



## RUSSIA REFORM MONITOR

The American Foreign Policy Council's Review of  
Russian Government Actions and U.S. Policy

# Russia Reform Monitor No. 2277

December 6, 2018 **Ilan I. Berman, Margot van Loon**

**Related Categories:** Democracy and Governance; Economic Sanctions; Europe Military; Human Rights and Humanitarian Issues; International Economics and Trade; Warfare; NATO; Corruption; Caucasus; Europe; Russia; Ukraine

### BATTLE LINES IN THE AZOV

In an sharp intensification of the the ongoing hostilities between Moscow and Kyiv, Russia has fired upon and subsequently seized several Ukrainian vessels in the Sea of Azov. The U.S. State Department joined Ukraine in condemning Russia's attempted intimidation, while officials in Kyiv asserted that Russia would not be permitted gain further influence or control in the strategic body of water, which is connected to the Black Sea via the Kerch Strait.

The seizure represents the latest incident in an escalating series of provocations. Since Russia's 2014 annexation of Crimea, the Russian navy has shut down the Kerch Strait and blockaded key Azov Sea ports, costing the Ukrainian economy millions of dollars. Kyiv has previously filed complaints with the Hague, claiming that Russia's actions violate the UN Convention on the Law of the Sea. These legal proceedings, however, are still ongoing. In the meantime, further militarization threatens to overtake any decision by the Hague as Ukraine pursues its plans to build a naval base in the Sea of Azov by the end of this year. (*U.S. News & World Report*, November 19, 2018; BBC, November 26, 2018)

### TIGHTENING THE NOOSE ON RUSSIAN MONEY LAUNDERING

Moscow is in the crosshairs as a money laundering investigation into Danske Bank continues to incriminate Russian clients. Steven E. Halliwell, the former CFO of the U.S.-Russia Investment Fund, writes that the investigation has exposed an endemic, system-wide corruption mechanism that allowed \$228.5 billion of illegal transfers to flow out of the country through Danske Bank's Estonian branch. The clients responsible for the transfers are not only Russian oligarchs but also ordinary bureaucrats seeking a way to convert rubles into hard currency and stash it away as a "survival mechanism" to preserve its value amid Russia's dire economic straits. Halliwell writes that President Vladimir Putin may need to consider enacting market reforms to stimulate new investment and staunch the bleeding of Russian wealth from the country, but notes that doing so would weaken the patronage system that keeps Putin in power at a time when he is already facing plummeting approval rates. (Reuters, November 19, 2018)

### HOW SOUTH OSSETIA HELPS THE WAR AGAINST UKRAINE

A tiny separatist enclave in the South Caucasus has taken on an outsized role in Russia's campaign to counter foreign encroachment and project power in its near abroad. According to a new exposé published by the *Washington Post*, Russia has taken advantage of the disputed international status of Georgia's breakaway region of South Ossetia to use it as an off-the grid "financial linchpin" in a triangular financial flow that enables Russia to evade international sanctions and support Ukrainian separatists.

In this off-the-grid model, money flows from Eastern Ukraine to South Ossetia and then to Moscow, where it is used to purchase fuel, food, and other vital materials that will be shipped to eastern Ukraine. The framework has been in place since 2015, and \$150 million has been funneled through it this year alone (roughly doubling last year's volume). South Ossetia, recognizing the affinity between itself and the separatists in Ukraine's east, maintains that the financial flows are fully legal, and plans to replicate the framework with Damascus and other Russian allies. "We have very big plans for turning our state into a transit corridor for various kinds of flows of goods... we don't fear sanctions," the deputy head of the South Ossetian Chamber of Trade and Industry has said. (*Washington Post*, November 21, 2018)

### MORE ELECTORAL MEDDLING FROM MOSCOW

Now that the U.S. midterm elections are over, American officials are lashing out at what they term to be Russia's ongoing efforts to influence and subvert political processes in democratic societies. Russia's efforts to undermine trust in U.S. institutions and elections has continued, despite warnings from Washington, and tell-tale signs of this influence was visible before and during the recent U.S. polls, Defense Secretary Jim Mattis has said. "We are seeing a continued effort along those lines," Mattis told attendees at the recent Reagan Defense Forum in Simi Valley, California. The threat posed by Russian President Vladimir Putin, Mattis said, is about more than one election. Rather, "it's his efforts to try to subvert democratic processes that must be defended." (Associated Press, December 2, 2018)