



THE ATLANTIC COUNCIL
OF THE UNITED STATES

Corruption, Democracy, and Investment in Ukraine

Jan Neutze • Project Director and Co-Author
Adrian Karatnycky • Co-Author



Policy Paper
October 2007



THE ATLANTIC COUNCIL

OF THE UNITED STATES

The Atlantic Council promotes constructive U.S. leadership and engagement in international affairs based on the central role of the Atlantic community in meeting the international challenges of the 21st century.

The Council embodies a nonpartisan network of leaders who aim to bring ideas to power and to give power to ideas by:

- stimulating dialogue and discussion about critical international issues with a view to enriching public debate and promoting consensus on appropriate responses in the Administration, the Congress, the corporate and nonprofit sectors, and the media in the United States and among leaders in Europe, Asia and the Americas;
- conducting educational and exchange programs for successor generations of U.S. leaders so that they will come to value U.S. international engagement and have the knowledge and understanding necessary to develop effective policies.

Corruption, Democracy, and Investment in Ukraine

Jan Neutze • Project Director and Co-Author
Adrian Karatnycky • Co-Author



Policy Paper
October 2007

For further information about the Atlantic Council of the United States or its
Program on Transatlantic Relations,
please call (202) 778-4990

Information on the Atlantic Council programs and publications is available on the
Council's website at <http://www.acus.org>

Requests or comments may be sent to info@acus.org

The views expressed in this report reflect the consensus of the authors and do not
necessarily reflect those of the Atlantic Council.



THE ATLANTIC COUNCIL
OF THE UNITED STATES

11th Floor, 1101 15th Street, N.W.
Washington, DC 20005

Table of Contents

Foreword.....	i
Members of the Atlantic Council Task Force	iii
Rationale for the Report.....	v
Executive Summary.....	vii
Overview of Corruption in Ukraine.....	1
Defining Corruption.....	4
Standard Indicators of Corruption for Ukraine.....	5
A Culture of Corruption?.....	6
Regional Differences Within Ukraine.....	8
Corruption in Specific Areas.....	10
Corruption in Economic Sectors.....	10
Corruption in the Judicial Sector.....	11
Corruption in the Executive and Legislative Branches.....	14
Political Parties and Political Corruption.....	18
The Role of the Private Sector.....	20
The Role of the Media in Investigating Corruption.....	23
Anti-Corruption Platforms of Political Parties.....	24
“On the Record” - The Political Parties’ View on Corruption.....	24
Relevance of the Election Outcome in Corruption.....	29
Conclusions of the Atlantic Council Task Force.....	30
Recommendations.....	31
Benchmarks for Measuring Progress.....	35
ANNEX I: Overview of Ukrainian Anti-Corruption Legislation.....	37
ANNEX II: List of Other Experts and Interlocutors.....	39

Foreword

Good governance and economic transparency are building blocks for democratic stability and development. Conversely, democracy is threatened where they don't exist. We at the Atlantic Council have witnessed the corrosive nature of corruption to young democracies in the post-Soviet space and in Russia itself – and we thus consider it one of the top challenges of the Atlantic Community to encourage those who wish to integrate themselves in its structure to above all tackle issues of political and business corruption.

We do not do this in any holier-than-thou manner, as we realize that not even the most developed of Western societies ever rid themselves entirely of corrupting influences. Yet, we all must hold the bar high for clean governance and realize that when corruption settles too deeply in a society it can place that country's future in danger.

Since its independence in 1991, Ukraine has been challenged by wide-spread corruption that, in the view of our non-partisan task force, permeates a significant part of Ukrainian politics, business, and society. Given Ukraine's strategic location, its economic heft, and its fragile stage of economic and political transition, how it deals with this issue following the recent elections is a critical factor to the country's political and economic health.

In order to assess the situation, and out of concern for a recent increase in corruption due to an apparent lack of political will to stop it, the Atlantic Council convened a Task Force of distinguished experts (see page iii) to wrestle with the disease and make policy prescriptions for the cure. Over the course of this project, the Task Force interviewed senior political leaders and business and NGO experts, both in the United States and in Ukraine. The result is a unique report which offers an unbiased perspective of the many different levels of corruption that exist in Ukraine, while assessing the role of important actors such as political parties, the media, and foreign investors in addressing this challenge.

This project was conducted around the time of parliamentary elections in Ukraine, when charges of corruption fueled the partisan debate. We found there was plenty of blame to spread in all political directions and felt no party or individual had a monopoly. Ukraine's political leaders have much to answer for yet they also must be part of the solution.

We hope this report will contribute to committing Ukraine's newly elected leaders to a more rigorous fight against corruption. That, in turn, is a precondition for Ukraine's aspirations to develop a stable democracy, build a fair and flourishing economy, and fully participate in European, Western and global institutions.

The Atlantic Council is grateful to all of the members of the Task Force who contributed to this project. We are indebted to the numerous experts in Ukraine and in the United States whom members of the Task Force met with for background interviews. Jan Neutze, assistant director of the Transatlantic Relations Program at the Council conceived of this ground-breaking project and served as rapporteur and co-author. Atlantic Council senior fellow Adrian Karatnycky contributed richly with his knowledge, advice and contacts. We owe particular thanks in the research and drafting help we got in Ukraine from

Vitaliy Moroz of Freedom House, and Ihor Lutsenko of E-Pravda, to our main translator Myroslava Luzina, and to our interns at the Atlantic Council, especially Yulia Kosiw and Paul Telleen, who provided valuable research and logistics support. We are particularly grateful to our sponsor, RJI Capital, for supporting this project with the very clear notion that greater transparency and less corruption in Ukraine will also create more jobs through greater investments.

A handwritten signature in black ink, appearing to read "Fred Kempe". The signature is fluid and cursive, with the first name "Fred" and last name "Kempe" clearly distinguishable.

Frederick Kempe
President and CEO

Members of the Atlantic Council Task Force on “Corruption in Ukraine”

The following is a list of members of the Atlantic Council Task Force who have endorsed this report.*

Ethan S. Burger, Scholar-in-Residence, School of International Service, American University, and Adjunct Professor, Georgetown University Law Center

Frances G. Burwell, Director, Program on Transatlantic Relations, Atlantic Council of the U.S.

Keith Crane, Senior Economist, RAND Corporation

Alan Dunn, Partner, Stewart and Stewart and former U.S. Assistant Secretary of Commerce

Adrian Karatnycky, President, The Orange Circle and Senior Fellow, Atlantic Council of the U.S.

Frederick S. Kempe, President and CEO, Atlantic Council of the U.S.

Jan Neutze, Assistant Director, Program on Transatlantic Relations, Atlantic Council of the U.S.

William G. Miller, Senior Policy Scholar, Woodrow Wilson Center, and former U.S. Ambassador to Ukraine

Steven Pifer, Senior Advisor, Center for Strategic and International Studies, and former U.S. Ambassador to Ukraine

Louise Shelley, Professor, School of Public Policy, and Director, Terrorism, Transnational Crime and Corruption Center, George Mason University

Gayden E. Thompson, RJI Capital and former Deputy Under-Secretary of the Army

*Individuals endorsing the report agree with the overall consensus represented by the report, but not all individuals will necessarily agree with every statement.

Senior Research Advisors

Vitaliy Moroz, Researcher, Freedom House Office, Ukraine

Ihor Lutsenko, Editor, E-Pravda

Corruption, Democracy, and Investment in Ukraine

Rationale for this Report

The challenges posed by corruption are by no means unique to Ukraine. Corruption is a phenomenon present in all countries, including today's most advanced economies and established democracies. Where it differs is in its scale and consequences. Corruption can be corrosive to public support for democratization, doing the process long term harm, as has been witnessed in many post-Soviet countries during their transition from Soviet-style communism to democracy. The Atlantic Council thus views fighting corruption as a key element in stabilizing relatively new democracies.

The Atlantic Council's Task Force on "Corruption in Ukraine" aims to present an outside perspective on the corrosive nature of corruption in Ukraine, a country critical to Europe's future due both to its size and geographical position. The report does not seek to single out Ukraine for criticism, but instead examines the frequent problem of corruption in transitional countries. It also does not compare Ukraine directly to other countries, as each situation must be dealt with individually in its own political context. In the report, we offer anti-corruption recommendations and benchmarks to Ukraine's leaders, to the private sector, to non-governmental organizations (NGOs), and to foreign governments and investors. These conclusions and recommendations are based on research and interviews conducted by members of the Atlantic Council Task Force in Ukraine as well as conversations with U.S., European, and Ukrainian experts on corruption.

We found that across the political spectrum, Ukraine's political elite agrees, with few exceptions, that corruption has become a threat to the country's democratic future and economic prosperity. Following the Orange Revolution, the Ukrainian government, as well as foreign governments and NGOs, began to address this issue through a range of legislative and administrative initiatives, including ratifying several international conventions against corruption, establishing governmental working groups, and cooperating with international advisory groups.

It is the judgment of the Task Force that the vast majority of these anti-corruption efforts have proven ineffective. Ukraine's extended political stalemate, a corrupt judicial system, and a failure in political leadership on all sides have allowed a widespread "culture of corruption" in Ukraine to persist. This has been exacerbated by a rise in international organized crime, which, paired with corruption in all branches of power, has the potential to make the Ukrainian government vulnerable to foreign political and economic influences, potentially endangering Ukraine's national security.

We concluded that only a significant reduction in the levels of corruption will enable Ukraine to provide the sort of investment climate that would generate large and consistent flows of foreign capital and prepare the country for its stated ambition of drawing closer to the European Union. This demands sustained efforts by political leaders who are not corrupt themselves.

While fighting corruption is an ongoing challenge for any country, including those in the developed world, election periods are also a good moment to galvanize change. Prior to the recent parliamentary elections, almost all political parties made anti-corruption programs a leading issue in their campaign – they must now deliver on their promises. The new Ukrainian government, working with the president, should make anti-corruption efforts a leading priority in a way that is unmistakable to voters and the international business and political community.

We hope the attached analysis and prescriptions can help Ukraine’s leaders analyze the challenge and tackle it. Such an effort will spur additional support from Ukraine’s friends abroad and among non-governmental institutions. It will generate greater investment and job-creation. It will ultimately strengthen Ukraine’s democracy, public support for its government, and its international standing.

If this report contributes to this process, it will have achieved its mission.

Executive Summary

Ukraine is facing a considerable challenge from corruption, which our research showed is present in nearly all levels of government and politics, the judiciary, and business. It is the view of the Task Force that corruption has become so severe that it has the potential to threaten Ukraine's political and economic stability as well as the country's European Union membership aspirations. While Ukraine has made progress since the Orange Revolution in areas such as developing an independent media and a more active civil society, its political leaders have failed to fulfill the core promise of the Revolution by effectively addressing corruption. Instead, our research revealed that public suspicions about corruption at the highest reaches of political power are widespread in Ukraine.

The country's major political candidates made anti-corruption policy one of the leading issues during the September 2007 parliamentary election campaign. This election thus provides an opportunity for a new government to launch an ambitious set of anti-corruption reforms. Yet, Ukrainian political leaders, even those that claim anti-corruption policy as a priority, have in the past failed to muster the political will to tackle this challenge. Indeed, allegations of corruption against some of these same political leaders and their parties reduce their willingness and credibility to act.

Corruption in Specific Areas

In assessing the challenges corruption poses to Ukraine, the Atlantic Council of the United States Task Force on "Corruption in Ukraine" has focused on the sectors most important to the country's democratic and economic development.

Corruption in Economic Sectors — Of all the sectors of the Ukrainian economy, experts interviewed by the Task Force agreed that energy, land and real estate, and the transportation sector have in recent years been the sectors most implicated in wide-ranging corruption. Of these, energy has been the most problematic.

Corruption in the Judicial Sector — The Task Force concluded that widespread corruption plagues the judicial system in Ukraine. Within the judicial sector, corruption stretches from bribery in the process of appointing judges to corrupt rulings and "lost" evidence. In addition, Ukraine has been plagued by so-called "raiding," the seizure of property by private interests made possible by corrupt court rulings. A recent survey of Ukrainians' trust in different government branches ranked the judiciary at the bottom, with only 10 percent having confidence in the judicial system.

Corruption in the Executive and Legislative Branches — Many of the experts interviewed by the Task Force assert that corruption among public officials and members of parliament is so pervasive that it has become routine and expected; a normal part of doing business. They in particular identified government procurement, privatization, and licensing processes as problem areas. The system of VAT refunds to businesses has been marred by radically uneven patterns of reimbursements, allegedly due to favoritism and "special arrangements" between businesses and state officials. The Task Force also heard widespread allegations of corruption in the Ukrainian legislature, including allegations of vote

buying and corrupt deputy defections from one faction to another.

Political Parties and Political Corruption — According to Ukrainian experts interviewed, the most problematic areas are: (1) how party lists are chosen for election participation; (2) financing of the political parties; and (3) parliamentary activities of people’s deputies and the parties. International observers ruled that Ukraine’s 2007 parliamentary elections were clean. However, prior to the elections, observers such as the delegation from the National Democratic Institute, raised concerns about recent modifications of election laws which have possibly opened the door for election fraud and falsification of future elections, i.e. by an increase in mobile ballot boxes and home voting.

The Role of the Private Sector — The private sector presents a mixed picture. The Task Force concluded that corrupt practices continue to be a major mechanism by which some corporations obtain market access, restrict competition, obtain favorable conditions, evade tax responsibilities, and secure needed regulatory rulings. At the same time there are many indications that the private sector is contributing to increased transparency and introduction of international best practices. This trend is most notable in the behavior of major international players entering the Ukrainian market and improved practices on the part of many major indigenous corporations. Ukraine’s oligarchs also play a mixed role. In seeking access to western capital and markets, they have begun to promote more transparent business practices. Journalists, however, have raised serious allegations about business leaders buying positive media coverage to cover up potentially harmful information about their companies.

Role of the Media in Uncovering and Investigating Corruption — Freedom of speech and freedom of the media in Ukraine have improved by most international indicators (such as the World Bank Global Governance Index) and the credibility of independent journalists has risen slowly but steadily. The development of a free press has been one of the major accomplishments of the Orange Revolution. Ukrainian journalists now more frequently address issues such as ethics violations and corruption by governmental officials and politicians. However, because of corruption in the political and judicial arenas, few media reports have led to actual criminal investigations.

