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Looting Ukraine: How East and West Teamed up to Steal a Country

by Oliver Bullough



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Introduction

Kiev's Maidan on the evening of December 3, 2004, at the height of the Orange Revolution, was an extraordinary place. Hundreds of thousands of Ukrainians were squashed together waving their orange flags, revelling in what they thought was a victory for democracy. Their joy and their hope for the future were intoxicating. Their new president, Viktor Yushchenko, responded to their mood. "We shall destroy the system of corruption in our country; we will take the economy out of the shadows," he pledged in his inaugural address a few weeks later.¹

Yushchenko lost many battles during his disappointing half-decade in power, but few so crushingly as this one: during his presidency, corruption grew instead of declining. In 2004, the year the Orange Revolution began, Transparency International's Corruption Perceptions Index rated Ukraine at 122nd in the world, alongside Niger and Bolivia. By 2010, the year that Yushchenko lost an election to his successor, Viktor Yanukovich, Ukraine had slid to 134th. And under Yanukovich, corruption grew even faster. By last year, it was 144th, while Niger and Bolivia had moved up to 106th.² Speaking in London before an Asset Recovery conference in April, General Prosecutor Oleh Makhitsky estimated the loss to Ukraine during Yanukovich's rule at "up to \$100 billion".³

Ukrainian corruption became a pyramid: bribes flowed upwards, with officials paying tribute to those above them. At the summit, Yanukovich, his dentist son Oleksandr, his family, and his friends became spectacularly wealthy, provoking Ukrainians last year into staging their revolution all over again. By then, the state was so weakened that it proved unable to defend those who ran it. "When you look at the system, it was stupid," explained Andriy Kutuzov, a Ukrainian lawyer who participated first-hand in taking bribes from clients to judges. "It's like building a house by taking bricks from the foundations and using them for the upper floors. However strong it looks, it's weak."⁴

The challenge for Ukrainians now is to make their new revolution succeed where the Orange Revolution failed. If they are to do so, they will need to do more than just arrest the people who took the bribes. The corrupt systems that supported Yanukovich and dismayed Yushchenko must be destroyed. If they are not, they will re-infect Ukraine, further weakening what already looks worryingly like a failed state.

In this paper, I will describe how some of these corrupt systems work, and how foreign countries and companies have colluded with local officials in abusing Ukraine. The Kremlin's influence is a part of the problem, but not all of it. Although Vladimir Putin and Gazprom have helped subvert bids to stop Ukrainian officials stealing from their own people, Western bankers and lawyers have also laundered and hidden the proceeds.



The most important contribution that the West can make to Ukrainian stability is to aid the new government in its fight against the cancer of corruption.

It is in our own interests to end this system. If Ukraine can reform itself, the organised criminals that now rule most of the territory of the former Soviet Union will lose one of their most important bases. Those opposing them will gain a new ally. We must prevent the flow of criminal money into our banks, and prosecute those who have allowed it to happen. The Ukrainians are fighting a war in eastern Ukraine, and struggling to rebuild their state. Nevertheless, the most important contribution that the West can make to Ukrainian stability is to aid the new government in its fight against the cancer of corruption.

Why the Orange Revolution failed

The leaders of the Orange Revolution—Yushchenko and his first prime minister, Yulia Tymoshenko—share much of the blame for its failure. Their feuding, and their inability to set an example of probity,⁵ helped discredit their ideas for many Ukrainians. However it is also true that two elements of the Ukrainian economy complicated their task: the country's dependence on Russian gas, and its access to Western offshore banks. Taken together, these two factors helped doom attempts to reform Ukraine.

Before 1991, the Ukrainian economy—like that of the whole Soviet Union—relied on cheap gas and nuclear power. But when Ukraine became independent, it jumped instantly from being part of the energy-rich USSR to being relatively energy-poor. This left it dependent on foreigners for the fuel it needed to heat its cities, dry its grain, and power its factories. In 2004, when Yushchenko won his revolution, Ukraine relied on Russia for 75% of its energy: 45% gas, the rest nuclear.⁶

Ukraine's energy poverty should logically have inspired its new leaders to push hard for fuel efficiency and to negotiate import contracts carefully. Instead, Ukraine's economy became more dependent on energy through the 1990s. By 2013, Ukraine was one of the least efficient users of energy in the world. It used 30 times more power for each dollar of GDP than Japan, almost twice as much as Russia, and more even than Iraq.⁷

In practice, Ukraine's stop-start approach to reform left it stranded between capitalism and communism, in a zone where insiders could arbitrage between regulated and non-regulated prices and make fortunes which they kept offshore.⁸ The country lost out, but the insiders—later known as oligarchs—profited. It was thus in their interests for Ukraine's economy to remain as inefficient as possible. Ihor Bakai, one of the insiders of the 1990s, noted in 2001 that "all major political fortunes in post-independence Ukraine were made on the basis of Russian oil and gas".⁹

Among the beneficiaries of this system was, for example, EuralTransGas¹⁰—a company owned by Dmitry Firtash—which in 2002 won a contract to supply 36 billion cubic metres of gas to Ukraine from Turkmenistan. The deal gave Gazprom \$470 million in transit fees. ETG was paid in gas, receiving 13.7 bcm to sell on its own account. That was worth up to \$1.5 billion on the European market. ETG was one of a number of companies (it was preceded by Respublika, then Itera, and succeeded by RosUkrEnergo), which fulfilled the same role. All of these companies acted as intermediaries between Russia and Ukraine, making vast profits, despite the fact that an intermediary was entirely unnecessary.

