

**GPML Central Asia Briefing No.1**

30 April 2002

**Money Laundering and Related Issues in Kazakhstan**

**1. Overview: drugs, corruption and security**

Kazakhstan is undergoing a profound period of transition. Thanks partly to huge oil and gas reserves, and rapid privatization in the 1990s, it has one of the fastest growing economies in the former Soviet Union. Foreign companies are interested in newly-identified energy resources, one of which has been called the greatest oil discovery of the last 30 years. Yet Kazakhstan's status as a drug trafficking corridor, its growing organized crime problem, regional insecurity, territorial disputes over the Caspian Sea, and allegations of high-level corruption linked to the energy sector create challenges to otherwise promising prospects. Kazakhstan is still in the process of developing some of the key legal and institutional frameworks to guarantee successful economic security and development. Concerns have been raised in Kazakhstan about a lack of political and financial transparency in the management of natural resources, and about the need for greater legal guarantees to encourage foreign investment. The potential links between drug trafficking and the financing of terrorism in the region are clear, and could implicate Kazakhstan, like some other parts of the region, in a transnational crime-security nexus that might, in the medium term, prove to be an obstacle to development. As of March 2002, Kazakhstan had some legal provisions on proceeds of crime, but no comprehensive anti-money laundering legislation, and no institutions yet capable of effective implementation and enforcement. Such institutions are an essential component for ensuring national and regional security from the debilitating effects of drug trafficking, corruption and terrorism.

**2. Drug trafficking<sup>1</sup>**

Kazakhstan's massive territory is strategically located between the major heroin producing areas of Southwest Asia, particularly Afghanistan, and markets in the former Soviet Union and Europe. This makes drug trafficking an attractive proposition for organized crime. The United States estimates that 80-90% of drugs seized in Kazakhstan originate in Afghanistan.<sup>2</sup>

Many illicit drug shipments are concealed in commercial truck cargoes. The borders with other Central Asian states are largely uncontrolled, except at major road and rail crossings. Railways linking Turkmenistan and Uzbekistan with the Russian Federation that cross the territory of Kazakhstan are particularly important trafficking corridors. Organized crime groups involved in drug trafficking, as well as terrorist groups, are committing sophisticated economic crimes involving money laundering, and are expanding their activities and influence.

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<sup>1</sup> Prepared with contributions from the United Nations Office for Drug Control and Crime Prevention (ODCCP) Regional Office for Central Asia, Tashkent, Uzbekistan.

<sup>2</sup> US Department of State (2000), *International Narcotics Control Strategy Report*, p.410

### 3. Money laundering and related crimes

The US State Department reported that in 1999 Kazakhstan opened more than 400 cases under the money laundering provision, Article 193, in the Criminal Code.<sup>3</sup> However, this figure is highly unusual and almost certainly inaccurate. Kazakhstan's Prosecutor-General's Office has said that they opened only a few cases under Article 193 in 1999, although the number of cases is growing every year.

#### 3.1 Organized crime

According to the US State Department, there is significant evidence of organized crime in Kazakhstan. More than 200 organized crime groups are reported to have ties with similar groups in the United States and Europe,<sup>4</sup> and these groups "have targeted banks, casinos and businesses engaged in food processing, distilling and export trade...Kazakhstan officials estimate that \$10 billion in illegal raw material export have occurred through illegal joint ventures, although this figure may be exaggerated."<sup>5</sup>

#### 3.2 Cash smuggling

Cash smuggling is common at Kazakhstan's borders and relatively large cash sums of US dollars have been seized. This may be evidence of illegal capital flight, however, rather than the smuggling of the proceeds of crime.<sup>6</sup> In one case, an undeclared \$831,200, originally from Kazakhstan, was seized by French customs in Paris airport. One of the most recent scandals involved the Kazakh Eurasian Bank group, three of whose officials were charged in Belgium with money laundering in connection with the purchase of a villa near Brussels.<sup>7</sup>

#### 3.3 Corruption and oil

Kazakhstan is ranked low on the Transparency International 2001 Corruption Perceptions Index, at 71 out of 91 countries, suggesting a high level of corruption perception. Development of the oil sector by rapid privatization involving foreign companies has heightened these perceptions in the last decade.