Anti-Corruption Platforms of Political Parties — The election result shows that out of the five parties represented in the new Rada, only three won sizeable numbers of seats: the Party of Regions (175), the Yulia Tymoshenko Bloc (156), and the Our Ukraine-People’s Self Defense Bloc (72). The report presents an overview of their anti-corruption policy platforms as well as a series of statements by their leaders which could serve as a useful guide to some of the new government’s policies. Ukraine’s political leaders should realize that Ukrainian voters will hold the new government accountable for the promises made during the campaign.

Major Conclusions of the Task Force

- Ukraine's long term economic and political health can only be assured through a successful fight against corruption.
- The post-election period provides an opportunity to accelerate the fight against corruption. Regardless of who forms the government, a new election presents the government, ministries, and investigative and police institutions with an opportunity to change personnel and introduce new initiatives.
- Despite widespread cynicism about the will of Ukraine's current leaders to tackle corruption, it is clear that there are significant societal forces interested in good and transparent governance. Among these are the independent media, the civic sector, significant portions of Ukraine's dynamically growing private sector, a middle-class chafing under petty corruption, and a growing number of foreign corporations and investors who are attracted by Ukraine's economic growth.
- Even with public support, anti-corruption efforts will not succeed unless there is strong, committed, and sustained leadership from the top, from the president, the prime minister, and the speaker of parliament.

Recommendations of the Task Force

To the President, Parliament, and Government of Ukraine:

- Establish a new judicial chamber focused on investigating corruption involving high- and mid-level officials
- Create an independent national investigative bureau to uncover and root out corruption
- Thoroughly investigate allegations of Constitutional Court corruption
- Coordinate and consolidate anti-corruption legislation
- Eliminate or reduce the scope of parliamentary immunity
- Raise awareness of the concept of conflict of interest among public officials
- Publish annual declarations of assets and incomes of public officials
- Demonstrate the integrity of anti-corruption efforts by investigating allegations across the political spectrum
- Create an office of independent inspectors general in every ministry and major government agency
- Tackle corruption in higher education to end distortions in the educational system
- Tackle the problem of money laundering through an investigative unit attached to the Central Bank
- Report annually on results of the fight against corruption and take responsibility

To Other Governments and International Organizations:

- Establish a research and training center for Ukrainian anti-corruption personnel based on international best practices
- Support anti-corruption initiatives through increased technical assistance

To Non-Governmental Organizations, Donors, and the Private Sector:

- Establish anti-corruption clearinghouse to track the disposition of cases related to corruption
- Support annual foreign business surveys that would report on the experience of companies with corruption
- Fund indigenous Ukrainian anti-corruption training centers

Finally, a range of benchmarks should be established so that Ukraine's progress in fighting corruption can be measured. These should include: number of public officials and politicians charged with or convicted of corruption per year (increased number of convictions would point to successful anti-corruption strategy); investigations launched across the political spectrum (not just focused on members of one political party); investigative follow-up to mismatches between declared incomes and reports of extravagant lifestyle of political leaders; percentage of Ukrainians admitting to engaging in either bribing of or being extorted by public officials as measured in nationwide surveys; and others.

Corruption, Democracy, and Investment in Ukraine

Overview of Corruption in Ukraine

In contrast to the long history of Ukrainian culture and society, Ukraine is a young state, having attained independence in 1991 at the time of the dissolution of the USSR. Since then, it has surmounted a wide array of problems that accompanied the simultaneous tasks of building independent state institutions and making a transition from a state-controlled to a market economy.

Today, its economy is growing rapidly, averaging over 7 percent annual growth since the late 1990s.¹ In the first half of 2007, the economy expanded at an annual rate of 8.2 percent.² And while its democratic institutions remain fragile, Ukraine has developed a tradition of political pluralism, vibrant civic institutions, and strong independent media. Moreover, the March 2006 parliamentary elections were deemed “free and fair” by international electoral observers. The gradual emergence of a market economy and Ukraine’s slow, but steady integration into the global economy have also led to increased economic transparency.

Still, the country is plagued by many serious challenges, among the most important of which is widespread corruption. This is hardly surprising. Many, if not most, post-Soviet states have been plagued with varying degrees of political corruption as well as increased levels of corruption in nearly all sectors of the economy. While the challenges posed by corruption are by no means unique to Ukraine or Ukrainians, the Atlantic Council’s Task Force on Corruption in Ukraine has concluded that the country today is experiencing a degree of pervasiveness of corrupt behavior which permeates society and all levels of government. Corruption, which in some cases intersects with the operations of Ukrainian and international organized crime, has reached a level that leads many Ukrainian and Western observers to describe it as a direct threat to the country’s democratic development and economic prosperity.

In May 2007, the Millennium Challenge Corporation (MCC) published a comprehensive public opinion survey as part of its “Threshold Program” on anti-corruption efforts in Ukraine. The MCC study systematically examined Ukrainian perceptions of the scale of the country’s corruption problem. According to the survey, 52 percent of Ukrainians believe that “corruption is justified in most situations to get things done”; and 77 percent of the population believe that “corruption levels have remained the same or have increased since 2004.”³

¹ Jason Bush, “Ukraine: What Crisis?” Business Week. August 22, 2007 http://www.businessweek.com/globalbiz/content/aug2007/gb20070822_029442.htm.

² The World Bank. “Ukraine Economic Update July 2007” http://siteresources.worldbank.org/INTUKRAINE/Resources/Macro_update_070703.doc.

³ “Corruption in Ukraine,” MCC National Baseline Survey 2007.

In recent months, alleged bribery and other corrupt practices among Ukraine's political elite contributed to one of the country's most severe political crises, according to politicians interviewed by members of the Task Force. In early 2007, a number of members of the parliamentary opposition defected to the governing coalition led by Prime Minister Viktor Yanukovich's Party of Regions, allegedly in return for significant bribes and economic inducements.⁴ In April 2007, President Viktor Yushchenko issued a decree dissolving the Verkhovna Rada (Ukraine's parliament) and calling for early elections in order to prevent these allegedly corrupt defections from letting the Party of Regions build a constitutional majority of 300 deputies. During a tense political standoff, the Yanukovich-led Rada-majority and Cabinet of Ministers contested the legality of Yushchenko's decree. In May 2007, Yushchenko dismissed the Yanukovich-backed prosecutor general, prompting the interior minister from the governing majority coalition to send riot police to "defend" the Prosecutor General's Office, and leading many observers to fear that the crisis might end in violence.⁵ While Ukraine was spared that drastic outcome by a last-minute agreement among the major political actors to conduct early elections, a similar conflict in the future may not be resolved peacefully.

During the 2007 parliamentary election campaign, corruption was one of the dominant campaign issues. All the major political parties included anti-corruption platforms within their party manifestos or their leaders made corruption an important theme in speeches and interviews. All these parties vowed to step up anti-corruption efforts should they control the government following the elections. According to press reports, Ukrainians are fed up not only with having to deal with corruption in most interactions with public officials, but also are deeply disappointed in their political leaders – particularly the president – who, following the "Orange Revolution" promised to put an end to mass corruption.⁶ Failure to deliver on some of the key promises of the Orange Revolution and a lack of effective government action over the past three years have caused many Ukrainians to regard new anti-corruption initiatives with cynicism.

While there are many reasons for the persistence of corruption in Ukraine, polling suggests that public disappointment is particularly strong in the case of President Yushchenko as many voters believe he is one of the few top politicians who is not tainted by corruption. Yet, Ukrainians believe he has done too little to fight it. According to the MCC survey, the majority of Ukrainians (61 percent) view the president as primarily responsible for fighting corruption, yet only 21 percent believe he has shown the political will to do so during his three years in office. Ukrainians, however, have even lower opinions of the Yanukovich-led Cabinet of Ministers (only 13.7 percent believe it has the political will to fight corruption) and of Ukraine's parliament, the Verkhovna Rada (11.1 percent), which is currently also dominated by Yanukovich's Party of Regions.⁷

Despite corruption and the continuous political stalemate, the Ukrainian economy has grown at an annual rate of over 7 percent in 2006 and 2007. Last year, personal incomes and wages, adjusted for

⁴ "Tragedy and farce – Ukraine's messy politics," *The Economist* print edition, April 4, 2007.

⁵ Peter Finn. "Agreement in Ukraine Appears to Resolve Political Crisis." *The Washington Post*. Washington, D.C.: May 27, 2007.

⁶ "Ukrainian president promises clean government" *BBC Monitoring Former Soviet Union*. Feb 4, 2005. p. 1.

⁷ "Corruption in Ukraine, 2007 Baseline National Survey for the MCC Threshold Country Program," available at http://www.pace.org.ua/images/pace_baseline_survey2007_eng.doc.

inflation, grew over 15 percent.⁸ However, unless Ukraine's political leaders address the issue of corruption effectively, the Council Task Force believes that Ukraine's economic growth could prove unsustainable, and that its political stability and democratic development may be undermined through the conflicts of interest and scandals that result from corrupt practices. Moreover, Ukraine could set back its ambitions for European integration by failing to meet European Union good governance and anti-corruption standards. At such a critical moment in the country's history, corruption could lead to public disillusionment in its democratic transition. In the most extreme case, official corruption leaves national leaders vulnerable to blackmail and bribery by foreign security services – thus endangering even Ukrainian national security. The Task Force heard allegations by investigative journalists and at least one high-ranking government official that this was happening in Ukraine.

It is the assessment of the Task Force that, absent change, Ukraine's economy will be adversely affected. Ukraine is already losing opportunities as major western investors look to less corrupt countries with more transparent economies and a more stable political setting. Developing the Ukrainian economy through outside investment and integration into regional and global institutions, however, is crucial to raising the standard of living for all Ukrainians. In turn, greater growth and transparency in the long-term will also help to reduce the possibility of public officials engaging in or being vulnerable to corrupt practices. It is thus the responsibility of the Ukrainian political elite to make the fight against corruption a national priority. Ukraine's top political and business leaders can only effectively lead the fight against corruption if they accept and implement international standards of good governance and transparency.

The Task Force found that public suspicions about corruption at the highest reaches of political power – across the political spectrum – are widespread in Ukraine. Allegations concerning corrupt practices, conflicts of interests, and non-transparency have long dogged many politicians associated with Yanukovich and the ruling Party of Regions, some of whom were linked to massive voter fraud on behalf of Yanukovich in the presidential elections of 2004.⁹ According to media reports and Task Force interviews with Ukrainian political observers, other Regions Party officials are alleged to have built their fortunes using corrupt practices.¹⁰

Opposition leader Yulia Tymoshenko was the biggest benefactor in the parliamentary elections, having increased her party's result from 22.29 percent in 2006 to 30.71 percent in 2007. She won partly because she was successful in carving out a reputation as an advocate of strong anti-corruption measures, although she continues to confront questions about her past, in particular about the energy-trading fortune she made in the mid-1990s.¹¹ Her then business associate, Pavlo Lazarenko,¹² a former prime minister (1996-1997), was convicted in a U.S. court for money laundering through U.S. banks.¹³

⁸ Jiang Zhu. "Ukraine: The Road toward Political and Economic Liberalization Continues", R&I Special Report. March 15, 2007. <http://www.r-i.co.jp/eng/rating/inter/detail/r070315.pdf>.

⁹ "Powell: 'Fraud and abuse' in Ukraine vote," CNN.com, November 24, 2004.

¹⁰ "Yuschenko Blames Biz Before Elections," by Lionel Laurent, Forbes.com, September 10, 2007.

¹¹ "Who Is This Viktor?," Paul Quinn-Judge and Yuri Zarakhovich, Time Magazine, January 2, 2005.

¹² U.S. Department of Justice complaint: "United States of America v. all funds on deposit at Bank Julius Baer & Company, Ltd., Guernsey Branch et al," 1:04-cv-00798-PLF (D.C.), Compl.

¹³ "Ukraine: Why Was Former Prime Minister Lazarenko Tried In The U.S.?", by Askold Krushelnycky, RFE/RL, June 8, 2004, <http://www.rferl.org/featuresarticle/2004/06/e5e3a921-0571-42c4-b50a-515eebd65485.html>.

Although observers agree that President Yushchenko himself is not corrupt, he dismissed officials and associates close to him in September 2005 amid charges they had been involved in corruption.¹⁴

While accusations are so widespread that many may be without merit, the Task Force nevertheless was struck by public perception of a pervasive environment of corruption that political leaders had failed to address.

Defining Corruption

According to the United Nations' "Global Program against Corruption," there is no single, comprehensive, universally accepted definition of corruption.¹⁵ The UN Convention against Corruption, which entered into force in December 2005, describes corruption as:

The promise, offering or giving to [or the solicitation or acceptance by] a public official, directly or indirectly, of an undue advantage, for the official himself or herself or another person or entity, in order that the official act or refrain from acting in the exercise of his or her official duties.¹⁶

Transparency International, one of the leaders in fighting corruption worldwide, has coined the definition of corruption as "the misuse of entrusted power for private gain."¹⁷

In its "Civil Law Convention on Corruption," which Ukraine signed in 1999 and ratified in 2005, the Council of Europe defines corruption as "requesting, offering, giving or accepting, directly or indirectly, a bribe or any other undue advantage or prospect thereof, which distorts the proper performance of any duty or behavior required of the recipient of the bribe, the undue advantage or prospect thereof."¹⁸ The Council in 1999 also established the "Group of States against Corruption" (GRECO), which is intended to monitor the implementation of the Convention. Ukraine joined GRECO in January 2006 as its 40th member.¹⁹ In its effort to promote technical cooperation in the fight against corruption, the Council of Europe in June 2006 launched a three-year program aimed at fighting corruption in Ukraine.²⁰

Most international anti-corruption conventions also distinguish between grand corruption (significant bribes within the highest levels of government) and petty corruption (involving smaller amounts of

¹⁴ "Ukraine: Corruption Allegations Abound," by Roman Kupchinsky, September 8, 2005, <http://www.rferl.org/featuresarticle/2005/9/E539907C-99DC-419B-92BA-483C36A92B38.html>.

