to oust an unpleasant government which had taken a strong stance on fighting corruption, organized crime, and money laundering (Chivers, 2008; Socor, 2007a, b).

Again, judging by subsequent events neither does this interpretation of events seem entirely unlikely. Simply put, Georgian decision-makers or governments that are pushing AML measures may risk to be forced out of office by actors who share a vested interest in maintaining an unregulated financial market, lax banking oversight, and weak state structures (Slade, 2007).

On the practical level, the April 2006 Moneyval report was critical of the absence of an effective system to detect the physical cross-border transport of currency (Moneyval, 2007, p. 8). This, however, seems mainly due to a lack of state capacity rather than willingness. Recall that the central government in Tbilisi does not have full control over large swaths of the territory. One of the consequences is that there is a steady stream of illicit commodities, such as stolen and untaxed goods, drugs, weapons, and money (Dadiani, 2005, p. 149). Not least, the presence of smuggling havens has a corruptive influence on state institutions and individuals. For example, in Shida Kartli, a bordering region of South Ossetia, the local chief of police was convicted of involvement in smuggling, while the governor of the province was arrested on money laundering and corruption charges (Galeotti, 2007, p. 51). It goes without saying that control over territory and monopoly on violence are necessary prerequisites for satisfactorily implementing AML laws.

Conclusions

In Georgia, a set of interrelated factors has contributed to create ripe conditions for money laundering: state weakness, widespread corruption, a largely cash-based economy, an unregulated banking sector, prevalence of organized crime and smuggling, as well as long-standing conflicts with the breakaway regions of Abkhazia and South Ossetia. As this paper has shown, from 2004 onwards, Tbilisi has considerably stepped up its efforts to fight money laundering and financial crime. To be sure, the new AML regime has some loopholes, specifically related to monitoring of non-financial businesses and professions, selective implementation of law, and physical cross-border transport of currency. Much remains to be done – but the progress achieved has been substantial.

The Georgian case is illustrative of many facets and dimensions that lie beneath adoption and implementation of AML measures in post-communist Eurasia. First, the Georgian case shows that adoption and implementation of AML regimes are part of a wider state-building process; that is, to ensure the functioning of state institutions and the provision of such essential functions as protection, arbitration, and money lending. In particular, efforts to combat financial crime are often related to the fight against corruption. Second, it shows that the foreign policy course of the government can be an important push factor for putting in place an AML legislation, as the strong westward orientation of the Saakashvili administration seems to propel the fight against money laundering. Third, there is a tendency to use money laundering charges as a tool to prosecute political opponents, thereby undermining the effective implementation of AML laws and political credibility. At the same time, for governments taking a strong stance on fighting the twin problem of money laundering and organized crime, there is the risk involved in becoming a target of destabilization efforts by actors that have a vested interest in keeping the state weak and vulnerable, and the financial market unregulated and uncontrolled. Fourth, the Georgian case shows that hasty privatization, deregulation, and economic liberalization – while in no way denying positive macro-economic effects – may open avenues for money laundering and financial crime.

To be sure, from a single-case study, one should be cautious about making overly broad and confident generalizations, especially when the case is selected for being “divergent.” Keeping this in mind, it seems nonetheless worthwhile to spell out some policy-relevant implications that follow from this study. First of all, successful strategies for tailoring effective AML regimes should be based on an understanding of political and economic background conditions. Without this, there is an obvious risk of treating symptoms without remedying underlying causes. Second, as this study has outlined, the context of transition economies raises difficult and to an extent qualitatively distinct challenges for developing effective AML strategies. Hence, expectations should not be unrealistic and the time horizon of reform should be considered quite long. Third, it is crucial to recognize that the extent of corruption and the institutional weaknesses of the state will serve as powerful constraints on the effectiveness and sustainability of judicial reforms. Clearly, legislative measures are needed to define money laundering, declare it a criminal offence, specify reporting guidelines, designate state authorities to receive STRs, and so on. However, stand-alone efforts to tackle money laundering through technocratic reforms are likely to have a limited impact – in Georgia and elsewhere in post-communist Eurasia. The fight against money laundering involves not only changing the letter of law, but it is also about transforming the AML culture in both public and private sector (Araujo, 2008).

Notes

1. By “post-communist Eurasia”, it is referred here to the geographical area covering Russia, the Baltics (Estonia, Latvia and Lithuania), Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan), the South Caucasus (Armenia, Azerbaijan and Georgia), as well as Central and East Europe (Albania, Belarus, Bosnia-Herzegovina, Bulgaria, Croatia, Czech Republic, Hungary, Macedonia, Moldova, Poland, Romania, Serbia, Slovakia, Slovenia and Ukraine).
2. In this context, we define “political will” as “the manifested readiness of ruling elites and individual decision-makers to expand personal efforts and use administrative and financial resources in furtherance of a specific policy objective.”
3. The analysis will focus on the situation in those parts of Georgia that are under government control; the situation in the separatist regions will be only taken into account as it has some bearing on developments in government-controlled Georgia.
4. This figure is based on a comprehensive overview of FATF-style mutual evaluation reports of all the Eurasian post-communist countries, carried out by organizations such as FATF, EAG, and Moneyval.
5. The precise assessment criteria are not provided in this paper but can be obtained from the authors upon request.
6. On the overlap of AML/CFT and corruption, see Ampratwum (2008).
7. In the course of writing this paper, open armed conflict broke out between Georgia and Russia.

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