Organized Economic Crime and Corruption in Ukraine

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One of the most disastrous consequences of the collapse of the Ukrainian communist system has been the wide-spread increase of economic crime. This phenomenon is self-sustaining, penetrating all levels of Ukraine's economy and administrative sectors. Criminal activity helps to sustain the shadow economy in Ukraine, which has been estimated by various sources to constitute 50-60% of the economy. Law enforcement and administrative efforts have been largely futile in curbing this corruption. Nevertheless, it is possible to overcome the criminal social and economic order that has become ingrained in this "shadow economy." This paper seeks to propose policy solutions for Ukrainian economic crime and corruption, that could be implemented at the national level.

Present day organized crime and corruption in Ukraine, complex in both content and structure, are a direct result of the profound economic, cultural, and political changes brought about during Ukraine's transition as a Newly Independent State. According to the Ministry of Internal Affairs, in 1990, the number of recorded economic crimes in Ukraine was 35, 723; by 1999, this figure had risen to 65,724. Hidden figures and underrepporting, however, ensure that these numbers are a gross underestimate. The highest levels of criminal activity occur in the credit and financial system; the fuel and energy sector; the area of taxation; mining and metals industries; foreign economic activity; and the area of privatization. Both Ukraine's administrative bodies and its criminal justice system are poorly equipped to handle this increase in criminal activity.

Clearly, Ukraine is unable to cope with the continuing onslaught of economic crime and corruption. What are the reasons for Ukraine's incapacity for dealing with this problem? And what

realistic countermeasures exist that can help combat these factors? This paper will examine the following six factors that contribute to Ukraine's current prevalence of criminal economic activity: political; economic; administrative and organizational; social and psychological; legal and law enforcement. Not coincidently, these factors also represent areas where potential countermeasures might be applied to reduce this negative trend.

Political Countermeasures

The loss of state organizational control over the economy, spurred by Ukraine's transitional period, has made it difficult for the government to implement effective measures to counteract the rise in economic crime. During the early stages of reform, the state's previously held monopoly on Ukraine's economic activities provided an environment in which economic crime could thrive. State assets became attractive to criminal groups because bureaucratic economic reforms of this period were carried out without supervision. As a result, organized crime groups aligned themselves with the few who controlled both political and economic power, forging close ties that would allow organized crime to both grow and receive bureaucratic protection.

The goals of Ukrainian organized crime groups were primarily to gain access to the privatization process; ensure various economic privileges that would allow them to increase profits; avoid taxation and criminal liability; and to launder illegally-obtained funds. This became possible through the bribery of public officials, who themselves, in order to sell their services at the highest price, frequently solicited bribes from criminals. During the mid-1980s, nearly 33% of criminal capital was spent on bribing public officials, and current research demonstrates that this figure has risen to 50%.[1] According to data provided by the Organization on Economic Cooperation and Development, in 1998, Ukraine ranked 16 out of 85 countries as being most corrupt. In 1999 it had a ranking of 24 out of 99 countries of the

world (Russia was number 17). In 2000, Transparency International's Corruption Perceptions Index ranked Ukraine third out of 90 countries, behind only Nigeria and Hungary as most corrupt countries. World Bank experts estimate that the annual amount of bribes in Ukraine is equal to two months of the commodity turnover in the country. Experts at the Ukrainian Center for Political and Economic Research cited such data in the journal *Natsionalna oborona i bezpeka* [National Defense and Security]. This publication also reports that within nine years the level of bribery in Ukraine rose by 2.6 times. For purposes of comparison, in 1999, 4,300 reports were filed against civil servants under Ukraine's Law on Combating Corruption. During the first quarter of 2000, the number had already exceeded 2,000.

A public opinion poll was conducted among 1,050 Ukrainian citizens of various social status, sex, education, age and occupation for this research. Four different questionnaires were developed concerning economic crimes, bribery, commerce and privatization-related crimes. Of the 1,050 polled, only two percent of Ukrainian citizens believed that no officials accept bribes. Those surveyed, instead, believe that the bribes are often necessary for securing required permits, licenses, and other documents.

Realistically, organized economic crime cannot exist without the cooperation of government entities. It is no coincidence that the term "oligarchy" has become firmly entrenched in the Ukrainian political lexicon. It is testimony to the symbiosis of the criminal, business and political worlds in Ukraine. In Ukraine, 364 of 450 national deputies have ties to the economic activities of 3,100 businesses that were responsible for 23.5% of the country's exports and 10% of the country's imports. Taken together, these businesses had a 4.1 billion hryvnia debt to the state budget.[2] As stated by Major-General V. Lytvynenko, first deputy head of the General Directorate for Combating Organized

Crime in Ukraine's Ministry of Internal Affiars, "The mafia are corrupt representatives of various branches of power."