The citizens of Russia, Ukraine, and Turkmenistan would have been better served by direct government-to-government arrangements, since all the energy companies involved were state-controlled. However, the deals were not intended to secure the best price, but rather to enrich the handful of individuals with access to them. They diverted resources away from Gazprom, Ukraine's Naftohaz, and Turkmenistan, and into the pockets of the companies' patrons. The people who ran these companies were connected at the highest levels in Kiev and in Moscow,¹¹ and the profits they made guaranteed Ukraine would do nothing substantive to make itself less energy-dependent, despite lacking large energy reserves of its own.

Nevertheless, the West provided legal residence for these intermediary companies. ETG was based in Hungary, and banked with Austria's Raiffeisen Bank, which held RUE's shares. But there are many other jurisdictions—including the Netherlands, the United States (Delaware), Austria, Switzerland, the Channel Islands, and the United Kingdom, as well as the more well-known 'sunny places for shady people' that we think of as tax havens—that have touted for ex-Soviet business.¹² Keeping the money offshore allowed the intermediaries to escape both Russian and Ukrainian taxes. Offshore financial channels allowed corrupt individuals to move their gains out of Ukraine and to enjoy the West's property rights, while continuing to exploit their positions inside Ukraine to enrich themselves. Ukraine's rulers have had no need to build a stable system at home because Western countries have been willing to sell them theirs.¹³

"In any corrupt scheme there is always an offshore company, always, always, always. As an official, you have money or resources, and this must get into a company under your control. The only way to do this so no one sees you is offshore," said Vitaly Shabunin, head of the Anti-Corruption Action Centre, and one of Kiev's foremost campaigners against graft.¹⁴

Ukraine's elected officials have long benefited from these same arrangements. President Leonid Kuchma exploited the schemes for his own benefit, using his ultimate control over international trade to act as an arbiter between Ukraine's different business clans and to secure his own power.¹⁵ He resisted any investigation.¹⁶ But Viktor Yushchenko abolished some of the most egregious schemes during his tenure as prime minister from 1999 to 2001. When he pledged as president to turn Ukraine into "an honest nation," he was promising to finish the job and to create a clear, logical, and transparent economy. If kept, Yushchenko's promise would have shaken up the whole system of Ukrainian politics, and cost insiders in Kiev and Moscow vast amounts of money. Those insiders mobilised successfully: when Ukraine objected to Russian demands for a significantly higher gas price, Gazprom turned off the taps in January 2006, cutting off several Eastern European countries who get their supplies via Ukrainian transit pipelines.

Three days into the stand-off, Firtash emerged with a new company—RosUkrEnergo (the successor to EuralTransGaz), which it later transpired he owned jointly with Gazprom—and a compromise was reached. The deal was equally murky. The proceeds remained offshore, the final ownership was unknown,¹⁷ and the same insiders held on to both their positions of power and their revenue flows. As a result, the reform process stalled. "Only one source of power proved to be stronger than the Orange Revolution—not (former) Prime Minister Viktor Yanukovich, nor Russia, but the power of energy-related interests," Margarita Balmaceda concluded in a book on the subject.¹⁸

By 2008, Firtash was telling US diplomats that he was a close adviser to Yushchenko, and was personally helping him to negotiate gas deals. "He described himself as a close friend and confidante of the president—someone the president can trust totally," the diplomats wrote in a cable to Washington.¹⁹ In short, the power of the entrenched business networks had defeated Yushchenko's attempt to reform them, assuming it was a genuine attempt in the first place.

By the 2010 presidential elections, Yushchenko was a spent political force, polling single figure rating among Ukrainians disgusted by his failure to deliver on his promises. This left the door open for the return of Yanukovich, defeated in the Orange Revolution, but by now rehabilitated as a political force. He inherited this chaotic situation and set out to turn it to his advantage, using the model pioneered in Russia by Putin. He brought corruption in-house, and removed any challenge

to his rule. He jailed Tymoshenko, and he installed fellow insiders—primarily from the Donetsk and Luhansk regions—to leading roles around the country.²⁰

According to Oleksy Shalaisky, head of the NGO Nashi Hroshi (Our Money) and an investigative journalist, the 'family'—as Yanukovich's allies were known—gained control of revenue streams across Ukraine, including those of the gas trade. The 'family', said Shalaisky, may even have assumed control of local mafia groups, taking a chunk of earnings from prostitution and other forms of organised crime. Each local ally gathered money and sent it to the centre, helped by the police, prosecutors, and courts, all of which could be deployed to intimidate or jail anyone foolish enough to resist. "We had never seen such greed in Ukraine," said Shalaisky.²¹

