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HEADLINES:

- \* RICIN IN GEORGIA?
- \* RUSSIAN ARMS IN IRAN
- \* UKRAINIAN MONEY LAUNDERING

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END NOTE

UKRAINE REMAINS ON MONEY-LAUNDERING BLACKLIST

By Taras Kuzio

Ukraine in 1993 acceded to the 1990 international Convention on Laundering, Search, Seizure and Confiscation of Proceeds from Crime. Ukraine in September 2001 was placed on a "blacklist" compiled by the Financial Action Task Force (FATF), which was established in 1989. Those placed on the blacklist include countries deemed by the FATF to be countries that "do not cooperate" in combating money laundering.

Ukraine's legislative record against money laundering, corruption, and the shadow economy is ^ - on its face - ^ very good. But, as with Ukraine's decade-long "struggle" against corruption, its campaign against money laundering and the shadow economy remains virtual (see "RFE/RL Crime, Corruption and Terrorism Watch," 6 September 2002).

In March 2001, a presidential decree outlined extensive "Measures to Eliminate the Shadow Economy." In August of the same year, the Ukrainian cabinet issued a statement outlining measures to combat money laundering that was followed by a presidential decree in December on "measures to avoid the legalization of criminally derived proceeds." A law with similar recommendations and title was finally adopted by parliament on 28 November 2002 and signed into law on December 9. The FATF believes the law is inadequate in a number of key respects, however, and a spokeswoman said on 22 January that the United States and Canada have introduced sanctions in response to the flawed legislation (see "RFE/RL Newslines," 23 January 2003).

Unfortunately, much of the impetus for this legislative activity has come from abroad. The same can be said of criminal cases launched against high-ranking corrupt officials or oligarchs. Combating phenomena such as money laundering is not a priority for Ukraine's leaders, critics say, despite the lip service they devote to such aims. "It is doubtful that commercial banks have given the state complete information, as bankers are often indirect participants in shadow schemes," the "Den" newspaper reported on 11 April 2002.

Why is Ukraine's struggle against money laundering and the shadow economy virtual? As with many international and domestic legislative acts signed by Ukraine and other CIS states, such measures have had not been effectively implemented. The neo-Soviet political culture that pervades state institutions and the post-Soviet ruling elite sees no contradiction between adopting and signing legislative acts and then undertaking or allowing domestic activities that fly in the face of such laws.

Another problem that reduces the effectiveness of the struggle against dirty money and the shadow economy is the selective use of such legislation against political opponents. In October 2001, the Estonian police provided evidence of the transfer of millions of dollars to foreign accounts by Prime Minister Pavlo Lazarenko in 1996-97; Lazarenko is now on trial in the United States. Yet Prime

Minister Lazarenko received two state medals for his services to the Ukrainian economy from President Leonid Kuchma and, despite being deprived of his parliamentary immunity, was allowed to leave Ukraine.

Instead of seeking to identify the circumstances of Lazarenko's money laundering within the Ukrainian political-economic system itself, Kyiv has rather sought to place the blame on the Baltic states as allegedly major conduits for money-laundering operations.

In October 2001, the Latvian Foreign Ministry reminded Ukraine that it had submitted a proposal to Kyiv to sign an agreement to struggle against economic and financial violations and the return of illegally transferred capital. Ukraine never agreed to the initiative.

The fact that Lazarenko reportedly laundered some \$12 million before leaving Ukraine in 1999 through the Slovyanskyy Bank, whose vice president at the time was the now-deceased Borys Feldman, was well known to Ukrainian law-enforcement officials. Yet they stopped neither that transfer nor the dealings that Yuliya Tymoshenko had with Somali Enterprises, an offshore company created in Cyprus by Unified Energy Systems of Ukraine, which she used to run. Money was being laundered by Somali to pay Lazarenko, according to the U.S. indictment against Lazarenko. Yet Tymoshenko was accused of wrongdoing only years later, once she came into political conflict

with Kuchma.

