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## **Ukraine, International Money Laundering and the Investigation of Organized Crime**

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Ukraine's environment of economic transformation has provided organized criminal groups with ample opportunity to drain Ukraine's resources. Economic reform and the liberalization of Ukraine's international trade policies have helped to facilitate capital flight by both individuals and legal entities. Ukraine's economic security is continually compromised because of the illegal currency accumulations by foreign and domestic groups, which are becoming more and more deep-rooted and international in character. In the year 2000, capital flight from Ukraine exceeded some \$2 billion.<sup>1</sup> This phenomenon is a considerable threat to Ukraine's economic security, in a country whose national yearly budget is only about \$6 billion.

Government restrictions to curb this criminal activity will likely raise concerns about property rights and capital freedom. The preservation and expansion of Ukraine's capital is, however, an economic necessity. Foreign trade profits that remain abroad serve to preserve the current criminalization of society and further promote corruption in state agencies. Ukrainian law enforcement officials estimate that the flow of currency out of Ukraine has increased by over 20 times since 1991.<sup>2</sup>

The Ukrainian Chief Directorate for the Struggle against Organized Crime, of the Ministry of Internal Affairs, reports that criminals maintain a high degree of control over this capital flight. This is evidenced by the fact that, as of 1996, over 6000 foreign economic contracts had not been completed, and there were over 3000 recorded violations of Ukraine's economic laws. Further, in 1997, there were 200 criminal cases filed in Ukraine involving the concealing of foreign currency earnings; the

prosecution of which resulted in a repatriation of \$33.5 million and 6.8 billion Russian rubles. The numbers of such cases appear to be increasing exponentially. Whereas in 1998 some 200 criminal cases relating to concealing of foreign currency earnings were filed; by the next year this number had doubled.<sup>3</sup>

The economic drain appears to be caused by a number of combined factors including Ukraine's unstable economy, high taxes, an individual desire for illegal wealth, and an incentive to invest in the economies of more stable, developed countries.

The most harmful threats to Ukraine's economic development include: international criminal groups, the depletion of raw materials and capital, an over-dependence on imports, a high ratio of foreign to domestic investment, surpluses of imports over exports, and inadequate regulation of competition from foreign producers.

Criminal penetration is endemic to Ukraine's organizational, administrative, legal and regulatory systems. There is little liability for violations of Ukraine's economic laws. Further, laws are often evaded and evasion occurs with the indifference and even assistance of corrupt officials. Clearly, procedures are needed to regulate Ukraine's international and domestic economic activities, both to correct deficiencies in the current system and to establish a mechanism to recover funds legally owed to Ukraine.

Past criminal codes have proven inadequate in grappling with and regaining control over Ukraine's criminal economic situation. Special provisions were added to the Ukrainian Criminal Code in 2001 to stipulate criminal liability for interfering with the economy, including interference with both foreign profits and non-repatriation of profits from exported sales and goods. In addition, specific provisions in the code now stipulate liability for larceny, bribery, document forgery and abuse of office.

These provisions, and government regulation of foreign economic activity, need revision and improvement, however, in order to have any real effect or make improvements. There exist a great number of contradictory standards, the adoption of hasty, at times, irrational decisions, protectionism and special interest lobbying. An example of this protectionism can be found in the exporting of scrap metal. Strategic raw materials are being removed from Ukraine, but these finished goods are exported under the guise of being scrap metal. In addition, a practice exists where exporters are entitled to a refund of the “value-added” tax, via arrangements with customs officials. False documents are produced in which “exporters” receive refunds without ever exporting any goods. This scheme is similar to a practice used by Russian automobile producers who reported “exports” and “re-exports” that occurred only on paper. Further, the practices of understating profits and tax evasion are also quite prevalent. Ukraine also fails to collect taxes due on understated profits and funds moved out of the country by authorized representatives of foreign legal entities.

Difficulty in detecting these crimes makes prevention efforts especially problematic. In order to have successful investigations and prosecutions, a thorough understanding is required of the means by which these crimes are committed. The various means by which economic crimes are carried out, including the concealing of foreign currency, depend on a number of objective variables. These include the environment of the crime; the specific sphere of activity, or area of the economy; the diligence of law enforcement and regulatory agencies; and the relationships and interactions of those carrying out the crime. Economic crime is equally affected by a number of subjective variables as well, including knowledge of paper flows; the level of criminal experience; and connections with collaborators in law enforcement agencies. The size and scope of an economic crime operation can range from unorganized (very little done by way of preparation, concealment or discovery prevention) to highly organized

(operations consisting of a wide range of personnel utilizing a comprehensive system of roles and employing various techniques).

There are primarily four main methods by which economic crime can be carried out in Ukraine. The methods used can be instructive in considering the detection and investigation tactics to combat them. The first of these is via the widespread practice of tax evasion. Businesses in Ukraine and abroad can evade taxes by keeping profits made in foreign currency in their businesses abroad, by collecting profits in foreign currency and paying workers in Ukrainian currency, and by using profits in foreign currency to pay “foreign expenses” so the money remains outside Ukraine. The development of international business relations between Ukrainian and foreign businesses, as well as the development of international networks of Ukrainian emigrants has provided another system by which Ukrainian businesses can conceal currency abroad. Often, Ukrainian partners will understate the cost of the goods or services provided, collecting the rest of the payment in foreign currency that will remain abroad. This currency can then be used to pay debts or make purchases, without any tax liability.