International banking circles, unlike those in Ukraine, employ certain measures to counteract corruption in the banking field. According to the newspaper "Den," a group of eleven international private banks adopted additional measures to combat organized crime and corruption.[3] The group, whose members include ABN Amro, Barclays Bank, Banco Santander, Central Hispano, Chase Manhattan Private Bank, Credit Suisse Group, Deutsche Bank, HSBC, J.P. Morgan and Societe General, is chaired by the American Citibank and the Swiss UBS. Peter Eigen, the head of Transparency International, a non-governmental organization involved with combating corruption, stated that as a result of the adoption of new principles "the process of depositing illegally earned funds into the world banking system by corrupt persons will become more difficult." Members of this banking circle have emphasized that the principles have enormous significance because they will be applied on a worldwide scale.

Economic Countermeasures

In the past ten years, economic reform in Ukraine has not served to deter economic crime, but rather has encouraged the conditions under which it can thrive. Failed economic reform resulted in many undesirable activities and outcomes, including the unequal allocation of areas of the economy that yield superprofits. For example, public officials are gaining access to financing and crediting privileges in super-profitable economic areas - - areas that possess the highest level of liquidity and recoupment of capital investment such as distillery and tobacco production, foodstuff and oil-processing industry and etc. Other undesirable activities and outcomes include: the creation of monopoly associations and

privileges; illegal redistribution of state resources to criminal businesses; granting of privileges to corporate and bureaucratic entities; fluctuations in pricing; and a significant decline in production in areas with low concentrations of resources. The resulting economic crisis opened the door for illegal exportation of goods to foreign countries, theft of currency and fraud. As a result, Ukraine was plunged into an economic crisis with all its negative consequences: a decline in production, economic imbalance, a decline in the standard of living, inflation and hyperinflation, a decrease in the productivity of labor and so on. This then created ideal conditions for rampant organized economic crime and corruption including: smuggling, exporting of unlicenced raw materials and rare-earth metals, massive tax evasion, counterfeiting, price manipulation, monetary resources fraud, engaging in forbidden trades, the establishment of fictitious enterprises, lending operations using counterfeit notes, murder-for-hire, contract killings, and so on. Consequently, an alternative economy developed, concentrated mainly on trade and intermediary trade activity. Even now, more than a half of all registered enterprises are operating in this area.

The combination of the ill-considered exclusion of the state from regulating economic processes, the disruption of economic ties with countries of the former USSR, liberalization of prices, various types of manipulation of money circulation, interest rates on loans, tax rates and granting various privileges to businesses engaged in foreign economic activity rendered the economy uncontrollable. These conditions then created the necessary foundation for an grand-scale increase in economic crime in Ukraine.

The methods chosen for economic privatization, coupled with the government's inability to exercise state control during reforms, served to create both a vacuum of public control and general apathy towards what has become known as the "economic theft of Ukraine." The result of this

exploitation of state weaknesses during economic restructuring was a redistribution of state property that benefitted criminal, bureaucratic, and corporate entities and considerably undermined the industrial potential of Ukraine.

Privatization and failed economic reforms caused a sharp decline in the gross national product and a corresponding decline in budget revenues. This, in turn, brought about a reduction of social welfare expenditures on low-income persons, whose numbers have been steadily growing in recent years. In order to redress this trend, Ukraine exacerbated the problem with fiscal policies that included intensified pressure of taxation on entrepreneurs; a considerable increase in expenditures from state special purpose funds; an increase in the number of financial and supervisory bodies; and an increase in payroll taxes.

These and other economic factors led to the polarization of society by social and economic status and the appearance of a new social class of the "superrich" and this, consequently, led to their increasing influence in the political sphere.

The aforementioned circumstances did not provide an opportunity to create an effective system of political, economic and social institutions for the market economy but, to the contrary, led to an even greater intensification of the conflicts that had caused and promoted the considerable increase in organized economic crime and corruption.