¹⁵ UN Office on Drugs and Crime, UN Anti-Corruption Toolkit, 3rd Edition, Vienna, September 2004.

¹⁶ UN Convention against Corruption, Article 15a, December 14, 2005.

¹⁷ Transparency International Website, <http://www.transparency.org/>.

¹⁸ Civil Law Convention on Corruption, Art. 2, ETS no. 174, Council of Europe, November 4, 1999.

¹⁹ "Ukraine Joins Anti-Corruption Monitoring Group", RFE/RL, January 12, 2006.

²⁰ See The Council of Europe website for more information about the "Project against Corruption in Ukraine" (UPAC): http://www.coe.int/t/e/legal_affairs/legal_co-operation/combating_economic_crime/3_technical_cooperation/upac/PC-TC-344-SummaryUPAC_12June06.pdf.

money within the context of established governance and social frameworks).²¹ For the purposes of this study, this report will focus primarily on grand corruption, which has important implications for Ukraine’s sovereignty, democratic development, economic growth and foreign investment.

The report’s focus on grand corruption is not meant to diminish the corrosive impact on the economy and on everyday lives of widespread petty corruption, which affects the lives of millions of Ukrainians who seek to send their children to school, receive state-guaranteed health care, and open and run small businesses. Everyday corruption also has a significant impact on the attitudes and outlook of younger generations which is affecting future prospects for change.

Standard Indicators of Corruption for Ukraine

Several international and non-governmental organizations track corruption through systematic indices based on surveys and expert evaluations. The most recent numbers on corruption in Ukraine by some of the standard monitors are provided below:

Freedom House – Nations in Transit 2007 — Since 2003, Ukraine has stagnated at a rating of 5.75 [1=highly clean, 7=highly corrupt] in Freedom House’s “Nations in Transit” ranking on corruption. The ratings of the report are based on the consensus of Freedom House, its academic advisers, and the author of the report.²²

Transparency International Corruption Perceptions Index (CPI) 2006 — With a CPI of 2.8 [10 = highly clean, 0.0 = highly corrupt], Ukraine ranks 99th out of 163 surveyed countries. It shares this ranking with countries such as Georgia, Mali, and Mozambique. The survey was based on perceptions of the degree of corruption by business people and country analysts. (The 2006 ranking was published in November 2006 and thus does not incorporate all of the recent developments under the Ukrainian government which came to power in the fall of 2006.) For purposes of comparison, in 2004, Ukraine had a CPI of 2.2 and was ranked 122 out of 145 countries surveyed.²³

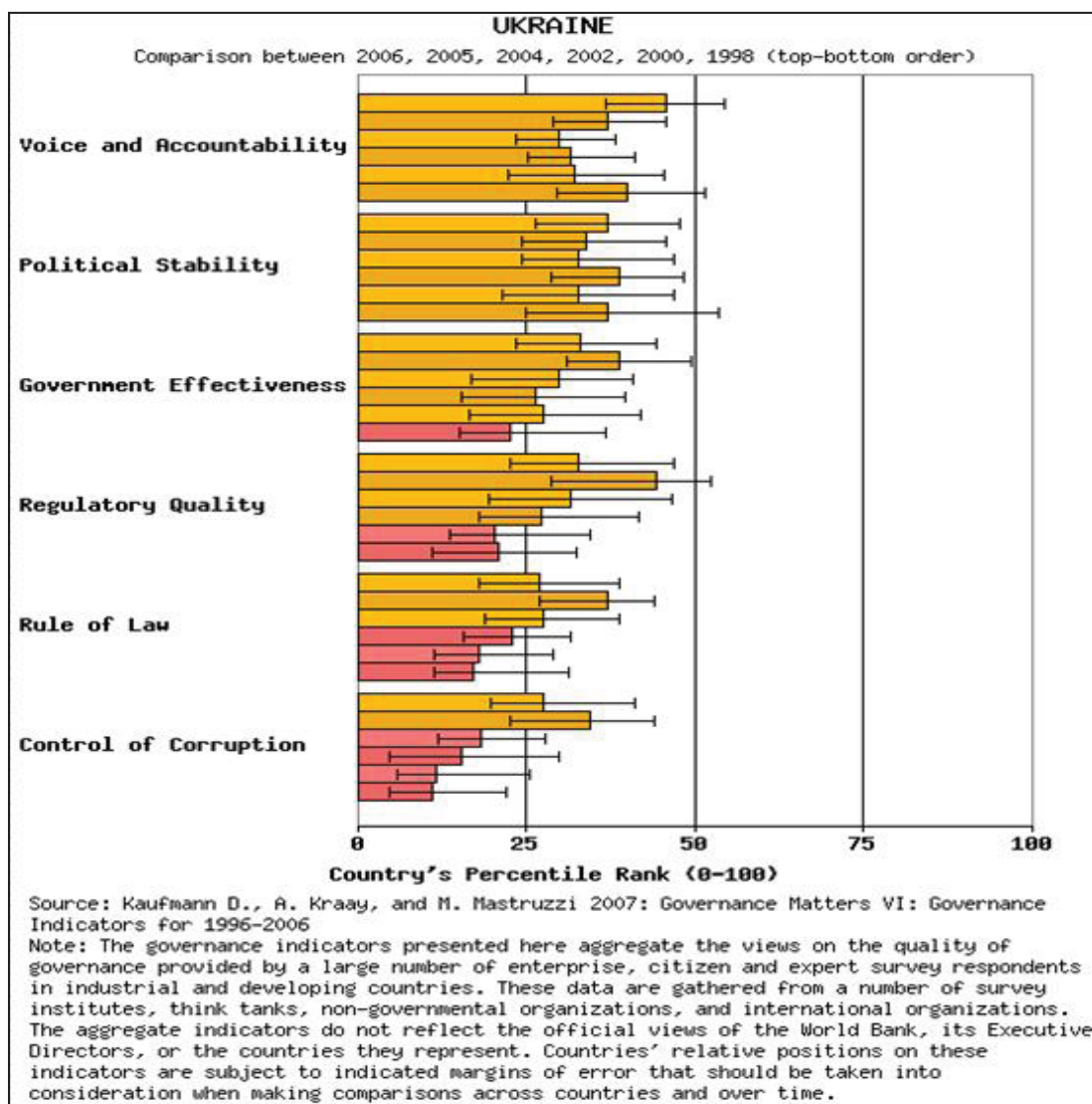
World Bank Institute – Governance Matters 2007 — The World Bank’s Worldwide Governance Indicators, which include measuring corruption in over 212 countries and territories, show Ukraine’s performance – after an initial improvement from 2004 to 2005 (following the Orange Revolution) – to have now slipped from a 34.5th percentile in 2005 to 27.7th in 2006 [100th percentile = highly clean]. World Bank experts have also pointed out, that following positive trends in 2005, Ukraine has entered a downward trend over the past year on five out of six governance indicators (including corruption), with “voice & accountability” (free and fair elections, free media) being the only indicator developing positively. (See chart below for more details).²⁴

²¹ UN Office on Drugs and Crime, UN Anti-Corruption Toolkit, p. 2.

²² Nations in Transit 2007, Country Report for Ukraine, Freedom House 2007.

²³ Corruption Perceptions Index (CPI) 2006, Transparency International.

²⁴ Governance Matters 2007, World Bank Institute.



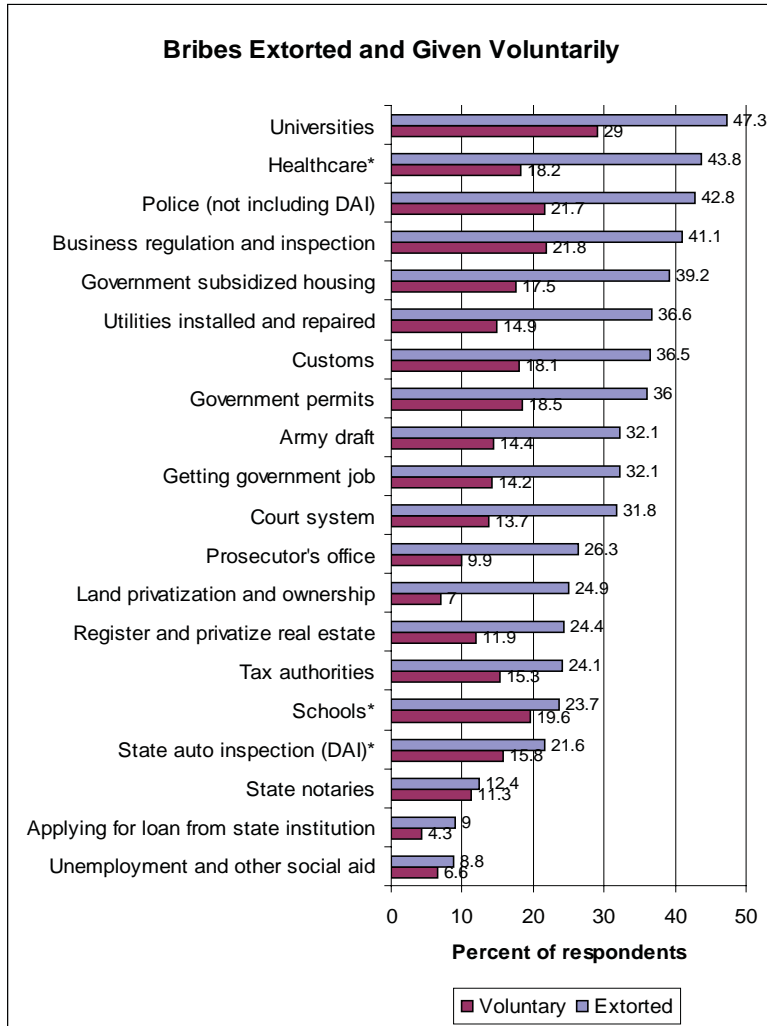
Culture of Corruption?

Recent figures published by the MCC 2007 Baseline Survey on Corruption in Ukraine²⁵ indicate that the public believes corruption is widespread in Ukraine in terms of “grand corruption” while most Ukrainians themselves have experienced a significant amount of “petty corruption” across a range of different sectors (government, business regulation and inspection, university, health care, etc.):

- 67 percent of Ukrainians who have dealt with government officials over the past 12 months say that they have been directly involved in corrupt transactions of some sort.²⁶
- Bribe extortion by officials (25 percent) is twice as prevalent as voluntary bribe-giving (11 percent).
- Large numbers of Ukrainians give bribes because it is customary and expected. Often bribes are given to ensure that public services are delivered either at all or in a timely fashion.

²⁵ See MCC 2007 Baseline Survey on Corruption in Ukraine, p. 5.

²⁶ The survey interviews took place from February 21 to March 21, 2007.



Source: MCC Survey 2007

could independently investigate wrong-doings by government officials, and a general lack of penalty enforcement once the rules are broken.

Instead, experts interviewed by the Task Force indicated that a post-Soviet “get it while you can mentality” seems to dominate the thinking of many who hold positions of power and influence. This attitude, coupled with the Soviet-era presumption that “this is the only way to get things done,” allows many Ukrainians to justify corrupt interactions with officials. Thus, the betrayal of the public interest is justified as helping one’s neighbor resolve a problem.

But there are also signs that things are changing. Rising public anger over massive high-level corruption was, together with voter fraud, one of the key catalysts for the Orange Revolution of 2004.²⁷ Speaking on Kyiv’s Independence Square after the revolution, Yushchenko and his team declared that his

Given this nearly endemic corruption in all layers of society and politics, what do Ukrainians themselves consider as “corrupt” behavior? How is this understanding formed? And how does it translate into political and civic action in the fight against corruption?

Whereas in the past, corruption was mostly defined by an exchange of favors, Ukrainian experts interviewed state that the majority of Ukrainians today also perceive monetary bribery and extortion as forms of corruption.

Different perceptions seem to exist with regard to “conflict of interest.” Ukrainian government officials expressed in interviews that among public officials, from the highest levels of government down to the local level, the delineation of what constitutes a “conflict of interest” is often unclear. In part this is due to a lack of unspecific ethical codes, the lack of an effective “inspector general” process that

²⁷ “The Orange Revolution” Wall Street Journal. New York, N.Y.: Dec 28, 2004. pg. A.10.

government would make the fight against corruption one of the highest priorities.²⁸ Unfortunately, the optimistic beginnings ground to a halt within the first year of the Yushchenko presidency. Progress on anti-corruption initiatives was slowed by the break-up of the “Orange Coalition,” which resulted in the firing of Yushchenko’s first prime minister, Yulia Tymoshenko. Well-intentioned anti-corruption initiatives went nowhere as a result of political infighting and “turf wars” among ambitious officials, or were watered down to a degree of complete ineffectiveness. Political observers have stated that advancing these initiatives appears to have become particularly problematic after Yanukovych returned as prime minister and his Party of Regions took control of the Rada following the 2006 parliamentary elections.

The lack of real progress on anti-corruption efforts is also due to bureaucratic disarray within the executive and a lack of Cabinet continuity. Ukraine has had three governments in two-and-a-half years, each of which has repudiated the policies of its predecessor. Moreover, the parliament has never been in the hands of a pro-reform majority (even after the Orange Revolution, there was never an Orange majority).

Regional Differences within Ukraine

Corruption is a nationwide phenomenon in Ukraine that affects all of the country’s 24 oblasts (provinces), the autonomous republic of Crimea, and the cities of Kyiv and Sevastopol (which have administrative status akin to oblasts). Yet, the research of the Task Force demonstrated that regional variations do exist, as corruption is more likely to occur in settings in which civil society is weak and media pluralism is absent. In Ukraine, such weaknesses occur along a geographic divide and an urban-rural divide, with civic groups and independent media most developed in major urban centers.