Politically motivated and selective prosecution of anti-money-laundering and corruption legislation is quite common. The case of radical anti-Kuchma oppositionist Tymoshenko is well known -- as is that of the destruction of the Slovyanskyy and Grado banks and the imprisonment of banker Feldman. "Den" on 11 April 2002 pointed out that "large political projects" (i.e., elections) cannot be undertaken without the use of funds from offshore zones and dummy companies. The oligarchic Social Democratic-United Party demanded \$50 million from Russian businessman Konstantin Grigorishin for the 2002 elections. When he refused, his businesses in Ukraine were destroyed. Our Ukraine deputy Viktor Pynzenyk calculated that \$500 million-\$600 million in funds from the shadow economy was spent in the 2002 elections. Even larger shadow economy funds will be likely spent in next year's presidential elections.

Interagency rivalries and the use of information for political blackmail also hamper anti-money-laundering activities. The State Tax Administration always opposed the creation of an independent financial-intelligence agency, as required by the FATF. Yet the Tax Administration head at the time, Mykola Azarov, was a member of the same pro-Kuchma For a United Ukraine electoral bloc as Prime Minister Anatoliy Kinakh, who supported its creation.

Anticorruption and organized-crime departments have long existed

within both the Ukrainian Security Service and the Interior Ministry -- although their effectiveness is suspect, as they have themselves often been implicated in illegal activities. After much opposition, the agency demanded by the FATF was established within the National Security and Defense Council.

During the 1990s, Ukraine, like most CIS states, organized a massive transfer of property from state to private hands. Most of the proceeds from this privatization process ended up in the shadow economy. Only in December 2001 did Kuchma introduce measures to halt "shadow privatizations" in which oligarchic groups maneuvered energy firms -- such as the Donbas and Luhansk oblast energy companies -- into incurring large debts in order to purchase them later with dubious funds at rock-bottom prices once they went into bankruptcy.

In presidential elections in the summer of 1994, Leonid Kuchma pledged to reduce the size of the shadow economy. Nine years later, it remains the same size. Obviously, some institutions and influential political-economic forces benefit from such a large shadow economy. As Kuchma admitted in a speech to the STA in December, "You understand the shadow sector is very large in Ukraine."

In a joint conference in June 2002 by the Interior Ministry and the STA, it was admitted that the shadow economy accounts for half of Ukraine's gross domestic product. Some 356 offshore

companies, the majority of which are not registered in Ukraine, own stakes ranging from 10 percent to 98 percent in fuel-energy, metallurgical, and mining enterprises (i.e., Ukraine's most lucrative sectors). Seventy-eight percent of the ore-mining sector is in the hands of offshore companies.

"Tremendous financial resources remain outside the budget," acting Prime Minister Kinakh said in November. Under Viktor Yushchenko's government (December 1999-April 2001), much of those funds was brought back onto the budget and used to pay wage and pension arrears. Tymoshenko's expertise was useful in understanding the complicated financial machinations surrounding corruption in the fuel-energy sector.

The Yushchenko-Tymoshenko government harmed too many vested interests, and the government was voted out by pro-Kuchma oligarchs and the Communists. Corruption today in the fuel-energy sector, where barter accounts for 92 percent of transactions, has returned to the levels under Lazarenko -- including with the involvement of high-level oligarchs such as Kuchma's son-in-law, Viktor Pinchuk.

Money laundering is intricately tied to the shadow economy, as it operates through transborder transactions and offshore zones. At one stage in the 1990s, the offshore zone of Cyprus ranked third in foreign investment to Ukraine. Dummy companies are set up in offshore zones to which capital is transferred by Ukrainian

businesses and banks (3,500 dummy companies were suspended last year alone). It is precisely due to the transnational aspects of money laundering from Ukraine that the United States imposed sanctions against it in December under the U.S. PATRIOT Act.

Ukraine's political-economic system is not conducive to combating problems like money laundering. The lack of transparency and Western-style "rules of the game" in the economy and budgetary spheres are all factors inhibiting Western investment while encouraging a deepening of corrupt practices within which Russian and CIS investors might best operate.

Dr. Taras Kuzio is a resident fellow at the Centre for Russian and East European Studies and adjunct professor, Department of Political Science, University of Toronto.