Organizational and Administrative Factors

Directors and staff of administrative and economic entities use state property, raw materials, labor, material, finished goods and financial resources without supervision. These individuals then form enterprising clans whose corporate interests outweigh those of the state. While the state must regulate the economy in order to prevent social and political unrest, the state must simultaneously avoid total

regulation of the economy, which would result in underproduction, deficit, and inflation. The inefficacy of government regulation systems in place is exemplified by the finding that, according to Main Control and Auditing Department of Ukraine (CAD), during nine months of the year 2000, more than 10,000 governmental organizations and 12,600 businesses misused government funds.

The system of state control is somewhat developing in breadth but not in depth - in the direction of improving its efficiency and quality. There are presently over 100 state agencies that exercise control over the economy but their effectiveness, however, in counteracting economic crime and corruption is extremely low.

Social and Psychological Factors

Countering the influence of criminogenic factors depends to a considerable degree on the emotional and psychological state of the individual, his/her level of material well being and level of legal consciousness.

One cannot underestimate the influence of economic crisis, political instability and social conflicts on the psychological condition of society or, by the same token, on the criminogenic situation within a state. On the one hand, these conditions can lead to social pessimism, apathy and political aggression. This is especially apparent in the presence of an ideological vacuum, resulting from the destruction of a traditional socialist system that supported the moral values for the State. Additionally, these social and psychological factors can lead to a belief in satisfying needs and acquiring profit by any means, including criminal ones.

Both civil servants and law enforcement personnel are commonly and justifiably mistrusted by the general Ukrainian population for their perceived frequent and unpunished willingness to abandon moral norms and violate their professional integrity. There is a common Ukrainian belief in the slogan,

"Everything can be bought and sold.." This prevalent mentality can thus render the use of social and psychological factors as countermeasures to organized crime and corruption virtually ineffective.

Legal Factors

Legal factors in combating economic crime and corruption must above all involve improving current legislation so that it provides a comprehensive system of countermeasures and reduces the conditions that breed such crime. Certain Ukrainian legal provisions currently in force, however, actually serve to promote it. Flaws in legislative regulation of political and economic reform in Ukraine have created a paradoxical situation in which legislation, rather than creating a sound legal foundation and ensuring compliance with the law, has become one of the factors that are destabilizing this process.

Ukraine's current legislative framework is of a declarative and abstract nature. Laws aimed at regulating economic relations do not provide any substantive improvements nor are they effective in helping to curb increasing economic crime. Current Ukrainian economic legislation is characterized by loopholes, internal inconsistency, and unregulated mechanisms for its implementation. Six in ten of those surveyed in our public opinion poll cited Ukraine's legislative framework as a contributing factor for crime and violations of law in the economic domain.

In the application of a legal framework to counteract economic crime, the emphasis should be shifted from the use of criminal and legal measures towards a more proactive legislative approach. For example, creating civil, economic, financial, and tax legislation that would help facilitate more transparency for economic entities would help exclude the possibility of unlawful, socially dangerous economic activity. It is essential to develop mechanisms for organizational, economic, legal, social and political measures that ensure the effectiveness of such legislation. To ensure legislative effectiveness in the prevention of corruption and economic crime, the state might employ economic forecasting,

legislative oversight of lobbying bills, monitoring social and economic consequences of legislation, and a procedure for introducing amendments.

Factors Associated with Shortcomings in Law Enforcement Activity

Aside from the pervasive corruption in the system of law enforcement and advisory bodies, Ukraine's current institutions possess fundamental shortcomings that prohibit them from combating corruption and economic crime effectively. Although supervisory and law enforcement agencies have jointly campaigned somewhat successfully against organized crime and corruption, our public opinion poll revealed that two-thirds of the general population, as well as 52% of the police force, regarded law enforcement work to be "low" level or in decline.[4] This decline can be attributed to the failure of the old Soviet-model law enforcement agencies of Ukraine to reorganize and "retool" in line with Ukraine's changing economic and social conditions in a timely manner. The result has been a Ukrainian economy characterized by criminal, rather than legal, economic activity.

Criminal activity in Ukraine benefits from a strong network created by the number of ex-law enforcement employees hired by Ukrainian businesses. The resulting ties between criminal economic activity and law enforcement result in lax pursuit and superficial investigation of criminal activities, especially at higher levels. Due to corruption, the anti-organized crime efforts of Ukraine's law enforcement agencies attack only small groups who pose no great threat to the economy.

The percentage of crimes committed by organized criminal groups is growing. In 1990 it comprised 4.7% of crimes, and in 1999 it comprised 12.1%.[5] The effectiveness of Ukrainian state crime solving measures could be improved with better logistical support of law enforcement agencies. Such agencies are currently overworked, underfunded, and lack proper equipment to effectively solve

economic crimes. Productivity in law enforcement may be low because of high levels of financial and social insecurity as well.