Politically, Ukraine has traditionally been divided along an approximate East-West axis. Historically, voters in Western and Central Ukraine are more eager for political and economic integration with the West than voters in the East and South. Moreover, in the West and Center, where the “Orange” parties dominate, political competition has emerged between the Our Ukraine bloc and the Tymoshenko bloc, with the rival parties competing for support from the predominantly “Orange” electorate. But in Eastern Ukraine, support for one party, the Party of Regions, is so dominant as to preclude the emergence of significant political opposition. This means there are fewer opposition voices in city and regional councils to monitor and act as a watchdog over local officials’ behavior.

Corruption is also driven by the availability of valuable state assets and resources slated for privatization or sale. And here, too, Ukraine is affected by major regional differences. In the 1990s, much of the privatization effort was focused on the industrial sector, which is disproportionately located in Eastern Ukraine. During that period, allegations of corruption tended to focus on the East. With corruption now gaining pace in the booming land and housing sector, the focus may be shifting geographically to the capital Kyiv and its peripheries as well as the tourist areas of Crimea and Western Ukraine.

²⁸ Steven Lee Myers. “Ukraine President Sworn In, Promising to Promote Unity” *New York Times*. New York, N.Y.: Jan 24, 2005. pg. A.9

The disparity in economic development between East and West has also influenced the pattern of corruption. The more industrialized and urbanized Eastern regions are better off than the agricultural and rural Western regions.²⁹ Lower incomes in the West generally translate into less petty corruption, and fewer valuable business properties results in less grand corruption. In the Eastern regions, the presence of large-scale energy, mineral and metallurgical enterprises with vastly higher profit margins provides far greater temptations for corrupt political leaders. However, given Western Ukraine's geographic proximity to the EU, its comparatively cheaper workforce, and its high tourism potential, regional disparities between East and West are likely to narrow in the coming decade as investments and incomes increase.

According to experts interviewed, some of the regional differences were exacerbated through deliberate government policy. In 1999, President Leonid Kuchma granted wide-ranging authority to the governors for managing state properties in their respective regions. These changes were intended to affect primarily the eastern Ukrainian regions with their vast, state-operated industrial base, particularly in the energy sector. The energy sector monopoly formerly held by energy traders from Kyiv was reduced. This allowed traders from the heavily-industrial Donetsk and Dnipropetrovsk regions in eastern Ukraine to quickly bring key enterprises in their regions under their control. A typical example of Ukrainian regionalism is the Donetsk region, where the influence of Kyiv today is practically nonexistent. It is in these regions that the Party of Regions has its political base and where it controls power in many key municipalities (in the 2007 parliamentary elections, out of 225 total electoral districts, the Party of Regions won close to ninety districts, but only five of those were not in the East or South of the country).

²⁹ "Judging Who is Poor In Ukraine," The Ukrainian Observer, <http://www.ukraine-observer.com/articles/227/977>.

Corruption in Specific Areas

Corruption in Economic Sectors

Of all the sectors of the Ukrainian economy, it is the consensus of experts interviewed by the Task Force, that energy, land and real estate, and the transportation sector have in recent years been the sectors most implicated in wide-ranging corruption. Of these, energy has been the most problematic.

The energy sector remains among the least transparent and most challenging in terms of perceived corruption. Organizations and individuals who monitor corruption in the energy sector allege that secretive intermediary companies have long controlled Ukraine's gas imports, often as a result of tenders and arrangements that have been far from open. This non-competitive process has led major anti-corruption monitors and most of the Ukrainian public to conclude that the arrangements involve corruption and kickbacks. Ukrainian officials deny that corruption exists in the energy sector, but they do not challenge the claim that the energy sector is far from transparent. One high-ranking Yanukovich government official admitted that the current intermediary process in the energy sector has not been transparent, but defended the process by insisting that this arrangement has allowed Ukraine's energy prices to remain low.³⁰

Analysts interviewed in Ukraine have also observed increasing corruption in the land and real estate sectors. The recent spikes in prices for land and real estate, along with state ownership of municipal and forest lands, and the ability of local officials to modify the land code status of privately held farm lands (where real estate development and non-agricultural development are restricted) have made these areas a prime focus of corrupt or non-transparent activity. Ukraine's real estate and building boom is therefore making grand corruption at the municipal and regional level a growing problem, particularly in areas in and near major urban centers. Moreover, the growing appeal of land with tourist and vacation potential has made areas of Western Ukraine and the Crimea the locus of new non-transparent schemes and allegations of growing corruption.

Another sector where corruption has traditionally been rife is transportation, particularly the railroads, where the cash turnover of hundreds of millions of dollars in ticket sales allows ample opportunity for petty and grand corruption. In the aftermath of the Orange Revolution, Ukraine's Minister of Transportation Hryhorii Kirpa, who was alleged to have been responsible for funneling millions of dollars in corruptly gathered government funds into the 2004 presidential election campaign, was found dead in the sauna of his country house.³¹ A police investigation ruled it a suicide, although media reports have doubted the accuracy of the investigation.³²

³⁰ Interview with a senior Ukrainian government official by Atlantic Council delegation, Kyiv, July 2007.

³¹ *An Orange Revolution*, Askold Krushelnysky, London: Harvill Secker, 2006.

³² "Ukrainian Suspected in Reporter's Murder Is Found Dead," by Steven Lee Myers, *New York Times*, March 5, 2005, <http://query.nytimes.com/gst/fullpage.html?res=9500EFDD113DF936A35750C0A9639C8B63&sec=health&spn=>.

Corruption in the Judicial Sector

In many societies, the judiciary and legal system limit corrupt business practices. Unfortunately, the Task Force concluded that this has not been the situation in Ukraine. This is not new: prior to the Orange Revolution, top political leaders were able to make many decisions on business deals and property without risk of any judicial review. However, because the system lacked transparency, and journalists sometimes received threats if they pursued investigations, the public was less aware of the extent of corruption. Today, Task Force research indicates that disputes over business decisions now enter the court system frequently. As a result, both the incidence and public perception of corruption are rising.

Interviews with legal experts as well as recent nationwide polling indicate that Ukrainians believe that corruption plagues the judicial system in Ukraine.³³ Of Ukrainians' trust in different government branches, the judiciary ranks at the bottom. Only 10 percent had confidence in the judicial system, according to the MCC survey. The unfairness of the judicial system was viewed as a serious problem by 79.3 percent of respondents. The same survey indicated that 49 percent of Ukrainians perceived the court system as corrupt, followed by the Prosecutor's Office (42.9 percent), and notaries (22.8 percent).³⁴

Most political leaders and senior Ministry of Justice representatives interviewed for this report admit that corruption is severe in the country's judicial system. Courts are understaffed, and judges are underpaid, making them susceptible to bribery and extortion. University law professors have pointed to the fact that many law students obtain their law degrees within a corrupt university system and move on to positions as judges and prosecutors without the experience and knowledge required for these positions. This affects the quality of the judicial system for years to come. Similarly, massive problems of corruption exist within the legal profession itself, particularly within the public notary service where certification of false documents has become a major problem, according to legal experts.

The judiciary is also vulnerable to corruption because Ukrainian laws, which were drafted rapidly and haphazardly in the 16 years of independence, are often mutually or internally contradictory. Thus, the same case can "legally" be resolved in different ways by choosing "convenient" articles from applicable laws. Many judicial branch employees will meddle in the process on behalf of special interests. Such corruption takes on two forms: (1) political influence, exercised through the intimidation of judges, manipulation of court appointments, or the taking of other measures aimed at restricting the court's independence; and (2) bribing judges.

Although many in the judicial sector are aware of the need to rectify this situation, various parties accuse each other of inaction in addressing corruption. Agencies such as the Prosecutor General's office point to the lack of political will for the passage of specific anti-corruption measures, arguing that existing laws tie their hands and do not allow for more wide-ranging investigations, particularly in cases of grand corruption. At the same time, politicians under investigation blame corrupt practices within the judiciary for "politically motivated" investigations. Once an investigation (either launched

³³ MCC Baseline Survey for Ukraine 2007, p. 12 & 41.

³⁴ Ibid.

by the Prosecutor General's office, the Ministry of Interior, or the State Security Service) reaches the trial stage, widespread corruption among judges, as well as their intimidation, often leads to cases being dismissed despite significant amounts of evidence, according to senior government officials and NGO experts. Corruption in the Ukrainian judicial sector may also be in play when certain cases are assigned to certain judges, or when a court clerk "loses" case materials or evidence.

The Stanik Case

One of the most noteworthy instances of alleged corruption in the judiciary involved a Supreme Court justice, Susanna Stanik. Following Yushchenko's April 2007 decree dismissing the Verkhovna Rada and announcing pre-term elections, the parliamentary majority rejected the validity of the decree and filed an inquiry with the Constitutional court, the only institution with the jurisdiction to decide cases involving application of the Constitution. Stanik, who is politically close to the majority coalition, was appointed reporting judge in the case.

Several days before the case went to a court hearing, a Ukrainian investigative journalism website published information on a bribe allegedly taken by Justice Stanik, specifically that she received a bribe in the form of two apartments in downtown Kyiv with a market value of \$2 million.¹ Although the State Security Service reportedly found additional evidence to support the allegation,² the procuracy [prosecutor general's office] promptly asserted there were no grounds for indicting Stanik, who has also denied all charges against her. As a result, the investigation was stopped. She was then dismissed by the president, but restored to office by a court decision. The Presidential Secretariat is now planning to appeal.

¹ <http://www.newsru.ua/ukraine/12apr2007/stannik.html>

² www.obozrevatel.com/news/2007/4/20/166831.htm

Appointment of Judges

The judiciary is also vulnerable to corrupt influences through so-called "councils of judges" and bodies of judicial self-governance, which have assumed the powers of appointing judges to administrative office. This fact is recognized by prominent figures in the judiciary system.³⁵ Through a mechanism of "telephone justice," government officials as well as heads of appellate courts can influence the decisions of judges from lower-level courts.³⁶ The Procuracy also has influence over courts and has more than once demonstrated its propensity for indicting judges in the middle of a complicated trial.³⁷

The highest governing body for judges is the High Council of Justice, which is in charge of recommending judges for appointment or dismissal. The Council is composed of about 70 justices, the majority of whom are heads of courts. The right to hand in an application for appointment to be considered by the council lies with the Head of the Supreme Court. Independent observers point out that the whole system of judiciary appointments is now within the powers of a single person who is not a nationally

³⁵ <http://www.obozrevatel.com/news/2007/7/27/181958.htm>

³⁶ Ibid.

³⁷ <http://justus.com.ua/articles/6291.html>

elected official.³⁸ Such a system places excessive power in the hands of one official, which leaves a significant gap with regard to transparency in the judicial system.

Additional Corruption in Ukraine’s Judiciary

While corruption in the judiciary is widespread and endemic, several recent rulings have been criticized by the Ukrainian media and judicial monitors as particularly glaring examples of corruption in Ukraine’s judiciary:

- forbidding publication of the Law on the Cabinet of Ministers of Ukraine;³⁹
- decisions on changing the relocation of internal armed forces;⁴⁰
- canceling decrees of the president;⁴¹
- prohibiting political parties from holding congresses;⁴² and
- simultaneous restoration of several former Procurators to their office.⁴³

In order to address the issue of corruption within the judicial system, experts from the Ministry of Justice have submitted a number of draft laws to the parliament, where they have been delayed since the Rada’s dissolution in May 2007. According to conversations with officials from the Ministry, the proposed laws include a new ethics and discipline code for judges and employees of the judicial system; standardized entry-exams and continuous legal education for judges; a requirement for financial disclosure by all judges; formation of a judicial academy to improve training for judges; and introduction of a standing disciplinary committee and a peer review system comprised of administrative judges who are not ruling cases at the same time.

The Problem of “Raiding”

Corruption in Ukraine’s judiciary has flourished in conjunction with an increased number of corporate lawsuits and numerous cases of “raiding,” which has become a common characteristic in the domestic economy. “Raiding” means seizing a property object. Investigative journalists described the practice of “raiding” to the Council Task Force as follows: Raiders infiltrate the company of interest with agents who collect information. A small share of stock is purchased. Then, a usually frivolous lawsuit is filed with a lower-level court in a remote town. Armed with an often anomalous court injunction, raiders resort to force, sending a pseudo-“security firm” to take possession of the property (through forcible entry). Further, by bribing law enforcement agencies, they keep the object under their control – even in the face of a corrected court decision. Then, they try to re-sell property to themselves or to those who ordered the raid, to change the composition of charter capital (which requires changing the statute of the enterprise).

In the last two to three years, around 2,500 Ukrainian enterprises have allegedly been raided. Ukrainian journalists interviewed assert that the main factors that allow for the practice of raiding are: corruption

³⁸ Ibid.

³⁹ <http://news.uzhgorod.ua/novosti/20086/>

⁴⁰ <http://for-ua.com/ukraine/2007/04/07/195546.html>

⁴¹ Ibid.

⁴² Ibid.

⁴³ <http://www.obozrevatel.com/news/2007/7/27/181958.htm>,

among judges, flouting of the law on territorial jurisdiction in commercial disputes (cognizance of a lawsuit should be taken by the court closest to the location of the defendant), and lack of punishment for those who engage in such tactics.

A state commission was convened in January 2007 to combat raiding. However, journalists following this closely point out that the commission thus far has mainly examined cases that involve the raiding of enterprises belonging to high-ranking officials. Similarly, journalists have reported on cases of members of parliament lobbying for action against raiding practices when they themselves or their benefactors have been affected.

Corruption in the Executive and Legislative Branches

Many of the experts interviewed by the Task Force assert that corruption among public officials and members of parliament has grown so pervasive that it has become routine and expected, and part of doing business. Imperfect legislation, including the absence of identifiable sanctions for violating many laws, combined with gaps in legislation (in particular, diffuse descriptions of procedures for issuing permits, absence of precise requirements governing the content of various forms of documentation, absence of evaluation techniques and so forth), creates space for state functionaries to violate the law.