Oversight became less welcome, and media outlets that investigated graft such as Ukrainian *Forbes*, *Korrespondent* magazine, and TVi television²² were closed or taken over by government allies over the course of 2013. Parliament meanwhile changed the laws to make the investigation of corruption harder. For example, the 2010 law on state procurement, drafted towards the end of Yushchenko's presidency, was amended 20 times in three years, each time reducing its scope.²³ By the end of Yanukovich's period in power, only 20 billion of the 50 billion euros of state tenders issued each year were open to public scrutiny.²⁴

As laws multiplied under Yanukovich, compliance became ever more onerous, so much so that it became prohibitive to obey them. "Being honest is very expensive in Ukraine," explained Oleg Marchenko, a partner at the Kiev law firm Marchenko and Danevych.²⁵ "The way the system is operating here is that it is much more profitable for everyone to engage in corrupt practices than to do it properly."

According to Marchenko, large companies paid bribes to officials for permits to operate and to export, to judges for decisions, and to prosecutors to stop investigations. If you wanted a VAT refund or access to state-owned land, to win a state tender or planning permission for a new development, it was cheaper and easier to pay a bribe than to go through the process legally.

According to estimates from the investment company Dragon Capital, between 20% and 60% of the entire Ukrainian economy now exists in the shadows, so a majority of Ukraine's economy may be illegal.²⁶ Along with Russian pressure, this fact also helps explain why Yanukovich turned his back on the Association Agreement with the European Union in the autumn of 2013. The agreement obliged Ukraine gradually to bring its judicial, economic, and financial systems into line with European norms—all of which would have been extremely expensive for the Ukrainian elite. The agreement would also have opened Ukraine's borders to European goods and services by bringing down customs barriers and streamlining procedures, thus reducing many of the most lucrative bureaucratic obstacles exploited by Yanukovich's 'family' and forcing their companies to compete on equal terms with European rivals.

Ukrainian protesters had set their hopes upon the Association Agreement for precisely this reason. Europe, for many Ukrainians, is not so much a geographical concept as an idea representing honesty, decency, and stability. This is why protesters fought so hard to remove Yanukovich, and that is what they continue to fight for now.

How did Yanukovich's corruption work?

Corruption in Ukraine takes several forms. One of them is VAT fraud, as illustrated by the case of the food processor Archer-Daniels-Midland (ADM). ADM admitted to paying bribes in Ukraine between 2002 and 2008, following a US Department of Justice investigation, and eventually paid fines totalling \$54 million. The bribes were paid to Ukrainian officials who had withheld VAT refunds from the company (with sometimes up to \$46 million outstanding). The company's subsidiaries in Germany and Ukraine paid these officials to regain their money, with payments hidden in the accounts as shipping or insurance fees.²⁷

According to an SEC statement from December 2013,²⁸ "The bribes paid were generally 18% to 20% of the corresponding VAT refunds." These percentages are thought to have risen during Yanukovich's years in power. In April 2014, the new head of Ukraine's tax service, Ihor Bilous, estimated that under Yanukovich VAT fraud alone had cost the country a quarter of its national budget, with the money instead flowing into officials' offshore accounts.²⁹ If correct, this means VAT fraud has been costing Ukraine more every year than the \$15 billion it is currently being loaned by the International Monetary Fund to rescue its finances.³⁰

A more sophisticated form of corruption involved embezzling money from the state budget rather than from companies or individuals. The easiest way to do this was to target the \$50 billion annual state procurement budget. Researchers estimate that 30% of the amount spent on procurement was embezzled: \$15 billion annually.³¹

The 2010 procurement law obliged the state to publicly advertise tenders and the results (although this obligation was increasingly restricted as Yanukovich's reign wore on, for example by removing state-controlled companies from the process). This allowed researchers to investigate both the companies taking part and the prices the state paid. Insiders quickly learned how to exploit the law's loopholes to make money without obviously doing anything illegal.

"In general all corruption was done in accordance with the law," explained Olek Shalaisky:

"A state body announces a \$200 million tender; six big companies want to take part. Two come from the 'family' and four are just normal. These four are phoned and told that if they take part they will be checked for taxes tomorrow and forever. Two of them pull out. The other two stay, and problems are found in their documents, and they are excluded from the auction. For example, we found that a document was refused because it was printed in font 13, not 14, and another because the stamp did not fully cover the director's signature. Two firms are left, both with high prices, and they win. And when you ask why the government paid twice what it had to, officials answer that it was all legal, in accordance with the law."³²

An example of how this worked was revealed in 2013 when the Anti-Corruption Action Centre (AntAC) investigated Ukraine's medical procurement market, and specifically the prices the government paid for HIV and tuberculosis drugs.³³ HIV is spreading in Ukraine at a rate in Europe second only to Russia and now infects around 1% of the working age population, almost a quarter of a million people. The Ukrainian Academy of Sciences estimates that only 5.7% of people who died of AIDS-related illnesses in the first half of 2013 had been provided with ART (anti-retrovirals) for the previous 12 months.³⁴

AntAC documented a system so murky that international drugs companies refused to take part in it. Their absence cleared the field for shell companies—what AntAC calls “pseudo competitors”—established by insiders and owned via nominees either offshore or in Ukraine to divide up the contracts between themselves. The prices paid by the Ministry of Health via these rigged tenders were one and a half to three times higher than those paid for the same drugs by Ukrainian patients’ organisations, despite the latter being poorer and smaller and thus in a weaker position to negotiate low prices with drugs suppliers.