Central Asia's oil reserves cover a number of countries, but Kazakhstan's vast territory, in particular, holds some of the greatest oil and gas resources in the world. During the last decade, foreign companies competed to win access to the rich Tengiz oil field, which is exploited by Chevron in a consortium that also includes Exxon Mobil and the Kazakhstan government. A second oil field at Karachaganak also holds healthy reserves. The greatest of all, however, is thought to be the Kashagan field on the Caspian Shelf, which has been called the most important oil discovery of the last 30 years. Foreign investment in oil development, however, is said to be impeded by uncertainty about territorial division of the sea, which used to be split between the Soviet Union and Iran and is now shared by five nations, including Kazakhstan and Turkmenistan.

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<sup>3</sup> US Dept. of State (2000), *INCSR*, p.693

<sup>4</sup> US Department of State (2002), *International Narcotics Control Strategy Report*

<sup>5</sup> US Dept. of State (2000), *INCSR*, p. 692

<sup>6</sup> For information about currency regulation, see the National Bank of Kazakhstan:

<http://www.nationalbank.kz/eng/CurrencyRegulation/>

<sup>7</sup> *The Times Of Central Asia*, 12 July 2001.

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Competition to gain access to Kazakhstan's energy resources after independence appeared to create opportunities for corruption. The US Department of Justice has investigated allegations that a US businessman diverted millions of dollars in payments from three oil companies to senior Kazakh politicians via accounts in international financial centers and Swiss banks. According to media accounts reported by the US Embassy in Switzerland, the US businessman was alleged to have transferred payments from foreign oil companies of more than \$60 million in the early 1990s through Swiss bank accounts and 'letterbox' companies in Switzerland and the British Virgin Islands to senior Kazakh officials in order to secure contracts for oil.<sup>8</sup> In January 2001, 33 Kazakh political leaders sent a letter to members of the US Congress and the Department of Justice requesting that any funds confiscated by the US Government as a result of the investigation be returned to the people of Kazakhstan.<sup>9</sup>

In March 2002, two Kazakh parliamentary deputies wrote to Kazakh Prime Minister Imangali Tasmagambetov asking for an explanation of the practice of placing public funds in the accounts of private offshore companies whose beneficial owners were senior public officials or their relatives. They also drew attention to Swiss criminal investigations of the accounts in Credit Agricole Indosuez bank.

Meanwhile, in Europe, Belgian prosecutors have investigated the major energy conglomerate, Tractebel, which co-owned the Kazakhstan gas-pipeline network until 2000, for allegedly paying bribes to officials.<sup>10</sup> Three Kazakh citizens, suspected of accepting bribes in the case, were accused of setting up accounts in Belgium to launder the funds of Kazakh officials.<sup>11</sup>

Another key case has been the conviction *in absentia* of Kazakhstan's former prime minister, Akezhan Kazhegeldin (1994-1997), in September 2001 to ten years imprisonment for embezzlement, bribery, tax evasion and arms possession. His assets in Kazakhstan were confiscated. Kazakhstan underwent a rapid process of privatization under Mr. Kazhegeldin and his critics maintain that he took financial advantage of that process. Some observers have said, however, that the charges were politically motivated because of his attempts to run against President Nazarbayev for presidential office.<sup>12</sup>

### 3.4 Oil swaps

Oil swaps are a common facet of the oil industry. The arrangement provides a way to get oil to refineries and then to market from remote oil fields and isolated nations, like Kazakhstan. Title to oil in one location is transferred to oil of an equivalent value that might be thousands of miles away. There is huge potential for abuse of such a system, where the title to oil might change several times. As well as an attractive opportunity for money laundering, oil swaps can be used to disguise "oil laundering" or sanctions busting, where the oil itself has come from an illegal source, like Iran or apartheid-era South Africa. Kazakhstan's geographical isolation makes oil swaps appropriate, and even necessary, but they have also created perceptions that the energy sector is vulnerable to bribery and money laundering.

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<sup>8</sup> See website: [http://www.us-embassy.ch/embassy/pol\\_e%20reports/071000Abachafunds.html](http://www.us-embassy.ch/embassy/pol_e%20reports/071000Abachafunds.html)

<sup>9</sup> For more information on the repatriation of state assets, see GPML Background Briefing, "Recovering Stolen State Assets: An Overview", 21 March 2001, Vienna (internal).

<sup>10</sup> *Businessweek* online, 2 April, 2001.

<sup>11</sup> *Eurasia*, 19 December 1999.