Another method involves the creation of fictitious companies by criminals to conceal currency assets and profits to fund, for example, criminal activity. For instance, a fake business is created using inaccurate or fabricated documentation, often using lost passports or the passports of deceased people, when registering with legal and customs authorities. The company then sets up a foreign economic contract and, through an authorized bank, acquires foreign currency and stores the funds outside Ukraine, pursuant to the fake contracts. Many perpetrators are sophisticated enough to not keep these bogus entities in existence for longer than 90 days (the mandatory limit for carrying out mutual settlements on export-import agreements - - after which the transactions are frozen in the bank account). Such operations are very difficult to uncover and can only be exposed using a regional

business register, and exposing both the illegitimate nature of the activities and the individuals involved with the business.

In other cases, businessmen export raw materials and goods from Ukraine maintaining that they will be temporarily stored or processed abroad, then violate this commitment by selling the goods and concealing their profits. Businessmen also sometimes import raw materials, claiming that they sell products manufactured from these raw materials abroad, while the company actually sells the raw materials or manufactured products in Ukraine.

Yet another common method employed to conceal currency assets is via international trade agreements. The terms of contracts may be changed by mutual consent or by signing supplemental agreements to them. In other cases, clauses are inserted into agreements with companies abroad, attesting to changes in the price of the goods -- say because of perishables becoming spoiled, for example -- thereby concealing the profits.

Probably the economic crime most difficult to detect is when Ukrainian businessmen conceal foreign currency with the aid of legal foreign entities. These schemes are largely used to convert funds and avoid taxation. Detection is difficult because the existence and origin of many foreign bank accounts is unknown. In 2000, over \$1.6 billion was transferred to Latvian banks via "Loro" accounts.<sup>4</sup> The fact that this amount is dozens of times more than the total amount of imports from Latvia certainly implies the existence of some illegal economic activity. The cooperation of the foreign bank is a prerequisite to successful investigation and interdiction; a proactive approach is critical to the timely discovery of the crime and determining the method by which it was committed.

There are many indicators that may exist to assist law enforcement in both detection and interdiction of such economic criminal activity. Some principal indicators include:

- a contractor's failure to meet a deadline for completion of settlements on foreign economic transactions;
- a recently formed legal entity entering into large foreign economic contracts;
- a large non-commodity contract (for example, for services only to be performed);
- a Ukrainian exporter's application for a barter contract specifically to change the terms of the agreement;
- currency declarations not filed with the State Taxation Administration by business entities;
- several contracts are made involving the same object or applications for changes in bargaining agreements.

Other indications of illegitimate economic activity include loopholes utilized to reduce or avoid tax liability, high turnover of personnel, family ties or other personal relationships with foreign partners or between contracting parties, and "abnormally" rapid success from business endeavors.

Awareness and investigation of these indicators will facilitate earlier detection of criminal economic activity, and thus will establish the necessary conditions for conducting successful investigations.

Law enforcement activities associated with the investigation of economic crime, including those involving the concealing of currency assets, cannot be limited within the country's borders. Cooperation between Ukrainian law enforcement agencies and their counterparts in other countries, first and foremost the Commonwealth of Independent States (CIS) countries, is particularly urgent. There have been efforts and headway in this regard and this is reflected in a number of international agreements. For example, the "Agreement on Mutual Action by the Ministries of Internal Affairs of the Independent

States in Fighting Crime” was signed in April 1992. And since 1993, the Prosecutor General of Ukraine has entered Agreements on Legal Assistance and Cooperation with the prosecutor’s offices of other CIS countries. Furthermore, steps have been taken to work more assiduously and - most importantly - on a multilateral level, in the “Convention on Legal Assistance and Legal Relationships in Civil, Family and Criminal Cases.”

Ukraine must do its part and fulfill its individual obligations to be proactive in the country’s implementation of international conventions, mutual assistance, and agreements made in the fight against international economic crime. In order to effectively investigate crimes involving the concealing of currency assets, Ukraine must improve the interaction and cooperation between law enforcement, the financial institutions, and monitoring agencies in Ukraine and with its foreign counterparts. For this to be successful and effective, however, a unified technical communications system/procedure must be developed and established - - especially in terms of networking and tracking. This communication platform has to facilitate country-to-country communication and cooperation, and also interaction with international organizations such as Interpol and Europol.

## Notes

1. *Visnyk - 02 #16*, 2000 Annual Statistic Report of the Ministry of Interior of Ukraine. Academic collection.
2. The Report of the Joint Meeting of Ukraine's Law Enforcement Executives. November 19, 1997.
3. *Visnyk - 02 #7*, 2000 Annual Statistic Report of the Ministry of Interior of Ukraine. Academic collection.
4. A Loro account is a commercial foreign account that operates within a Ukrainian bank. Via a local account in Ukraine, a foreign bank can perform transactions in accordance with Ukrainian regulations and legislation.