The study concluded that \$4.9 million out of the \$21.9 million spent on ARTs—22% of the total—was embezzled in 2012, and a slightly higher proportion in 2013. Only six companies out of the 6,500 registered pharmaceutical suppliers in Ukraine won tenders to provide anti-retrovirals, often delivering them late. In sum, “corruption, staged competition... prevent Ukraine from overcoming the epidemics of HIV/AIDS and tuberculosis, both of which have threatened the country’s national security”.³⁵

Other abuses of the state procurement system were easier to see.³⁶ In 2011, Yanukovich’s son Oleksandr, previously an unsuccessful dentist, bought the Ukrainian Bank of Development (UBD). In February 2012, all employees of the Tax Service began to receive their salaries via UBD, rather than the state-owned Uneximbank.³⁷ In 2013, UBD also gained the accounts of the interior ministry and, in some parts of the country, the judicial services.³⁸ UBD also won the right to issue credits to state railway companies. UBD’s assets increased ten-fold in just four years, much of it money that would otherwise have been earned by a state institution.³⁹ Oleksandr Yanukovich’s MAKO holding company was equally successful in other sectors, making its owner, in the three years of his father’s rule, the second richest man in Ukraine’s Donetsk region after Rinat Akhmetov.⁴⁰

‘Intermediaries’ offer another channel for corruption. The most well-known are those set up by Firtash to sell gas to Ukraine. Anti-corruption campaigners in Ukraine also have suspicions about a contract signed between Royal Dutch/Shell and Ukraine to exploit shale gas reserves in the Donetsk region.⁴¹ Their production sharing agreement, signed in January 2013, could result in enough gas being produced by 2018 to end Ukraine’s energy reliance on Russia. Shell will invest \$10-50 billion in exploration and drilling, and the deal runs to 2050.⁴² But the final stakes are held 50% by Shell, 45% by a state oil company, and 5% by three little-known geologists through a firm called SPK GeoService. All parties claim the deal is above board, that the geologists are not nominees acting for an insider, and that Shell did all the required due diligence. The geologists insist they bring expertise to the deal, a claim they justified in an interview by pointing out that one of them speaks English.⁴³

It nevertheless challenges commercial sense to imagine that a government and a super-major with access to the planet’s finest geological expertise would need to give three obscure geologists an equity stake in a deal expected to earn tens of billions of dollars. Both members of the Ukrainian parliament and activists have insisted that the deal be investigated.

Another form of corruption involved the illegal privatisation of state property. The most dramatic examples of this phenomenon involved Yanukovich’s palace at Mezhyhirya, and his hunting lodge at Sukholuchya, both of which were privatised without any of the formalities required by law. In 2007, when Yanukovich was prime minister, the land at Sukholuchya was transferred to the State Forestry Commission, which then transferred it—without either tenders or an official announcement—to a private company called Dom Lesnika, which was owned by Astute Partners in the UK. That company was in turn controlled by a nominee director, Reinhard Proksch, a US-

trained Austrian lawyer resident in Liechtenstein. The governor of the Kiev region changed the designation of the land from agricultural to recreational, meaning that Yanukovich could then build himself a guesthouse to stay in.⁴⁴

In the case of Mezhyhirya, Yanukovich seized a nature reserve outside Kiev and transformed it into a private estate complete with golf driving range, yacht club, zoo, tennis court, and a gigantic log palace, which he filled with his possessions. Mezhyhirya was owned by Tantalit, a Ukrainian company, which was owned by Euro East Beteiligungs GmbH, another Austrian company, which was in turn owned by Blythe (Europe) in the UK, which was also controlled by Proksch.⁴⁵ These privatisations went unchallenged by prosecutors, judges, or police.

These transactions were facilitated by a corrupt judiciary. According to the lawyer Andriy Kutuzov, court reforms designed to create a more independent judiciary had the effect of making them corrupt: "Before 2001, every third day I was in court because I had to collect debts and it was unheard of to pay a bribe. Then the judicial reform took place. There was suddenly no possibility of getting a ruling without paying a bribe. The whole legal system changed, you just started taking money from clients to judges."⁴⁶

In the final years of Yanukovich's presidency, property rights became so loose, and rule of law so weak, that state officials and insiders began, simply, to seize businesses: "It was Yanukovich's approach to ask for a share, usually 40%, so they did not need to manage it, but could control it", says Kutuzov. That, for example, was the fate of the television station TVi. Konstantin Kagalovsky, a London-based former vice-president of Yukos Oil, launched TVi in 2008, and, by 2013 it was probably the only media outlet consistently independent of government control.⁴⁷

In April 2013, the state register of companies in Ukraine was changed to transfer ownership of TVi from Kagalovsky's UK company Wilcox Ventures, to a second UK company, Balmore Invest. That same month, TVi's management was locked out of the station and the staff were informed that they were now working for a new owner. "On April 23, in the morning people went to work and, in the office there were these big guys, these fighters in tracksuits, they did not let the director into work," said Denis Bigous, then an investigative journalist for TVi. "In the time of Yanukovich, people who wrote about corruption were not well-loved."⁴⁸

Because both companies are UK-registered, the case has been fought in London, which is why the details are now known. It has emerged that a forged signature was used to gain power of attorney over the company's assets, and to deprive Kagalovsky of his channel. In January, the High Court in London found Alexander Altman—who helped arrange the take-over—to be in contempt of court, and he could face a jail sentence when hearings resume later this year.