<sup>12</sup> Radio Free Europe-Radio Liberty, 15 August 2001

### 3.5 Oil transfer pricing and capital flight

The government concedes that Kazakhstan suffers high levels of illegal capital flight, despite the existence of currency controls and capital transfer restrictions. The Ministry of Finance has estimated that between \$500 million and \$1 billion is lost annually by transfers abroad.

Much of the capital flight is achieved via the practice of transfer pricing, particularly in the lucrative oil sector. International Monetary Fund (IMF) estimates coincide with those of the government: the IMF estimated that under-invoicing of petroleum products resulted in \$410 million of capital flight in 2000, almost 2.5 per cent of Kazakhstan's \$18.26 billion gross domestic product.<sup>13</sup> At the higher end, the Washington-based Center for Strategic and International Studies estimates that Kazakhstan loses around \$1 billion annually through transfer pricing.<sup>14</sup> Under-invoicing can be a tax avoidance strategy, and is also indicative of capital flight generally, but these estimates correspond to public allegations about fraud and money laundering related to the resale of oil products.

## 4. Financial sector reform and regulation

Kazakhstan has a fairly well-developed banking system compared to the other countries in the region, and this increases its vulnerability in relative terms to money laundering and related corruption.

In 1993, Kazakhstan began implementing a comprehensive structural reform program aimed at moving towards a market economy. Banking reform was more rapid than in other Central Asian states. The mono-banking system was split into a two-tier banking system with the National Bank of Kazakhstan (the central bank) in the first tier and all other banks in the second tier.

More than 200 new banks were rapidly licensed in 1991-1993 but, in an environment of liberal licensing policies and lax prudential regulations, many of the new banks were small, undercapitalized and non-viable. During this initial liberalizing phase, the lack of supervision and experience in banking made the sector vulnerable to crisis and criminal activity. An attempt was made to restructure the banking sector between 1994 and 1996, after a series of bank insolvencies. More than 100 banks had their licenses withdrawn and by the end of 1998, only 70 banks remained.<sup>15</sup>

By 1999, only one bank in Kazakhstan — the Export-Import Bank of Kazakhstan — was still fully state-owned and, according to the IMF, the central bank was fully independent. An IMF official said that Kazakhstan had introduced international banking standards covering capitalization, asset diversification, management quality, and accounting, as well as minimum requirements for banks' charter capital, and that state involvement in the banking system was limited to central bank supervision of commercial banks.<sup>16</sup>

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<sup>13</sup> IMF, *Republic of Kazakhstan : Selected Issues and Statistical Appendix*, Country report No. 01/20, Jan. 2001, p.12.

<sup>14</sup> Center for Strategic and International Studies, "Crude Business": Corruption and Caspian Oil, 1 Sept. 2000, [www.csis.org/turkey/CEU000901.htm](http://www.csis.org/turkey/CEU000901.htm). For further general discussion of illegal flight capital and transfer pricing, see Raymond W. Baker, 'The Biggest Loophole in the Free-Market System', *Washington Quarterly* Autumn 1999, pp.29-46.

<sup>15</sup> Helena Tang, Edda Zoli, Irian Klytchnikova (2000), *Banking Crisis in Transition Countries*, World Bank working paper.

<sup>16</sup> Kuanyshbek Sazanov (2001), assistant to the Executive Director of IMF on a number of countries, including Kazakhstan, *Finance and Development*, letters to the editor, vol. 38, no. 3, September 2001

However, bank regulators have minimal training in money laundering issues, and concentrate almost exclusively on traditional banking supervision concerns.

### **5. Response to money laundering**

#### **5.1 National legislation<sup>17</sup>**

Kazakhstan has no comprehensive suite of legislation addressing money laundering, but does have some provisions relating to proceeds of crime. Article 30 of Kazakhstan's Drug Law, "On Narcotic Drugs, Psychotropic Substances, Precursors and Measures on Combating Drug Abuse and Illicit Drug Trafficking" (1998), imposes liability for the laundering and use of proceeds derived from illicit traffic in narcotic drugs, psychotropic substances and precursors. This two-paragraph article authorizes state authorities charged with interdicting illicit drug trafficking to institute legal action against a legal entity performing a financial operation with intention to launder the proceeds of illicit drug trafficking.

Article 26 of the Drug Law gives a broad definition of money laundering offences, covering the types of activities stipulated in Article 3, para. 1 (b) (ii) of the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988 (the 1988 Convention). However, Article 26 is not applicable in practice for the purpose of criminal prosecution because, according to the Criminal Code, the legal provisions of other laws that impose criminal liability shall be applied only after their inclusion in the Criminal Code (Article 1, para. 1).