According to the State Accounting Chamber, instances of corruption in governmental bodies are commensurate to the ability of an official to control government resources. Such possibilities emerge in cases of influence over privatization procedures, licensing and rationing of export operations, budget transfers to the regions, provision of credit in the banking sector, providing government subsidies, and the supervision of government purchases.⁴⁴

Government Procurement

The Task Force concluded, based on its research, that government procurement is one of the most corrupt spheres of state activity. Vague procurement regulations leave the process of government procurement in the hands of a few public officials, and a lack of oversight often results in considerable losses for the state budget. The Law on Government Procurement (of February 2000),⁴⁵ which is currently in force in Ukraine, endows a public organization called the “Tender Chamber of Ukraine”⁴⁶ (Tenderna Palata Ukrainy – TPU) with wide powers. This organization has practically usurped the whole system of government procurement. TPU has the right to be the single representative of public interests in procurement decisions and thus controls the system of government procurement. Governmental bodies responsible for procurement, as well as bid participants, are required by law to inform TPU of practically every move in conjunction with the procurement process. Thus, TPU has the means to pressure government agencies or state-owned enterprises when, as parliamentary critics allege, these enterprises and agencies do not make concessions which could be lucrative either for TPU or firms close to it.

⁴⁴ http://www.ac-rada.gov.ua/achamber/control/ru/publish/printable_article?art_id=733680.

⁴⁵ <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=1490-14>.

⁴⁶ <http://www.tpu.net.ua/>.

The Lazarenko Case

While accusations of grand corruption have surrounded many of Ukraine's top politicians, the case of former Prime Minister Pavlo Lazarenko, who was found guilty by a U.S. court for money laundering connected to corruption in the energy sphere, is particularly notable, both for its scale and because it was confirmed by a politically neutral U.S. judicial system. According to energy sector experts, in the mid 1990s, intermediary energy traders were involved in barter trade that resulted in vast private fortunes, with a large proportion of the profits of intermediaries allegedly ending up in offshore accounts held by high-ranking government officials. According to U.S. court documents, Lazarenko declared a personal income of below \$15,000 while serving as prime minister (1996-1997), while amassing a personal fortune exceeding \$300 million. In 2000, Lazarenko was indicted in California on charges that he used U.S. banks to launder \$114 million he stole from the Ukrainian government. In August 2006, he was sentenced to nine years in federal prison.¹

Observers have pointed out that Lazarenko's rise and fall was closely connected with the fortunes of an energy trading company called United Energy Systems of Ukraine (UES). The company was founded by Yulia Tymoshenko, at the time a close ally of Lazarenko's. In the mid-1990s, while Lazarenko was deputy prime minister for energy, UES was awarded a government contract as one of Ukraine's primary natural gas distributors. Experts estimate that, before being forced out of the gas market in the late 1990s, the company had brought a significant part of the Ukrainian economy under its control.² U.S. court documents have alleged that much of Lazarenko's wealth stems from a variety of kickback schemes involving UES and others.³

Questions remain that during Lazarenko's time in power in the mid 1990s, businesses from his home town Dnipropetrovsk, including Tymoshenko's United Energy Systems, amassed multimillion dollar fortunes by virtue of their corrupt relations with him.⁴ To this date, Tymoshenko, who in recent years has become active in calling for rooting out corruption, has not provided a thorough public accounting of her income and expenditures during that period, preferring to answer questions in general terms, and asserting that she and her business were themselves victims of extortion by Lazarenko's government.

¹ "Former Ukraine PM is jailed in US," BBC News, August 25, 2006.

² <http://www2.pravda.com.ua/archive/2005/february/4/tym.shtml>

³ For more details see the U.S. Department of Justice complaint: "United States of America v. all funds on deposit at Bank Julius Baer & Company, Ltd., Guernsey Branch et al," 1:04-cv-00798-PLF (D.C.), Compl.

⁴ "Ukraine ex-premier accused in U.S. of money laundering," by Alex Rodriguez, Chicago Tribune, June 9, 2003.

Privatization

Interviews with NGO experts raised considerable allegations of corruption in connection with privatization processes in Ukraine. A widespread form of flouting the intent of privatization laws is adjustment of the terms of a privatization contest, allegedly to fit the characteristics of a certain bidder.⁴⁷ A glaring example of this was the bid contest in March 2007 to sell 76 percent of the stock of the "Luganskteplovoy" company.⁴⁸ The requirements for potential investors were composed so that only one bidder was able to meet them. In addition, the State Property Fund, which was managing the sale,

⁴⁷ "Deal casts doubt over Ukraine transparency," by Roman Olearchik, FTI, September 3, 2007.

⁴⁸ "Luganskteplovoy: Iskander Makhmudov Takes All" Ukrainian Intelligence. March 30, 2007
http://www.ukraine-intelligence.fr/a2077-Luganskteplovoy_Iskander_Makhmudov_Takes_All.html.

allegedly disregarded several regulations by publishing the announcement on the closing date for bid offers, making it nearly impossible for potential investors to learn about the tender in time to submit bids. As a result, the shares were sold at close to the starting price of UAH 292 million (the company was sold for UAH 292.5 million). The events surrounding the “Luganskteplovoz” tender process are under investigation by the procuracy.

Licensing

Bribery is believed to be widespread in the sphere of licensing and permits. Experts interviewed in Ukraine allege that government functionaries responsible for issuing licenses often require businesses to provide documents that are not mandatory, or they deliberately conceal information in order to confuse a potential licensee, or they delay issuing documents in order to induce licensees to offer a bribe. At the same time, it is not uncommon for officials to issue licenses to some entrepreneurs, without collecting all the required documentation in return for a bribe.

According to experts interviewed by the Task Force, corrupt officials may even use licensing as a means of gaining control over businesses. For example, during the grain crisis of 2006, the government introduced licensing, and then rationing of grain exports. This affected grain traders, who were unable to complete contracts concluded with foreign clients, as well as grain producers, who were forced to sell their harvest on the domestic market for prices below what they could have received by exporting the grain. Both traders and producers suffered significant losses. According to some agricultural firms and grain traders, after rationing was introduced, they began receiving offers from companies close to the governing party to sell their distressed businesses quickly and cheaply.

Corrupt officials also found opportunities for natural resource exploitation. According to interviews with experts, the government offers licenses for lots that are undesirable, with the result that they do not sell or sell for the low initial offer price. At the same time, licenses for better lots and deposits are issued to state-owned companies, which then sub-license to private companies on the basis of a contract for joint activities. The state-run sublicensing company often chooses a privately run company as the winner without much explanation, citing “commercial secrets.” Thus, mining and extraction companies enjoying access to authorities also receive access to the most valuable deposits, bypassing open auctions.

Moreover, while these auctions had earlier been administered by the Ministry of Natural Resources, a contest for determining an auction administrator was conducted in 2007. Observers note that the contest was won under dubious circumstances by a company named “Multiservice” which was already under scrutiny by the Anti-Monopoly Committee.

The VAT Refund Problem

After the Yanukovych government came to power in August 2006, and Mykola Azarov was appointed Minister of Finance, reports surfaced in the Ukrainian media on unpaid reimbursements of Value Added Tax (VAT) to enterprises. The VAT accounts for 37 percent of all income to Ukraine’s state budget and its timely reimbursement is crucial to the cash flow of many Ukrainian businesses and foreign companies operating in Ukraine. The Task Force’s research led to the conclusion that VAT policy is linked to corruption and favoritism.

First, radically uneven patterns of reimbursements may signal favoritism and “special arrangements” between some businesses and state officials. Second, according to anti-corruption experts and high-ranking former government officials interviewed for this report, delays in reimbursements can create a situation in which tax officials collect kickbacks in return for quicker processing of rebates urgently needed by companies. Anti-corruption experts argue that the timely payment of the reimbursements due to companies reduces opportunities for corruption, while growing backlogs in such payments may be an indicator of corrupt schemes.

The president also has criticized the state of affairs around the VAT. At an interagency meeting devoted to the issues of VAT charges and reimbursement in October 2006, he stated, “We are worried about the trends that surfaced in many regions on deferral of budget payments, reported by Ukraine’s business elite.”⁴⁹ According to the president, “the amount of unreimbursed VAT totaled UAH 7 billion, while before [Yanukovich became prime minister] it was just at UAH 4 billion.”⁵⁰

In addition, the backlog in payments varies considerably by region suggesting clear favoritism toward companies located in areas of Ukraine that strongly support the ruling party. According to the president, “the percentage of payments made to the Donetsk region, has increased two-fold in August 2006, while the percentage of timely reimbursements to the Kyiv region dropped almost four-fold.”⁵¹ As of April 2007, the amount of late payments for VAT reimbursement had risen to UAH 8 billion in VAT, although businesses located in the ruling party’s political base (the Donetsk region) were unaffected by the problem.⁵²

In response to these accusations, Minister Azarov has asserted that Donetsk enterprises had high export volumes, which accounted for the uneven VAT reimbursement. As a way to deal with the issue of unreimbursed VAT, Azarov proposed establishing special-purpose accounts, which he said would “allow combating corruption in VAT reimbursement.”⁵³ This idea was heavily criticized by opposition politicians and business representatives, who warned against a substantial reduction of working capital from businesses’ cash flows.

Alleged Corruption in the Legislature

Experts interviewed by the Task Force alleged that corruption is wide-spread in legislative circles, particularly in cases where Rada deputies pursue their own business interests.⁵⁴ This leads to the enactment of laws favoring the interests of particular commercial structures and politicians. For example, in 2006, a scandal erupted because members of parliament voted for a certain version of the Law on Government Procurement, but the text delivered to the president for signature differed substantially, lacking many amendments adopted by the Verkhovna Rada. It was never established who changed to the text. Such irregularities led the Cabinet of Ministers to adopt Directive # 657 on August 15, 2007,

⁴⁹ http://www.president.gov.ua/news/data/1_11141.html

⁵⁰ <http://www.pravda.com.ua/news/2006/11/1/50045.htm>

⁵¹ Ibid.

⁵² <http://www.newsru.ua/finance/16apr2007/pdv.html>

⁵³ <http://www.gazeta.lviv.ua/articles/2006/10/26/19125/>

⁵⁴ “Yuschenko Wants Business And Politics To Stay Apart,” Ukrainian News Agency, July 4, 2007, <http://www.ukranews.com/eng/article/52713.html>

which introduced a specialized anti-corruption check for draft laws “at the stage of their legal review, with the aim of preventing possible corruption risks.”

Political Parties and Political Corruption

According to Ukrainian experts interviewed by the Task Force, manifestations of alleged corruption among political parties is apparent in three areas: (1) participation in the election and formation of party lists; (2) financing of the political parties; (3) parliamentary activities of people’s deputies and the parties.

Transparency in the Preparation of Elections

Critics allege that the formation of party lists in Ukraine is a closed process. As a report by the Committee of Voters of Ukraine stated prior to the 2007 elections, “a lack of open discussion among party members as to formation of the party ticket is the main problem of party nominations for the oncoming elections.”⁵⁵ Businessmen, virtually unknown to the public, are given a spot on the party list because they actively and generously finance the political party’s election campaign.

Since the Orange Revolution, widespread falsifications of votes at the national level — through vote buying and corruption of election commissioners in order to falsify election results — have become much less frequent. The Central Election Commission (CEC), while not perfect, operates under relatively transparent mechanisms. Attempts at intimidation, such as the initial rejection by the CEC to certify the Bloc of Yulia Tymoshenko (BYuT) for participation in the 2007 elections, have been quickly rebuffed by the courts.⁵⁶ According to Ihor Popov, head of the Committee of Voters of Ukraine, “fraud and falsification at the polling station remain possible.”⁵⁷ Although the OSCE certified the elections as overall clean and in line with Western European standards,⁵⁸ several election monitoring delegations expressed concern about changes in the election laws prior to the election, particularly with regards to increased voting at home by way of mobile ballot box.⁵⁹

Political campaign financing and reporting on political spending are not well regulated in Ukraine. Certain limitations on the sources of financing and economic activity of a party exist, but holes in existing laws allow for uncontrolled financial contributions during election campaigns. Although the Ministry of Justice theoretically has oversight over the activity of political parties, in practice, there is no effective monitoring of the parties’ spending and no real oversight as to whether their activities adhere to the law or not.⁶⁰ A lack of independent financial audits of party activity, a lack of regulations requiring mandatory financial disclosure, and insufficient power given to the CEC to exercise financial oversight,

⁵⁵ http://www.cvu.org.ua/?lang=ukr&mid=fp&id=1398&lim_beg=0.

⁵⁶ “Ukrainian Court Rules CEC Must Accept Opposition Candidates for September Elections,” PR Newswire, August 14, 2007, <http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/08-14-2007/0004645497&EDATE=>.

⁵⁷ <http://www.dt.ua/1000/1550/60106/>.

⁵⁸ “OSCE endorses Ukraine’s election as open and competitive,” Kyiv Post, October 1, 2007.

⁵⁹ Statement of the NDI Pre-Election Delegation to Ukraine’s 2007 Elections, Kyiv, August 20, 2007, available at <http://www.accessdemocracy.org/showdoc.asp?lang=1&id={8D34A1B0-B1DE-4705-AEF3-51053FD6205A}>.

⁶⁰ www.parliament.org.ua/upload/docs/Analytics.ppt.

contribute to corrupt campaign finance schemes. As for the recent election campaign, independent monitors have calculated that financial spending by parties just on direct and indirect advertisement exceeded official campaign finance limits that were set for the entire election campaign.⁶¹

According to experts interviewed, much of Ukraine's political struggles are rooted in the lack of a fully developed political culture, where the role of the parliamentary majority and the opposition are clearly defined. Ukrainian law does not describe the status and role of the parliamentary opposition. Some observers suggested that if a law on the opposition did exist, certain parliamentary committees could be chaired by representatives of the opposition, thus allowing activities of the majority to be effectively monitored. In September 2006, newly appointed Prime Minister Yanukovich argued for immediate adoption of the law on the parliamentary opposition.⁶² However, although the corresponding bill was approved in its first reading only on January 12, 2007, it had not been passed into law at the time this report was issued.

In an exception from the parliamentary procedures, the opposition did control the Committee of Fighting Organized Crime and Corruption, headed by Volodymyr Stretovych, during the last two parliamentary terms. The Committee examined 11,567 petitions, complaints and recourses, and submitted 125 written statements to law enforcement agencies with regard to the most notorious corruption cases. Nevertheless, there were no public investigations either by the Office of General Prosecutor, or by the police.