Additionally, judicial sentencing for economic crimes is becoming more lenient. A content analysis was performed for this research on 1,839 criminal cases considered by the courts during 1992-1999 in 25 regions of Ukraine on economic and corruption (malfeasance in office) crimes. According to our analysis of court sentencing practices, in up to 50% of cases, convicted persons receive punishment below the minimum. In 24.2% of cases, only a fine was imposed on convicted economic criminals. Asset forfeiture and revocation of the right to hold certain positions is rarely imposed. Of those committing economic crimes in office, only 14.1% were imprisoned, 80% received lighter sentencing than the minimum, 17% of those convicted were subject to asset forfeiture, and 22.7% of those convicted lost the right to hold certain positions. The perceived lack of enforcement by the public can only serve to further the distrust of law enforcement and "legal nihilism."

Further, out of the total number of crimes stipulated by the chapter of the Criminal Code of Ukraine on economic crime, 59% do not reach trial. In addition, a considerable number of economic criminal cases (about 50%) are dismissed at the preliminary investigation stage without any further action taken with the accused. In addition, Ukrainian state agencies report only about 50% of the crimes committed by organized criminal groups, which makes it difficult to effectively research this type of crime. An international standard for reporting criminal activity is in order if the situation is to be well researched for purposes of international comparison.

In order to combat large-scale corruption, there must be better control over the activities of state administrative and executive branch agencies, which currently receive very little oversight. Both private citizens and the media have been unable to effectively press the responsible agencies to fulfill

their responsibilities in combating corruption. In order to successfully campaign against corruption, legislation must be passed creating investigative and auditing commissions. The Ukrainian state also needs to create a public anti-corruption committee which would encourage and give citizens incentives to uncover and report organized criminal economic activities.

Ukraine's economic difficulties are an easy target for foreign criminal groups, who move funds and goods in and out of the country in order to conceal profit and evade taxes. The transnational crime implications of Ukrainian organized economic crime have not adequately been remedied by existing treaties. There are significant Ukrainian criminal ties to the U.S. and Russia, which facilitate international organized criminal activity and allow fugitive criminals to continue criminal activities from abroad. As of this writing, essential joint efforts between the U.S. and Ukraine are currently on hold, pending U.S. Congressional ratification of the Treaty on Mutual Legal Assistance in criminal matters between the two countries. All industrialized countries must make concerted and collaborative efforts to investigate and prosecute economic criminals from all nations.

The common belief in Ukraine is that Ukrainian organized crime is as equally powerful as the state; it is running the economy; and it is immune from criminal prosecution. Its presence undermines Ukrainian attempts to normalize market relations and combat economic criminal activity.

Ukrainian law enforcement agencies and supervisory bodies require restructuring aimed at increasing the qualitative effectiveness of law enforcement activities. The establishment of an objective and impartial unit to combat corruption and organized economic crime in Ukraine's National Bureau of Investigation (NBI) is urgent. The NBI itself, however, as decreed by the President of the Ukraine, has not yet been created. The need for the NBI or a similar agency responsible for pretrial investigation, removing the sources of corruption and economic crime, and forecasting the dynamics of crime in

Ukraine is urgent. Further research must be done on combating economic crime in mixed economies (like Ukraine). Reforming law enforcement agencies and supervisory bodies before new legislation and directives are developed must be a prerequisite to help state agencies battle and overcome organized economic crime.

Notes

1. Zotov M.N. *Role of Preliminary Investigation Agencies under Combating Corruption. Corruption: Political, Economic, Organizational and Legal Issues. Collected Articles of the International Scientific Conference (Moscow – September 9-10, 1999). /Edited by Luneyeva V.V./ - M.: Jurist, 2001. P.41.*

2. *Yuridicheskaya praktika* [Legal Practice] 25 (22 June 2000).

3. Vremya "Banks are Uniting against Crime," *Den* [The Day], #133/November 14, 2000.

4. To study law-enforcement employees' opinions about the current system of law enforcement and controlling agencies of Ukraine, researchers conducted a poll among 95 employees of the Organized Crime Department and 71 employees of Prosecutor's Office of Kharkov region. All respondents hold different positions and have different record of service.

5. *Crime in Ukraine: Statistic Collection / State Statistics Committee of Ukraine; Kyiv – 1988. P.41; Express-Information on Crime in Ukraine for the period of twelve months of 2000. Kiev, 2002, p. 34-36.*