However, the definition of money laundering offences provided in Article 193 of the Criminal Code of 1998 does not cover all types of money laundering activities as defined in Article 3 of the 1988 Convention. The definition in Article 193 is the following (unofficial translation): "Carrying out financial operations and other transactions involving funds or other property, knowing that such funds or other property [is] derived from illegal conduct, as well as using of such funds or other property for performance of entrepreneurial or other economic activity". Compare this definition with the more comprehensive provisions in Article 3, para. 1 (b) (i) and (ii) of the 1988 Convention.

Under Article 193, individuals are punishable by fines equivalent to 5-7 months of the minimum wage, or by imprisonment of six months to three years. There are harsher punishments (2-5 years in prison with the confiscation of all assets) for committing the crime as part of a group, repeatedly, and for public officials found to be abusing their position for personal gain.

A presidential decree (with the status of law) "On Banks and Banking Activity" (1995) stipulates that the investigating authorities must have officially initiated a criminal case and have some evidence to trigger the release of client information by the banks. At the same time, Article 50 mentions that tax authorities have access to client information in accordance with national tax law. However, tax and law enforcement investigators can obtain bank records only after applying through a prosecutor, who decides whether investigation is warranted.

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<sup>17</sup> Based on the contributions of ODCCP Regional Office for Central Asia, Tashkent, Uzbekistan

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Draft anti-money laundering legislation, which includes provision for international cooperation, is now in circulation, but is unlikely to pass into law for some time.

In 1997 and 1998, Kazakhstan ratified all three United Nations drug control conventions, including the 1988 Convention. In December 2000, the country signed the UN Convention against Transnational Organized Crime.

### 5.2 Anti-money laundering institutions

In accordance with the Decree of the President of 22 January 2001, a former Tax Committee was replaced by the Financial Police Agency, which was empowered to investigate money laundering and other economic offences. Under the Law “On Operative and Search Activity”, the Agency is empowered to “*extract information from the technical channels of communication, from computer and other technical means*” (Article 1.3), in order to detect and prevent offences, as well as to detect the persons who committed the offences.

The Deputy Chairman of this Agency reported at the Almaty Conference to strengthen legal cooperation in the fight against organized crime and drug trafficking, jointly organized by Kazakhstan and ODCCP (5-7 March 2002), that, since the Agency was established, a total of 31 money laundering cases were investigated and brought to court. None of the cases was related to drug trafficking. The Agency lacks modern equipment and basic training on the use of special investigative techniques, such as the surveillance of bank accounts and the monitoring of companies’ financial activity of companies.

### 5.3 “Shadow capital” amnesty

In 2001, the Kazakhstan Government introduced a controversial amnesty related to the legalization of assets. In effect, this meant that for a few weeks, until 13 July 2001, Kazakh citizens with bank accounts abroad could return their money to Kazakhstan with no threat of fines, taxes or inquiries about how the money was earned. The government’s public rationale was to encourage wealthy businessmen who held their assets outside the country, thereby hoping to avoid taxes and an unstable economy, to repatriate their assets. The authorities argued that an amnesty, together with a favourable investment climate and the lowering of interest rates, would reverse capital flight and bring back as much as \$500 million to the economy.

Opposition parties and professional societies criticized the initiative, arguing that it would allow corrupt officials to launder assets that they had stolen and hidden in banks abroad.<sup>18</sup> A parliamentary debate agreed that the authorities would exclude criminal assets from the legalization process, but it was not clear how they would identify the origin of funds if the amnesty were to allow repatriation without enquiries.<sup>19</sup>

According to the National Bank of Kazakhstan, about \$480 million was repatriated from almost 3,000 individuals. The average amount returned was \$18,000 and the highest \$800,000. Around 88 percent of all deposits were made in cash.<sup>20</sup> However, if estimates

<sup>18</sup> Kazakhstan 21<sup>st</sup> Century Foundation, 10 July 2001.