Moreover, allegations of political corruption in the parliament arose when, in early 2007, deputies defected from opposition parties to the ruling majority coalition. Thirty-four percent of Ukrainians believe that these defections were caused by bribery.⁶³ President Yushchenko also repeatedly and publicly warned about corruption within the parliament in his speech to the Parliamentary Assembly of the Council of Europe.⁶⁴

Political corruption in parliament can also take the form of payments to encourage voting on a particular bill. The price of passing a bill, according to some investigative journalists, may be as high as a few million dollars. A deputy's behavior is shielded by the right to full immunity while serving in the parliament. A deputy may be taken to court on administrative charges only with the expressed consent of the parliament by constitutional majority (300 votes), which is a significant obstacle to the administration of justice. Today, the issue of revoking the deputies' immunity is one of the major issues (promoted primarily by Our Ukraine and BYuT) in the ongoing election campaign.

⁶¹ http://www.parliament.org.ua/index.php?action=draft_art&dtopic=3&ar_id=1158&ch_id=&as=0.

⁶² <http://ua.proua.com/news/2006/08/05/143304.html>.

⁶³ www.kiis.com.ua/txt/doc/12042007/press120407ukr1.doc.

⁶⁴ www.president.gov.ua/news/data/print/17221.html.

The Role of the Private Sector

The private sector presents a mixed picture with regard to corruption. The Task Force concluded that corrupt practices continue to be a major mechanism by which some corporations obtain market access, restrict competition, obtain favorable conditions, evade tax responsibilities, and secure needed regulatory rulings. At the same time there are many indications that the growing role of the private sector is contributing to increased transparency and introduction of internationally accepted “best practices.” This trend is most notable in the behavior of major international players entering the Ukrainian market and improved practices on the part of many of Ukraine’s major indigenous corporations.

The Mixed Role of Foreign Investors

Foreign direct investment has exhibited dynamic growth in the past three years. From 2005 until the first quarter of 2007, foreign direct investment (FDI) into Ukraine constituted \$14.4 billion.⁶⁵ As a result, major international corporations have entered the Ukrainian market. Most such players operate under the U.S. Foreign Corrupt Practices Act or similar standards. Their entry into the Ukrainian market has increased levels of transparency and corporate best practices. The growing presence in Ukraine of major international auditing and accounting firms and their work with many of Ukraine’s major corporations also contributes to a higher degree of compliance with best practices by domestic actors, including higher levels of transparency, accurate public reporting of assets and revenues, and tax compliance.

Some foreign corporations demonstrate a tenacious commitment to transparent and open practices. One such case is the major multinational IKEA: According to business analysts, the Swedish furniture giant has been trying to enter the Ukrainian market for several years. At the start of its Ukraine operations, the company allegedly announced that it would not pay a single bribe. To date, IKEA has not been able to obtain the land it needs for constructing a retail store on the outskirts of Kyiv, nor has it built any retail stores elsewhere in Ukraine. While Kyiv government officials have cited environmental concerns in denying IKEA access to land, business analysts in Ukraine have noted that IKEA’s difficulties may very well be linked to its stated non-corruption policy.⁶⁶

While many foreign companies bring with them better practices, lawyers who advise foreign direct investors note that non-Ukrainian companies sometimes can be part of the problem. In an environment in which market access must be developed in a highly corrupt environment and alongside a shadow economy that in 2006 represented an estimated share of 27 percent of total GDP, foreign investors indirectly contribute to corrupt activities by hiring third-party consulting services to help open doors and facilitate market access. Experts interviewed by the Task Force believed that some of these intermediaries use part of their fees to provide “inducements” in the form of money or other material benefits to government officials.

On balance, however, domestic and international anti-corruption monitors agree that the arrival of foreign investors and international corporations, in particular companies from mature market economies,

⁶⁵ http://www.ukrstat.gov.ua/operativ/operativ2007/zd/zd_rik/zd_u/pi_07u.html.

⁶⁶ http://news.monstersandcritics.com/business/article_1182363.php/Ukraine_capital_probably_wont_allow_Swedens_IKEA_to_build_store.

has had a positive impact on reducing corruption in Ukraine. Such large multinational corporations have a broad planning horizon, global opportunities for profit, high revenues, and an imperative to preserve a reputation of corporate integrity. As a result, they and their personnel are less likely to engage in corrupt practices or to establish corrupt connections with Ukrainian authorities. When multinational corporations remind Ukrainian officials that they have competing opportunities for capital investment, it drives home the cost of corruption to economic growth and national prosperity.

Ukraine's Oligarchs and Indigenous Corporations

Ukraine's major private players, known in popular parlance as oligarchs, have had a mixed legacy in this regard. While many fortunes in Ukraine emerged in murky circumstances and some are alleged to have involved corrupt and extra-legal if not illegal practices, experts indicated to the Task Force that, with the accumulation of vast wealth, corrupt practices began to pose a potential risk to the assets of Ukraine's new rich. As a result, many Ukrainian oligarchs and their corporations have begun to adopt best practices and to distance themselves from corrupt activities as much as possible.

Ukraine's major corporations and emerging corporate players have also begun making significant use of international capital markets. Growing use of such instruments as Eurobonds and listings by Ukrainian corporations on international exchanges has led Ukrainian corporations to fulfill the transparency and compliance requirements needed to gain access to such sources of capital. As a result, Ukraine's private sector is integrating the corporate best practices of mature economies into its own corporate culture, including the use of established accounting and audit firms and stronger tax compliance.

Some major Ukrainian corporate leaders are now working to strengthen the rule of law by using their charitable foundations to sponsor legal clinics for judges and others in the judicial sector. At the same time, suspicions persist that the oligarchs have only created an impression that their companies are working according to existing legislation but continue to engage in corrupt practices. Such suspicions are bolstered by charges by Ukrainian corruption monitoring groups that corporations spend millions of dollars each year to bribe journalists to promote positive news or neutralize negative information about their companies.⁶⁷

Small and Medium Enterprises in Ukraine

According to business associations, Ukraine's small and medium size enterprises (SMEs), are more susceptible to corrupt practices. Some SMEs engage in petty corruption, as it allows them to resolve often complicated bureaucratic procedures (dealing with the tax inspectorate, sanitation and fire code inspections, and other regulatory bodies more easily and quickly). SMEs typically find they must pay petty bribes or risk their ability to conduct business and maintain profits. Finally, one of the main concerns of SME owners seems to be ensuring "equal" access to corruption mechanisms. Experts interviewed indicated that the owners of SMEs with privileged access to former state resources and favorable state regulatory decisions, tempted by the opportunities for quick growth, are more likely to engage in grand corruption.

Property Rights and Ownership Protections and the Legacy of Past Corruption

In early 2005, when the new Orange government came to power, it promised to review the legacy of

⁶⁷ Andrew Kramer. "Russian Company Accused of Buying Negative Press Coverage," New York Times. March 14, 2007. pg. C9.

the past and consider reprivatization of former state assets which had been privatized under dubious conditions. Yulia Tymoshenko, who served as prime minister in an “Orange” reform government in 2005, was a particularly strong advocate of such reprivatizations, announcing that 3,000 companies were to be placed under review.⁶⁸

President Yushchenko suggested a much smaller number of reprivatizations, citing concerns for economic stability. Critics have argued that the confusion about the number of reprivatizations played a role in slowing economic growth, which officially plummeted from double digits in 2004 to slightly over two percent in 2005 under the new government.⁶⁹ While a global fall in metal, steel, and chemical prices contributed to this steep decline, economists believe that uncertainty over the disposition of dubiously or corruptly privatized assets also contributed to the economic downturn in 2005. Oligarchs, uncertain of the status of their holdings, began holding back assets needed for expansion and modernization. At the same time, foreign investors, interested in purchasing assets in Ukraine, were reluctant to do so in an environment in which ownership might prove in question.

In the end, Tymoshenko was forced from office following fierce internal divisions in the Orange camp. The new government of Prime Minister Yuri Yekhanurov moved assertively to put an end to reprivatization. As a result, only one major enterprise was reprivatized. Kryvorizhstal, Ukraine’s largest steel mill, was purchased by domestic owners in 2004 for approximately \$800 million, in what was seen as a badly flawed privatization. The company was reprivatized and sold in an open auction one year later to the Mittal Group for approximately \$5 billion.⁷⁰

The Task Force believes that Ukraine’s political elite has faced a stark choice: to remedy the messy and corrupt legacy of the past, or to forgo a moral reckoning in favor of creating an environment that promotes economic growth. A review of the positions taken by the major political parties indicates that Ukraine has largely chosen the latter path. Today, Ukraine’s reform-oriented leaders appear to have modified their support for reprivatization as a remedy for past corrupt practices.

The Role of the Media in Investigating Corruption

For the Ukrainian mass media, the 2004 Orange Revolution spelled an end to their fear of state-initiated persecution.⁷¹ According to most international indicators (such as the World Bank Global Governance Index) freedom of speech and freedom of the media have improved and the credibility of independent journalists has risen slowly but steadily. Ukrainian journalists now more frequently address issues such as ethics violations and corruption by governmental officials and politicians. Investigative journalists

⁶⁸ Valentinas Mite. “Ukraine: Premier Says Government to Review Former Privatization Deals.” RFE/RL February 17, 2005. <http://www.rferl.org/featuresarticle/2005/02/fbce9528-a708-414e-8199-9d8ae0a0f4ec.html>.

⁶⁹ Some experts disagree with the official growth rates published for 2005, arguing that the elimination of “Special Economic Zones” in that year, which had been a source of wide-scale tax evasion on imported goods, skewed statistics on value-added in trade for 2005. According to these calculations, if value-added in trade had been more accurately measured, the assumption is that Ukrainian GDP growth for 2005 would have been at least 5 percent.

⁷⁰ “Viktor Gets His Groove Back,” by Adrian Karatnycky, Wall Street Journal, October 26, 2005.

⁷¹ Oleksandr Sushko, Olena Prystayko, *Nations in Transit - Ukraine 2006*, Freedom House. <http://freedomhouse.org/template.cfm?page=47&nit=409&year=2006>.

have also begun to compare politicians' (such as Tymoshenko,⁷² Yanukovich,⁷³ and to some extent Yushchenko,⁷⁴ and others) officially declared incomes to their real income, housing and lifestyles, as well as to draw the public's attention to ongoing corruption and economic investigations that point to abuse of power by high-level officials.

Although some investigative reporting on corrupt practices has touched the nerves of powerful politicians, Task Force research indicates that information unearthed by media reports rarely translates into formal investigations by law enforcement agencies. This is in part due to corruption in the judiciary and enforcement bodies. While reports about high-level abuse of power, or conflict of interest, have put several senior political leaders on the defensive, many politicians do not perceive such allegations as a public indictment that justifies a formal investigation. To increase political accountability, NGOs such as Freedom House and others have begun training a network of watchdog groups in 15 regions of Ukraine, whose function is to monitor governmental activities in different spheres.

The most active media in conducting systematic corruption investigations are smaller internet-based outlets and blogs. While the number of internet users is still low in Ukraine (4.9 million as of May 2007⁷⁵ - roughly 10 percent of the population), the annual growth rate of internet users is 30 percent. Several mass media publications also have begun to focus their attention on investigations into corruption schemes involving governmental officials and politicians. Dzerkalo Tyzhnya (The Weekly Mirror), an influential weekly newspaper (www.zerkalo-nedeli.com), has a separate section on the notoriously problematic energy sector. Ekonomichna Pravda (www.epravda.com.ua), allied to the popular Ukrainskaya Pravda website (www.pravda.com.ua), and Donetsk-based independent Ostriv (www.ostro.com.ua) closely monitor the most important corruption incidents in Ukraine.

Ukrainian journalists interviewed for this report have noted, however, that the printed mass media conduct far fewer corruption investigations. This is especially true for those newspapers and magazines owned by industrial-financial groups where the owner is in a position to influence the editorial policy of a paper. Yet, media investigations of corruption in Ukraine are likely to increase due to increased internet usage, the rise of independent blogs, and a developing culture of investigative reporting.

⁷² <http://ua.pravda.com.ua/news/2007/6/27/60900.htm>.

⁷³ <http://www.pravda.com.ua/news/2007/7/3/61066.htm>.

⁷⁴ <http://ua.pravda.com.ua/news/2006/5/18/41872.htm>.

⁷⁵ "In 2007 internet users increase in numbers," Ukrainian Government Portal. June 7, 2007. http://www.kmu.gov.ua/control/en/publish/article?art_id=81592003&cat_id=32740.

Anti-Corruption Platforms of Political Parties

The 2007 parliamentary elections were deemed free and fair by international observers.⁷⁶ The focus has now shifted to creating a post-election climate that will be conducive to combating corruption in the economy, judiciary, and government generally. It would be naïve to suppose that one election could end corruption. Yet, this election provides an important opportunity for the new government to overcome the cynicism that surrounds this issue and make some important steps forward.

According to the election results, Ukraine's voters gave the Orange forces (The Bloc of Yulia Tymoshenko and Our Ukraine-People's Self Defense) a small majority which is in the process of forming the next government. Voters also gave the Party of Regions nearly 35 percent of the vote, making Regions an important factor in the legislature. In the coming months, it will become clear how the new government, which is likely to be shaped by an Orange majority, will address the issue of corruption. In the mean time, the best guide for understanding the kinds of policies that they will pursue in the new parliament and government are the positions they staked out in their election platforms and during the election campaign.

OU-PSD Election Program (<http://for-ua.com/elections2007/52/program/>)

BYuT Election Program (<http://for-ua.com/elections2007/53/program/>)

Party of Regions Election Program (<http://for-ua.com/elections2007/51/program/>)

"On the Record" - The Political Parties' Views on Corruption

[Editor's note: The party platforms listed below are the public positions of each party. Listing them in this report does not constitute an endorsement of any political party by the Atlantic Council or its donors.]