Other 'raids' (as these court-sanctioned take-overs are known) are less well-publicised and harder to investigate. Businessman Bernard Carr lost an office building to competitors who managed to gain access to the land registry:

"It's basically about who pays the police more. The problem was that the police were being paid by both sides. We were paying the police and so was he. So we went to court and tried to buy our way through the court. The lawyers said if we paid 6,000 euros we would win, but you can't guarantee the other guy won't pay 7,000 euros. And you don't get a refund if you lose, which we did...I have lost count of the number of times I've been told that if I pay someone a couple of grand a problem would go away, but then not have it go away."⁴⁹

How are the proceeds of corruption laundered?

To extract illegal money from Ukraine, Russia, or anywhere, and transform it into legal money offshore, requires ingenuity. In recent years, several Western companies have proved happy to establish the legal vehicles required.

One such vehicle is Astute Partners, the vehicle through which Yanukovich concealed his ownership of Sukholuchya, his hunting estate. It was a British “shell” company created in 2004 and kept in readiness by a Trust and Company Service Provider (TCSP) for the day when someone might want it. On September 3, 2009, someone did indeed want it, and the director and owner changed from being “Nominee Director Ltd” to Reinhard Proksch, who could conceal the company’s true ownership behind attorney-client privilege.⁵⁰

Because Yanukovich was designated a politically-exposed person (PEP), anyone conducting business with him was legally obliged to do extra due diligence and check that the money or assets involved were not tainted. Proksch has insisted he has all the documentation at his office. “I am not a crook,” he told Reuters in February 2014, shortly after Yanukovich was ousted. “I really think that we have done nothing wrong... I’m really looking to sort it out.”⁵¹ He has since denied any connection to Yanukovich, telling an Austrian newspaper that Blythe and Astute belonged to “a Dubai-based Russian investor”.⁵²

If Proksch did indeed decline to do business with Yanukovich, others would have stepped in, however. Navimax Ventures Ltd, a British company through which the president owned three palaces in Crimea, as well as a coal producer in the Donetsk region, was created by A1 Company Services. Its director is Fynel Limited (Cyprus), which is in turn managed by Latvian nominee Stan Gorin.⁵³

These kinds of structures have several advantages. First, the sheer number of jurisdictions—Ukraine, UK, Nevis, Austria, Cyprus, and Latvia, as well as others hidden behind secrecy jurisdictions and nominee directors—complicates any potential investigation. Second, the “British” ownership gives both a veneer of respectability and access to UK courts. Third, ownership via Nevis or a similar jurisdiction makes it impossible for any future investigator to find information on beneficial ownership since registers there do not ask for it, and therefore do not have it. Fourth, Cyprus and Latvia have long-standing experience of dealing with former Soviet clients, and their bankers and directors have a reputation of waving through Know-Your-Customer requests without serious checks.⁵⁴

A whole industry thus exists to provide clients with companies nested through several jurisdictions, without asking questions about what those companies will be used for. A World Bank study published last year laid out a “three layer test” for offshore structures. Since there are rarely commercial reasons for complicated structures, the bank suggested that any company with more than three layers should be subjected to heightened checks to see whether it is hiding money or obscuring ownership. Some of the structures Yanukovich employed had five layers before they even got beyond a secrecy jurisdiction, and should have raised concerns anywhere they did business.⁵⁵

TCSPs, the organisations that set up companies on the behalf of individuals, are the system's gatekeepers. Under international Financial Action Task Force guidelines they are supposed to ascertain the identity of the beneficial owner of any structure they create, but the World Bank study found that 42 out of 102 TCSPs surveyed failed to do so.⁵⁶ Any lawyer involved in money laundering would know which TCSPs do not ask questions, and route business their way.⁵⁷

Because the same names have appeared in investigations into both Yanukovich's money and the money known to have been stolen from Hermitage Capital—the case that led to the death of the Russian lawyer Sergei Magnitsky, and a subsequent international anti-corruption campaign—it is clear that these offshore networks of companies and banks are well-established, operate with impunity, and are available to anyone who is willing to pay for them. "In the Hermitage case, there was a pre-existing money washing machine, a network of offshore companies that exist just to launder money. It does not appear to be beholden to any one particular crime," said Jamison Firestone, a Western lawyer, who employed Magnitsky. "There are go-to guys. They are not our targets; they are just the intermediaries. There are always guys who are in the business of moving money without putting your finger prints on it."⁵⁸