<sup>19</sup> *Eurasia*, 19 July 2001, Astana

<sup>20</sup> *The Times Of Central Asia*, 26 July 2001, Eurasianet, 23 July 2001.

that put capital flight at around \$10 billion are accurate, the amount repatriated was low. One report estimated that Kazakhs had transferred \$400 million to Romania alone.<sup>21</sup>

### 5.4 International cooperation

Kazakhstan has signed several multilateral agreements on co-operation in the fight against illicit traffic in drugs and organised crime. It is a signatory of the Agreement on Co-operation among CIS Member States in Combating Crime of 25 November 1998; the Agreement on Co-operation among Border Guards in the Field of Border Control on the CIS Member States Border-Transfer Points with the non-member States of 25 November 1998; and the Agreement on Co-operation among CIS Member States in Combating Illicit Trafficking in Narcotic Drugs, Psychotropic Substances and Precursors of 31 November 2000.

Cooperation with CIS Member States in the field of mutual legal assistance, extradition and confiscation abroad in criminal cases is carried out within the framework of the Minsk Convention of 1993 on Legal Assistance and Legal Relations in Civil, Family and Criminal Matters, and the Protocol of 1994.

Kazakhstan signed the Memorandum of Understanding (MOU) on Sub-regional Drug Control Cooperation – together with the Governments of Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan and the United Nations International Drug Control Programme (UNDCP) – on 4 May 1996 in Tashkent. The Russian Federation and the Agha Khan Foundation signed the MOU on 16 January 1998 and Azerbaijan in 2001. Kazakhstan is a member of the Shanghai Cooperation Organization (formerly the Shanghai Five), which also includes China, Kyrgyzstan, Russia, Tajikistan and Uzbekistan.

Kazakhstan is also a signatory of the Central Asian Agreement on Joint Fight against Terrorism, Political and Religious Extremism, Transnational Organized Crime and Illicit Drug Trafficking, signed on 21 April 2000, by Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan.

Kazakhstan has signed bilateral intergovernmental agreements in the field of drug control, organised crime, co-operation in controlled delivery, customs and judicial matters with the Governments of the Central Asian countries, the Russian Federation, Lithuania and Iran.

On 5-7 March 2002, Kazakhstan jointly organized with the United Nations Office for Drug Control and Crime Prevention (UNODCCP) a three-day regional conference in Almaty to strengthen legal cooperation in the fight against organized crime and drug trafficking. The conference was the first event in Central Asia after the terrorist events of 11 September 2001 that was designed to discuss judicial cooperation in detail, including the links between organized crime and terrorism. As well as considering how to strengthen technical cooperation efforts to improve criminal justice in Central Asia, the participating senior criminal justice officials discussed ways to speed up the ratification process of the United Nations Convention against Transnational Organized Crime and its three Protocols. Since then, Kazakhstan has ratified the Convention.

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<sup>21</sup> *Vremya*, 5 April 2001.

**6. Financing of terrorism**

Kazakhstan participated in an international conference on terrorism, held in Bishkek, Kyrgyzstan on 13-14 December 2001. The conference, which focused on the special needs of the Central Asian countries, was co-sponsored by UNODCCP and the Organization for Security and Cooperation in Europe (OSCE). The Declaration of the Bishkek International Conference on Enhancing Security and Stability in Central Asia: Strengthening the Comprehensive Efforts to Counter Terrorism noted the complex links between terrorism, illicit drugs, transnational crime, arms trafficking and money laundering.

Since 11 September 2001, the Kazakh authorities have increased cooperation with Middle Eastern countries on criminal matters related to the financing of terrorism. In February 2002, the Saudi interior minister visited Kazakhstan to conclude bilateral agreements, including an extradition treaty aimed at economic crimes. The Saudi Arabian Government has started to monitor Saudi firms operating in Kazakhstan that are suspected of funding terrorists and money laundering.<sup>22</sup>

Kazakhstan has not yet signed the United Nations Convention for the Suppression of the Financing of Terrorism, 1999.

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<sup>22</sup> BBC Monitoring Service, London, 2 Feb. 2002

## **GLOBAL PROGRAMME AGAINST MONEY LAUNDERING**

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The **Global Programme against Money Laundering (GPML)** was established in 1997 in response to the mandate established by the 1988 Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances. The Convention called on Member States to criminalise the offence of money laundering and to establish a comprehensive legal framework to deal with all associated matters. The **Programme's** mandate was further strengthened in 1998 by the UN General Assembly Special Session, which broadens its remit beyond drug offences to all serious crime.

The **Programme** is the focal point in the UN system for issues related to money laundering and proceeds of crime, including technical assistance to Member States in bringing their countermeasures into conformity with global standards.

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