Our Ukraine-People's Self Defense Bloc (OU-PSD)

On August 2, the leaders of nine political parties signed an agreement to create a new political alliance, the Our Ukraine-People's Self Defense Bloc. During the signing ceremony, Our Ukraine leader Vyacheslav Kyrylenko said: "In creating this bloc, we start the people's campaign against political corruption, the campaign for abolishment of deputy immunity, and for building up a European Ukraine."⁷⁷

This political bloc links segments of the "Orange camp" which have the president's support. As an association of several political parties with rather different ideologies (from the classic conservative right to the center-left), the Our Ukraine-Self Defense Bloc has put forward a program that contains populist elements (i.e. a new law aimed at taxing the rich), while keeping a dominant center-right

⁷⁶ "Ukraine's elections open and competitive but amendments to law of some concern, international observers say," OSCE Press Release, October 1, 2007 available at http://www.osce.org/odihr-elections/item_1_26824.html

⁷⁷ <http://www.novy.tv/reporter/ukraine/2007/08/02/19/31.html>

position. The bloc's main positions include preservation of the Ukrainian state and further democratic development.

In its anti-corruption program, OU-PSD proposes the following measures:

- Abolishing immunity for legislative deputies, a main slogan of the campaign (according to recent polls, 38 percent of the population consider deputies' immunity the main factor that contributes to grand corruption); ⁷⁸
- Creating a "National Anti-Corruption Bureau" that would tackle "grand corruption";
- Introducing the position of an elected justice of the peace (similar to a small claims court judge) and creating an "Independent Court Chamber" with the purpose of re-certification of judges;

Our Ukraine's proposed policies in other sectors are also aimed at reducing corruption mechanisms:

- Energy sector: decrease dependence on energy imports through new technologies, diversification of sources and energy routes, as well as development of alternative energy sources.
- Private business: cut in half the number of permits required to establish a business, decrease the number of regulatory/supervisory institutions, and provide equitable rules of competition that apply to all.
- Education: abolish corruption associated with entering institutions of higher education by introducing mandatory entrance exams through third-party testing centers.

Our Ukraine-People's Self Defense Statements on Anti-Corruption Efforts:

"I am convinced that the next parliament, as well as the next government, will have both the desire and the will to adopt this anti-corruption legislation, and to create a joint center for investigation of corruption cases, similar to the FBI, which would crack down on incidents of corruption among Ukrainian officials"

- **President Yushchenko**, during a videoconference "Educated Youth – an Investment for Ukraine", Sept. 1, 2007

"It is impossible to live under this corruption, it does not allow the country to develop. You have become the mechanism of corrupt authority"

- **President Yushchenko** during a coordination meeting of the heads of law enforcement agencies, August 31, 2007

"The main task of our bloc after the elections is the merciless fight against corruption" -

Yuri Lutsenko, the head of the People's Self Defense, at a campaign rally in Cherkasy, August 25, 2007

"The people's crusade against political corruption must begin with abolishing parliamentary immunity"

- **Vyacheslav Kyrylenko**, head of the political council of the "Our Ukraine – People's Self-Defense" bloc, at the bloc's congress, August 7, 2007.

⁷⁸<http://www.pace.org.ua/content/category/1/1/1/lang,en/>

Bloc of Yulia Tymoshenko (BYuT)

The political program of this party is in many ways associated with the personality and profile of its leader. During her eight months as prime minister in 2005, Tymoshenko proved to be a contradictory state manager. Having been charged with and subsequently cleared of corruption herself by Ukrainian courts,⁷⁹ she forcefully presented proposals for anti-corruption programs to increase transparency within the country's economy and politics, while pursuing re-privatization policies that threatened Ukrainian oligarchs and caused concern among foreign investors.

Tymoshenko today advocates some left-of-center populist economic policies, while at the same time taking a step toward the European center-right, by announcing that her bloc would become an observer member of the European People's Party (EPP), the largest party group in the European Parliament and comprised of center-right parties.⁸⁰

BYuT's election program "Ukrainski Proryv" (The Ukrainian Breakthrough) is comprehensive, containing 350 pages of text that provide a detailed description of BYuT's proposed policies. A short variant of the program is intended to appeal to voters with the promise of rapid social improvements:

Our country deserves everything and all of it at once. We are for a fundamental and rapid increase in the country's standard of living for all people.⁸¹

The BYuT program gives a prominent place to anti-corruption measures. The anti-corruption section is written from a liberal market perspective, as it calls for decreasing the role of the state to a minimum. In particular BYuT advocates:

- reducing the potential for corruption by decreasing the state role in the economy;
- insisting upon criminal accountability for corruption, with the possibility of lifetime imprisonment for public officials convicted of corruption;
- creating a special commission to analyze statutory acts for their potential in corruption and lobbying schemes;
- introducing open auctions for the privatization of non-agricultural lands;⁸²
- controlling budget distribution through designated institutions; and
- assigning control of the Accounting Chamber of Ukraine to the parliamentary opposition as a guarantee of governmental transparency and accountability in finance.

Like Our Ukraine, BYuT wants to tackle corruption in the energy sector by decreasing Ukraine's dependence on energy imports by more energy-efficient technologies and integration into the European market.

⁷⁹ For more background see "Capable Or Crooked? Yuliya Tymoshenko Leaves Few Unmoved," by RFE/RL, at <http://www.rferl.org/featuresarticle/2005/01/d782cc7b-36f6-47ae-8fb9-25951eea425d.html>.

⁸⁰ <http://www.tymoshenko.com.ua/ukr/news/first/4344/>.

⁸¹ <http://for-ua.com/elections2007/53/program/>.

⁸² The BYuT program does not address the sale of agricultural land indicating a view that the sale of agricultural land should not be subject to market mechanisms. This contradicts with the Presidents' view that all sale of land questions should be market-based.

BYuT marginally touches on the question of corruption in other areas of its program. In particular:

- Business support: simplification of enterprise registration procedures for SMEs;
- Transport: new oil and gas pipeline construction, with the purpose of strengthening energy security;
- Privatization: equal conditions for investors, a new program of privatization for investors, (no specifics were mentioned regarding reprivatization, which is a deviation from the 2005 calls for mass reprivatization);
- Land questions: the right of investors to long-term leasing; and
- Law: resolving the problem of judicial branch financing, thereby easing corrupt influences on the courts.

Overall, the question of addressing corruption features prominently in BYuT's program. Problems of energy security and energy independence and combating political corruption are also prominent in the BYuT campaign. On the anti-corruption issues, the bloc has the greatest amount of agreement with Our Ukraine-Self Defense.

BYuT Statements on Anti-Corruption Efforts:

“Ultimately, no government is really interested in [eliminating corruption], because any group that gets in power ends up using corruption for its own purposes. In order to eliminate it, you have to have the political will to do so. When my group takes office, the first thing we're going to do is establish a strong opposition to ourselves”

– **Yulia Tymoshenko** in an interview to The Jerusalem Post, January 26, 2007.

“We will review thousand of documents and will rescind those that allow officials to take bribes for every single step that entrepreneurs make when they have to deal with officials”

– **Yulia Tymoshenko** during the presentation of BYuT's electoral program, April 17, 2007.

“BYuT proposes self-accountability of the members of parliament by abolishing deputy immunity,”

– **Hryhoriy Nemyria**, Member of Parliament (BYuT) and Tymoshenko's Foreign Policy Advisor, interviewed on July 23, 2007.

“Anti-corruption policy is a matter of great strategic importance and our leadership pays close attention to this issue,”

– **Oleksandr Turchinov**, Member of Parliament (BYuT) and Deputy Secretary, National Security and Defense Council, interviewed on July 25, 2007.

Party of Regions (PoR)

The election program presented by the incumbent Party of Regions emphasizes the “economic achievements” of the current government. The election program is especially designed to be attractive to the strata of society with a low income level, for example by promising massive increases in payments for families with children.

The Party of Regions did not initially make corruption a major emphasis in its campaign and only presented its anti-corruption program after Yushchenko sent Yanukovich a tough letter, criticizing Regions for being the only of the three main parties that was ignoring corruption. In response, Vice Prime Minister Oleksandr Kuzmuk presented a program, which was reminiscent of previous Regions programs. That program includes:

- improving existing anti-corruption laws and institutions;
- raising qualifications of public officials;
- strengthening the role of NGOs, the media, and civic associations in reporting on corruption.⁸³

Despite statements by Regions officials that anti-corruption efforts are a priority, independent observers interviewed by the Task Force believe that the lack of new or more specific ideas for fighting corruption, as well as the nature of the presentation of the party’s anti-corruption policies, are evidence that anti-corruption efforts simply are not a priority for the Party of Regions.

In spite of continuous allegations in the Ukrainian media that the Regions faction in the Rada, as well as Regions members in senior government positions, are engaged in corruption, the Party of Regions attempts to portray itself as the most professionally competent party: “We contrast systemic reform, competence, the results of our team, and the trust of our compatriots to the populism of the Orange demagogues,” states the Regions elections program.⁸⁴ The issue of corruption and the mechanisms of how to combat it are not described in detail except to demand “absolute adherence to the law.” According to the Party of Regions, this will also help to decrease the “shadow” economy and corruption in politics.

Statements on Anti-Corruption Efforts:

“The issue of corruption in Ukraine, as well is in other countries of the world and especially in post-Soviet countries, does exist. This issue is very sensitive for the society. That is why reforms aimed at combating corruption and creating an independent judiciary are among the priorities of the government’s activities”

– **Prime Minister Yanukovich**, answering questions from the deputies during the Council of Europe Parliamentary Assembly, April 17, 2007.

“We will overcome corruption and will make criminals, irrespective of their posts, answer according to all the strictness of the law”

– **Prime Minister Yanukovich** at the Party of Regions congress, August 4, 2007.

⁸³ <http://www.pravda.com.ua/news/2007/8/17/62777.htm>

⁸⁴ <http://for-ua.com/elections2007/51/program/>

“Implementation of an anti-corruption strategy is possible in the case of consolidation of patriotic, pragmatic forces that have opened the way for structural reforms since last year. It is possible after conducting democratic elections, in which these forces will gain a convincing majority of votes”

– **First Deputy Prime Minister Mykola Azarov** in a meeting with a delegation of the Atlantic Council of the United States, July 27, 2007.

Relevance of the Election Outcome for the Fight against Corruption

The scope and quality of anti-corruption policies will depend on which coalition will come to power. Given the election results, which gave the Orange forces a narrow majority, an “Orange Coalition” (OU-PSD & BYuT) seems most likely for the near future. Ukrainian political observers suggest that an “Orange” coalition would be likely to issue calls for constitutional reforms, reform of the judiciary, and canceling deputy immunity. It is unlikely that Our Ukraine would allow Tymoshenko to start a showy “war on corruption,” as such actions would have the potential to drive away investors. Some progress on anti-corruption measures nevertheless seems likely.

However, should President Yushchenko and the likely new Prime Minister Tymoshenko repeat their performance of 2005, which resulted in the break-up of the Orange coalition, a grand coalition between OU-PSD and the Party of Regions looms in the background. Yet, such a coalition consisting of ideological adversaries would appear to give little chance of coming to terms with corrupt practices, as the two political forces would constantly be counterbalancing one another. Thus, effective decision-making would require numerous compromises. It is unclear how such a coalition would be able to address reform issues in the judiciary, because an honest and transparent judiciary would presumably destroy corruption schemes used by some politicians in both camps. At the same time, under such a scenario, the president might become a driving force behind decisive changes if he leaned on independent business leaders and those from the Party of Regions, all of whom stand to benefit from closer integration with the West and who appear to be ready to support stronger anti-corruption initiatives.

Conclusions of the Atlantic Council Task Force

It is the conclusion of the Atlantic Council Task Force that nothing is more important to Ukraine's long term economic and political health than combating corruption. Corruption is perceived by Ukraine's citizens, by the business community, and by civic monitoring organizations to be a pervasive and debilitating factor in the country's life. If investment is to grow, and Ukraine to be fully integrated into the global economic community, business and political leaders, both in Ukraine and elsewhere, must have greater confidence in the overall impartiality of the state system.

In addition to the corrosive effect corruption can have on competition, economic efficiency, effective policymaking, and foreign economic investment, corruption has the potential to pose an existential threat to Ukraine's sovereignty and democracy. That existential threat has two dimensions. First, corruption at the highest levels threatens Ukraine's emerging democracy as leaders engaging in corruption perceive the democratic rotation of power as a threat to their impunity and economic position. Around the world, corrupt leaders have resorted to many means to maintain their place at the apex of power, including restrictions on democratic practices and election fraud. Second, corruption has the potential of threatening Ukraine's sovereignty. High-ranking officials who engage in corrupt practices can leave themselves vulnerable to blackmail by foreign intelligence services and thus subject to pressure from foreign powers.

While this report has focused primarily on grand corruption, petty corruption for most Ukrainians is a matter that directly affects their daily lives, causing public anger and cynicism. The Task Force believes that tackling the phenomenon of corruption will require that Ukraine's political leaders take sustained, systemic action. Political leadership – particularly, leading by example – is what is most required from the country's highest elected officials. Tackling corruption will also require a wide array of well-publicized and closely monitored measures and benchmarks, some of which are outlined in this section of the report.

The post-election period provides an opportunity to accelerate the fight against corruption. Regardless of who will be in power, the election presented the new government, the ministries, and the investigative and police institutions with an opportunity to change personnel and seek a fresh start. A new mandate to govern can create momentum in government institutions that may be converted into a more rigorous attack on corruption.

Putting a governing coalition together may require political compromises that will erode the government's ability to implement the strongest anti-corruption measures possible. Yet, over the long term, international governance indicators point to an increased interest in Ukraine in good governance and transparent political and business processes among significant societal forces. These include the independent media, the civic sector, students, significant portions of Ukraine's dynamically growing private sector, a middle-class chafing under petty corruption, and a growing number of foreign investors who are drawn by Ukraine's economic growth. They also represent important electoral and resource bases for political leaders eager to take up the banner of anti-corruption. If today's leaders do not take up the fight against corruption, new political forces will likely emerge to fill the void.

Even with public support, anti-corruption efforts will not succeed unless there is strong and sustained support at the top, from the president, the prime minister, and the speaker of parliament. National leaders must demonstrate leadership on this issue. They cannot avert their eyes if politicians and government officials appear to live well beyond their means. They cannot turn the other way when civic groups and the media raise serious allegations pointing to corruption.