Particularly large bribes are typically paid directly into an offshore bank account, probably in Cyprus, while so-called 'black financiers' can exchange cash held in Ukraine for money held in a bank account offshore, typically for a 5% cut.⁵⁹ Most officials want to be able to move this money back to Ukraine, which is why they want offshore companies to connect them directly to the international financial system. Cyprus is consistently the single biggest investor in Ukraine (accounting for almost a third of the total sum as of April 1, 2014). Investigators think most of the Cypriot money is illegal and on its way back in the guise of legal foreign direct investment. Other lax jurisdictions also invest heavily in Ukraine. The British Virgin Islands was in the top 10 largest investors last year, while Belize invested almost as much as the United States.⁶⁰

Sometimes, the money is invested in legitimate businesses outside of Ukraine, which makes it difficult to investigate. Oleksandr Yanukovich, for example, owned a coal-trading company based in Switzerland, which was audited by PwC.⁶¹ "It is almost 100% likely . . . that any Ukrainian with a large amount of money has been earning it unofficially," said Borys Danevych, the second partner in the law firm Marchenko and Danevych.⁶² Nevertheless, it can be almost impossible to separate dirty money from legitimate funds once they have flowed through an offshore bank account.

What is Ukraine doing about it?

Ukrainian officials are naturally distracted by the disintegration of the south east of the country, and thus are not giving the battle against corruption the attention that it deserves. Indeed, this may be why this area of the country is under attack. "I speak to people in Ukraine and they cannot deal with asset recovery and the complexity of tracing assets when they have Russia on their doorstep," said Antonio Suarez-Martinez, a lawyer from Edwards Wildman in London, and an expert in money-laundering enforcement. "Half the lawyers are concerned about being conscripted and sent to the front."⁶³

Nonetheless, officials are taking some steps to prevent Yanukovich's system re-creating itself under the new president. In April, parliament took the first step towards passing a new procurement bill, which will restore the lost elements of the 2010 law, and learn from its deficiencies. "It is a very good piece of law that tries to close the deepest corruption risks," said Oleksii Khmara of Transparency International Ukraine.⁶⁴

Parliament is currently considering a new 'anti-corruption strategy', which will include the creation of an anti-corruption agency, a public information campaign to dissuade the giving and taking of bribes, an efficient way of monitoring officials' earnings and expenditure, further simplification of the procurement system, and tougher punishments for corrupt officials.

The precise details are being thrashed out between deputies, but Viktor Chumak, head of the parliamentary committee for fighting corruption, said the country also needed new registers of property, and a register of beneficial ownership.⁶⁵

"We need a clear, honest, transparent institution to fight corruption, we have adopted all laws to make corruption a criminal offence with prison terms, and with large fines. In legal terms we have already done a lot, but we need to change the institutions. There must be a preventive organ to fight corruption, and there must be an organ to investigate corruption. There must be high salaries and highly motivated staff."

Different officials are currently battling over who will control the new institution—dubbed 'Ukraine's FBI'—with the presidential administration, the government, and parliament all keen to have final oversight, and the power that that would bring. Oleksii Khmara of Transparency International wants the agency to be as independent as possible, and only to "co-ordinate" with the government rather than be run by it. "It's hard to get this through parliament because they understand that, when the institution is established, they will be punished," he said.⁶⁶

Change is made difficult by the fact that the Ukrainian parliament still, for the moment, contains the same deputies elected under Yanukovich. Chumak says that just 10% of his peers were honest.⁶⁷ Pessimistic though that sounds, most journalists and activists dismissed the figure as hopelessly optimistic. Denis Bigous said the total was "more like 10 people".⁶⁸

However, the Justice Ministry has also contributed by drafting a new version of the anti-corruption law, which will regulate conflicts of interests and also bring in a lower threshold for the size of purchases that officials have to declare. The ministry is currently proposing a threshold of 80,000 hrynias from the existing 150,000 (\$6,800 from \$12,800), although most activists would like it to be significantly lower still.

Other ministries are taking lower-profile, but nonetheless significant steps to plug some of the loopholes that have facilitated corruption. The agriculture ministry, for example, has made land leases longer, and abolished grain and granary certification, which will free farmers from some of the demands of regional officials.

Most officials and activists agree that, since judges have significant freedom of action, the judiciary would be the hardest sector of the state to reform. The issue is so difficult that most officials do not bother suggesting a solution, preferring to focus on easier questions, although one did say—only half-jokingly—that Ukraine could outsource its entire judicial system to the European Union.

"If the judicial system was less corrupt, that would bring everything else into line. A lot of these other things about transparency and public information are important, but they're details," said Thom LeGrand, a Western diplomat who has liaised with the Ukrainian government in the fight against corruption. "None of this matters if your courts are not open and transparent, and if your prosecutors are not doing their jobs."⁶⁹

Outside parliament, journalists and activists are working very hard to seize the opportunity to investigate corruption. One team retrieved the documents Yanukovich attempted to destroy at Mezhyhirya by throwing them into a lake. Divers fished them all out and dried them in the sauna. They then scanned them and posted them online, where they are available on the website YanukovichLeaks. They handed the originals to prosecutors.

Another team, led by Denis Bigous, is attempting to piece together shredded documents dumped by the businessman Serhiy Kurchenko, who became extremely rich under Yanukovich, and is widely seen as having been a front man for the 'family'. He fled Ukraine in February, and left 45 bags of confetti documents in dustbins near his office.

The journalists plan to present any proof of crimes that they find to prosecutors, and then to insist that those prosecutors do their jobs. AntAC already has files full of the complaints it sent to prosecutors before Yanukovich's downfall, and has documented each case when they failed to take action. If they continue to sit on cases that need to be prosecuted, AntAC intends to send the files to the general prosecutor's office in the expectation that the dilatory lower level prosecutors will be punished. Some prosecutors do appear to be taking a more proactive position than they did in the past. Anna Babinets, an investigative reporter, said she had been invited by the prosecutors to share her findings three times.⁷⁰

"I was there the last time two or three weeks ago, someone called me from a hidden number and he said he was the deputy head prosecutor and he wanted to see my documents about Kurchenko," she said. "I believe in cooperating with the prosecutors. I try to be like a kid. I have been a journalist for a long time and I understand this is naïve, but I want to believe them. If they lie to us, then they will have a big fight."⁷¹

Babinets said she had been surprised by how little prosecutors understood about investigating financial crimes, and had even volunteered to spend a couple of hours a day teaching them how to use the most common internet resources. She said they had no idea how to use the state procurement database or news databases regularly accessed by journalists to verify information.⁷²

With so many officials remaining in their old jobs, so many of the old schemes remaining legal, and with the courts, police, and prosecutors in no condition to punish offenders, Ukrainians worry that the gains of the revolution are not yet won. Their battle to build an honest state, already complicated by the unrest in the south east, is extremely complex and far from over. The experience of 2004-5, when the Orange Revolution changed the president but failed to change the system, is at the forefront of minds that have been focused by the blood shed during the Maidan uprising.

"The protests in 2004 were very different. That was like a protest party, we had songs and fun, and it was very easy, but this time it was very hard with real tragedy, it was very painful for everyone in the country, now we are angry, and we will be angry with this government too," said Babinets. "In 2004 we thought that Yushchenko would be president, and that would be enough, and everything would be great, like he was superhero, but we were wrong. Now we understand that nobody can change it, only we can."⁷³

What should the West do?

Ordinary Ukrainians are obsessed with recovering the money their former rulers have hidden in the West. Any statements on the subject by Western officials have enormous resonance. Expectations are high that the Western authorities will follow through on their promises, and return the money to Ukraine. Considering the lengthy legal process that lies ahead, the main problem facing Western officials is managing those expectations. "If the money which was stolen from Ukraine is not returned here, it will be such a massive blow against Euro-integration, it would be like they don't care about these 100 deaths," said Shabunin.⁷⁴

In this context, the possibly over-estimated figures given by Ukrainian officials for how much money was stolen from the country are not helpful, since most ordinary Ukrainians expect the return of \$30 or \$40 billion to be a relatively straightforward affair. So far, the actual amount of assets frozen has fallen far short of that kind of sum, with the UK freezing just \$23 million, Switzerland \$193 million, and Austria and Liechtenstein freezing non-specified amounts. The court cases initiated to return the money have barely started.

"It is hard to freeze money, and even harder to return it, and it will take two, three, or five years but people from Ukraine believe that the EU can send this money by the autumn, that they could be getting five or ten billion dollars by the autumn," said Khmara.⁷⁵

The experience of the corruption case brought against Pavlo Lazarenko, prime minister of Ukraine in 1996-7 and a close ally of Tymoshenko, suggests that even "two, three, or five years" could be optimistic. Lazarenko fled to the US when he lost his immunity from prosecution in 1999, and was arrested and charged. He was finally convicted of corruption in 2006, and sentenced to nine years in a federal prison. He was freed in 2012. Despite the previous Ukrainian government hiring a top British law firm to find them, his assets have yet to be returned to Ukraine. It is now some 17 years since he lost the prime ministership and the US accused him of stealing \$250 million.⁷⁶ US investigators believe the money is being held in accounts in Antigua and Barbuda, Guernsey, Liechtenstein, Lithuania, and Switzerland.⁷⁷

Despite the political will shown at the Asset Recovery Conference in London in April, the process of clawing back some of Yanukovich's wealth is also likely to take years, if not decades. Even if the money is found and it is proven to have been stolen, and even if the countries holding it agree to return it, it may still be handed back under strict and humiliating conditions. Switzerland, under the continuing oversight of a foreign NGO and the World Bank, has returned only \$48 million of the money that was stolen from Kazakhstan.⁷⁸

Western countries need to focus too on other aspects of their assistance to make sure Ukrainians do not become disillusioned while the court cases drag on. Within the country, prosecutors, journalists, and NGOs all need help in investigating corruption. Financial and technical expertise could be very valuable. A programme to provide government services online could be relatively cheap to provide, and by reducing the number of face-to-face interactions with ordinary Ukrainians, it would help reduce the options for officials to levy bribes.

Western countries could also be far more proactive in prosecuting foreign companies that have engaged in corruption in Ukraine. Forcing them to clean up their acts would give not

only an example of best practice, but would also put pressure on the Ukrainian government to enforce its own laws properly. If local companies did not have to abide by the same rules, foreign firms would be at a disadvantage.

The most important assistance that could be given to the peoples of the former Soviet Union, however, would be to prevent their leaders using Western countries as repositories for their stolen wealth. International guidelines already exist to implement this.

If TCSPs, banks, lawyers, and other foreign professionals applied AML regulations as zealously towards post-Soviet kleptocrats as they do towards potential terrorists, then the whole system that has maintained chaos and corruption in the former eastern bloc would collapse. As it stands, however, Western investigators show no interest in investigating proactively, and thus the kleptocrats have few grounds for concern.

In May 2013, lawyers acting for Hermitage Capital sent the British Revenue Service a packet of documents alleging wrong-going by GSL, a British TCSP, which set up the companies used to launder taxes paid by Hermitage in Russia. These taxes were illegally claimed as refunds by officials (in the case that led to the death of Sergei Magnitsky). The documents alleged not just GSL's involvement in creating the companies, but also its attempts to frustrate the investigative process in a civil case brought by Hermitage, and in failing to fulfil any of the AML requirements.⁷⁹ The only response Hermitage received was a pro forma.

"We have gone all over the world filing criminal complaints about the money laundering in the Magnitsky case. The only place where we have hit a stone wall of inaction is the UK," said Bill Browder, of Hermitage Capital:

"By not acting, the British authorities are giving the green light to money launderers and organised criminals, and it's impossible to do anything about it.

There should be repercussions for known money launderers, but there are none that we can see in the UK. The environment here encourages them all the more. There have also not been repercussions in some of the offshore jurisdictions, but you don't expect them to behave, but in the UK we would have expected better."⁸⁰

In the UK, the anti-corruption process is led by the Department for International Development, and focuses on countries with which Britain has an aid relationship: primarily, in sub-Saharan Africa. I could find no ministry, or enforcement agency, prepared to talk to me, even off the record, about the UK's efforts to track down and return Ukrainian money.

The United States government has been better. In 2011, the Justice Department announced the creation of a new Kleptocracy Asset Recovery Initiative⁸¹ to help investigate former officials from the governments being overthrown in the Arab world. It pledged to find assets stolen by corrupt officials and use civil forfeiture law to confiscate them. Although this was very welcome, the US did nothing specifically for Ukraine. A grand jury indictment against Firtash was issued in June 2013 but then sealed, and an arrest warrant was only issued after Yanukovich was overthrown. Firtash is currently on bail in Austria, awaiting extradition. To the bafflement of Ukrainians, the charges relate to bribes paid in India, and have nothing to do with Ukraine at all.

Conclusion

Western countries won significant goodwill among ordinary Ukrainians thanks to their rhetorical and financial support for the Maidan revolution. This pro-Western sentiment is of crucial importance in keeping pressure on Ukraine's new president and his officials, and forcing them to reform the country on a European model. That goodwill cannot last forever, however, and the West will have to take substantial steps to assist Ukraine in overcoming the many obstacles on the path to a more honest future.

Yanukovich's use of Western money-laundering vehicles is well known in Ukraine, as is the fact that Western countries took no effective steps to stop this while Yanukovich was in power. If those countries do not help put an end to the system now, Ukrainians will believe that their admiration for the West is not reciprocated. If cynicism spreads among Ukrainians and they conclude that the West and Russia are as bad as each other—that, in essence, Westerners say pretty things but in reality care only for money—then the revolution will fail.

Anyone who wishes to see Ukraine join Europe, rather than slide back into Moscow's embrace, must then be prepared to help Ukraine break its post-Soviet habits. The most effective form of help would be to block the institutional pipelines that sucked money out of Ukraine and pumped it westwards. This would deprive corrupt Ukrainian officials of the ability to hide their ill-gotten gains, strengthen the state, and empower its citizens.

Western money-laundering and offshore operations supported Yanukovich and continue to support Putin, and thus maintain regimes inimical to the values that Western governments profess to hold. Allowing former Soviet kleptocrats to steal from their own peoples not only strengthens them individually but, by allowing them to fund allies in the West, weakens us in turn. Tackling the offshore structures that have facilitated the theft of the people's property in the former Soviet Union is, therefore, in everyone's interests—except, that is, those of the thieves and their fences.

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ABOUT THE AUTHOR

Oliver Bullough

Oliver Bullough is an award-winning journalist and author. He has written for newspapers and magazines in Britain and America, including the *Guardian*, the *New York Times*, and the *New Republic*, and previously served as a *Reuters* Moscow correspondent. His most recent book *The Last Man in Russia and the Struggle to Save a Dying Nation* is published by Penguin. Oliver travelled to Ukraine in the spring of 2014 as part of his research for this report.

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LEGATUM INSTITUTE

11 Charles Street
Mayfair

London W1J 5DW
United Kingdom

t: +44 (0) 20 7148 5400

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