While no easy task, national leaders should make ethical standards — including avoidance of conflict of interest — a requirement for all high and mid-level government decision-makers. Income declarations made by public officials must be treated seriously and false declarations should be subject to criminal sanctions. Ukraine's leaders must show not only that they support such policies, but that they will rigorously enforce them, even at the expense of members of their own party or coalition.

Ukraine has made significant progress in its 16 years of independence. It has established a functioning but flawed democracy with competitive elections, the rotation of power, and a free media. Ukraine has also seen the gradual emergence of a creative private sector which has driven much of the country's growth. In coming years, Ukraine's politics will be dominated by the challenge of creating a dynamic economy which in turn creates expanding opportunities and increases living standards for its citizens. Ukraine's rapid economic growth is now attracting outside financing and investment. But foreign investment will not be forthcoming in the future if ownership rights and profits are placed under a cloud by corrupt practices. And economic growth will stall if it is not based on market principles, but rather on insider deals shaped by graft and corruption.

Recommendations

To be defeated, widespread grand corruption must be addressed through a range of measures. What follows is a set of recommendations to Ukrainian authorities, foreign governments, non-governmental groups, private donors, and the private sector that build upon initiatives already underway. These recommendations, while far from exhaustive, represent some of the more important components of an effective anti-corruption strategy.

Recommendations to the President, Parliament, and Government of Ukraine:

Establish a New Judicial Chamber - The problem of corruption is so widespread that the public and nongovernmental experts believe it has significantly corrupted the judiciary. As a result, serious consideration should be given to the creation of a special chamber staffed by a new generation of judges and focused specifically on fighting corruption involving high and mid-level officials. Well-compensated judges serving in the chamber would be selected on the basis of excellent academic credentials and a track record of judicial independence. To guard against abuse, the chamber should have a limited statutory life of five-ten years, renewable by a parliamentary majority or super-majority.

Create an Independent National Investigative Bureau - As a corollary to a new judicial chamber targeted on grand corruption, Ukraine's leaders should establish an independent National Investigative Bureau to uncover and root out corruption. Such a bureau, modeled on the U.S. Federal Bureau of Investigation, should be given significant resources and technical means to target investigations of

grand corruption and bribery. At the same time, the government needs to establish proper oversight of the new bureau and implement safeguards to protect against possible abuses. As a precursor, Ukraine should establish an inter-agency group, drawing investigators, prosecutors and other officials from the procurator general's office, ministry of interior, ministry of justice, militia, and security service of Ukraine to tackle corruption. This group should use targeted strike teams to go after corruption in the government and particular economic sectors, including sting operations. Nothing will send a stronger message that the new government is serious about corruption than the early arrest, trial, and conviction of officials or others engaged in corrupt activities.

Thoroughly Investigate Allegations of Constitutional Court Corruption - In the lead up to the 2007 parliamentary elections, serious allegations were made of corruption involving members of Ukraine's constitutional court, Ukraine's highest judicial body. These charges cannot be swept aside but must be thoroughly and impartially investigated if anti-corruption efforts are to be seen as credible by Ukrainian citizens and Ukrainian society.

Coordinate and Consolidate Anti-Corruption Legislation – In the past, efforts to establish a comprehensive anti-corruption policy have been plagued by institutional and personal rivalries. Numerous initiatives have been announced, but few have been implemented. With the elections over, and after the formation of the new government, the president and the prime minister elected by the new parliament should make resolving this policy deadlock a top priority and agree to implement a national anti-corruption strategy. This agreement and the push to press required legislation should come within the first 100 days of the new government.

Eliminate or Reduce the Scope of Parliamentary Immunity - Parliamentary immunity is a complex issue. Given the legacy of politicized prosecutions during the era of President Kuchma, it is not surprising that legislators might fear the use of state executive institutions to pressure or persecute opposition or independent members in the Rada. But today hundreds of thousands of Ukrainian officials serving not only in the Rada, but also in regional, municipal, and local legislative bodies are immune from prosecution. This contributes to widespread public cynicism about politicians and creates an environment in which corruption can flourish. Ukrainian election laws need to ensure that individuals with criminal pasts cannot take part in the legislative process.

Raise Awareness of the Concept of Conflict of Interest - Government leaders and legislators must declare their or their family's current or past relationships with financial, commercial, and other interests. In cases of such past relationships, government officials should recuse themselves from decisions made by their ministries that provide specific material benefit to such interests. In addition, the Rada should establish clear boundaries for private sector activity by deputies, and legislation should ensure that former government officials cannot lobby their ministries for a fixed period after they leave office.

Publish Annual Declarations of Assets and Incomes - Public officials enjoy a public trust. As such they must observe the highest standards of transparency and integrity. National leaders across the political spectrum should support the strict enforcement of declarations of assets and incomes. These declarations should be detailed and include income sources, stocks, bonds, and cash assets, as well as the financial value of gifts provided by friends and family. Moreover, state authorities must thoroughly investigate cases in which there are obvious anomalies between the declared assets and incomes of

government officials and Rada deputies and their everyday life-styles. In such cases, prosecution should be pursued.

Demonstrate the Integrity of Anti-Corruption Efforts - Anti-corruption campaigns and prosecutions cannot be seen as mechanisms of political retribution, if they are to be credible to the public. Official prosecutions cannot be exclusively focused on the activities of members of the political opposition and must target officials from across the political spectrum.

Create a Network of Independent Inspectors General - Every ministry or major government office should have within it an independent Inspector General's office with wide-ranging powers to launch internal investigations and audits. Each Inspector General should be appointed independently of the top leaders of the government ministry or agency they supervise.

Tackle Corruption in Higher Education - While this report has primarily focused on grand corruption, there is one area of petty corruption with major implications for future economic growth and prosperity: Ukraine's system of education. Corruption in education is perceived by many Ukrainians to be an endemic problem that deserves urgent attention. A distorted educational system that excludes many talented students while rewarding less-qualified students who entered educational institutions through corrupt means, will produce less qualified employees for the workforce. One major remedy would require a rigorous system of entrance exams to ensure merit-based entry into institutions of higher education. This system has been introduced with great efficacy at the University of Kyiv-Mohyla Academy, which can serve as a national model. Establishing a merit-based testing system on a national basis should be one of the top priorities of the new parliament and government.

Tackle the Problem of Money Laundering - Organized crime and grand corruption encourage the growth of illegal money laundering. The government should establish an investigative unit aimed at tackling money laundering. Such a unit could be attached to Ukraine's Central Bank, a method which has been effective in cleaning up the financial sector of other transitional countries, such as Georgia.

Report Annually on Results and Take Responsibility - Surveys of Ukrainian public opinion indicate widespread cynicism about the willingness of political leaders to root out corruption. The only way to change these perceptions is with results, through vigorous investigations, prosecutions, and convictions of high-ranking officials and former officials engaged in corrupt activities. Even a few convictions of high-level officials could have a significant impact on overall levels of corruption, as it would demonstrate to the public and to officials that the state is seriously attacking the problem. National leaders must not only take responsibility for ensuring anti-corruption measures, they must establish and regularly comment on progress toward meeting anti-corruption timetables and benchmarks. To this end the president and prime minister should issue an annual report on the extent of corruption and the effectiveness of anti-corruption efforts in the country.

Recommendations to Other Governments and International Organizations:

Establish a Research and Training Center for Anti-Corruption Personnel — The European Union and United States should together create a regional anti-corruption research and training facility. The focus should be on training personnel from the police, and prosecutorial and investigative agencies, from across Eastern Europe, but with an emphasis on Ukraine. Training could, for example, be conducted on the model of the Marshall Center in Germany, which has helped promote best practices in the militaries of the region. The involvement of law enforcement and judicial personnel from the established democracies of Europe and North America could, potentially, also become an important dimension of Ukraine's cooperation with NATO.

Support Anti-Corruption Initiatives — While the funding of anti-corruption efforts in Ukraine is primarily the responsibility of its national leaders, the presence in Ukraine of anti-corruption expertise from other countries can be of great importance. Funding for non-governmental, training, and technical assistance efforts in this sphere should be a high priority for U.S., Canadian, and European foreign aid efforts. Such assistance should be aimed at developing an indigenous capacity that can provide ongoing training and advice.

Recommendations for Non-governmental Organizations, Donors, and the Private Sector:

Establish an Anti-Corruption Clearinghouse — A website should be established and run by a credible non-governmental group to track the disposition of cases related to corruption. Along with tracking current cases, the website should include a listing of completed investigations into corruption allegations, including information on cases investigated, how many came to trial, and which resulted in convictions with criminal and civil sanctions. In addition, the website could monitor the number of cases brought annually by prosecutors as well their ultimate disposition. Such statistics could be helpful in assessing the effectiveness of anti-corruption efforts, and could also determine whether the prosecution of corruption is biased in favor of, or against, specific political parties or interest groups.

Support Foreign Business Surveys — The private sector should support the publication of annual surveys in which foreign companies in Ukraine report on their experience of petty and grand corruption. Such surveys, released on an annual basis, can be an invaluable indicator of broad trends in the area of corruption and can help identify the sectors, ministries, professions, and institutions in which corruption is most deeply rooted.

Fund Indigenous Training Centers — Philanthropic donors and businesses working in Ukraine should support the establishment of indigenous anti-corruption training centers to be established in cooperation with Ukrainian institutions. These centers should work with non-governmental monitors, train the judiciary, interact with police personnel, and train investigative reporters. This technical assistance can be a crucial counterpart to official state efforts to strengthen anti-corruption capacities.

Benchmarks for Measuring Progress

Anti-corruption advocates, as well as investors who are looking at Ukraine as a potential business opportunity, must be able to track the effectiveness of anti-corruption efforts. As corruption by its nature is a difficult phenomenon to measure, evaluating progress is an ambitious task. One way of measuring the effectiveness of anti-corruption efforts is to apply a combination of quantitative and qualitative indicators.

While the indicators referred to at the beginning of this report (such as the World Bank Global Governance Index) present an important tool in measuring the overall level of corruption in a country, a combination of quantitative and qualitative benchmarks could include the following:

Quantitative	Qualitative
Number of public officials/politicians charged with and/or convicted of corruption per year	Investigations/convictions across the political spectrum (not just focused on one political party)
Publication of detailed declarations of assets and incomes of top political leaders (on the national, regional, and local level)	Investigating follow-up generated by mismatch between declared incomes and reports of extravagant lifestyle of political leaders
Number of corruption-related articles and stories in the media	Investigative follow-up and government action on corruption allegations in the media
Perceptions of corruption and bribe-paying by the Ukrainian public as measured in nationwide surveys	Notable shifts in perception of the Ukrainian public
Economic indicators (GDP development, tax revenue, FDI, time it takes to start a business, number of foreign investors in Ukraine, percentage of shadow economy)	Elimination of bureaucratic red tape, creation of one-stop shops for licenses and permits, independent audits by recognized auditing firms
Number of reported incidents of election fraud	Political stability, including formation of a parliamentary majority, a viable parliamentary opposition, and the quality of cabinet level appointments
Number of anti-corruption laws passed by the parliament and signed by the president	Implementation of anti-corruption promises made during the election campaign, i.e. abolishing/reducing deputy immunity; establishing a national anti-corruption bureau; reforming the judiciary
Surveys of perceptions of corruption among foreign businesses	Notable shifts in perception among foreign investors
Number of extradition treaties between the Ukraine and other countries (Increasing number represents vote of confidence on the Ukrainian legal system)	Successful cross-border prosecutions of parties guilty of corruption

ANNEX I: Overview of Ukrainian Anti-Corruption Legislation

According to Ukrainian legal experts, Ukraine's current anti-corruption legislation lags behind international standards. Anti-corruption legislation in force today is often so vague that the same corrupt activity may be classified both as a misdemeanor and a felony.⁸⁵

The main pre-Orange Revolution legislative acts containing anti-corruption regulations are:

- the Law of Ukraine "On Civil Service" of December 16, 1993;
- the Law of Ukraine "On Combating Corruption" of April 3, 1997;
- the Criminal Code of Ukraine of September 1, 2001.

Official statistics have recorded the number of administrative misdemeanors involving corruption at 3,000 to 5,000 per year. These documented acts are mainly committed by civil servants of the lower ranks.⁸⁶ These official statistics do not necessarily present an adequate picture of corruption in Ukraine. Moreover, around 3,000 cases of bribery are registered per year. Of that number, only 398 people were charged with bribery in 2005.⁸⁷ Of those charged with abuses, only about 1 in 10 is eventually punished.

A brief timeline below outlines the anti-corruption efforts by various Ukrainian government institutions following the Revolution of December 2004:

March 16, 2005 – Six years after Ukraine signed the Council of Europe's Civil Law Convention on Corruption on November 4, 1999, in Strasbourg, the Verkhovna Rada passed a law ratifying the convention. The law entered into force on January 1, 2006. (In January 1999, Ukraine also signed the Council's Criminal Convention on Corruption but has not yet ratified it.)⁸⁸

November 18, 2005 – Yushchenko signed a decree "On principal measures of bringing the economy out of the shadow and combating corruption." The primary activity foreseen by the decree was monitoring corruption activities in the political, economic and social spheres. The decree also instructed the cabinet of ministers to prepare a draft law on a simplified procedure for dismissal of political appointees, and on general principles and ethics standards (such as developing a financial disclosure procedure, establishing blind trusts, prohibition of expensive gifts in any form, etc.).

December 29, 2005 – President Yushchenko signed a decree on convening an inter-governmental commission on combating corruption under direction of the National Security and Defense Council of Ukraine (NSDC). The aim of the decree was to coordinate anti-corruption activities of all government agencies.

⁸⁵ http://mndc.naiu.kiev.ua/Gurnal/15text/g15_08.htm.

⁸⁶ Ibid.

⁸⁷ Ibid.

⁸⁸ Mission of Ukraine to European Communities. "Ukraine has ratified the CE Civil Law Convention Against Corruption and is prepared to ratify the criminal law convention against corruption"
<http://www.ukraine-eu.mfa.gov.ua/eu/en/publication/content/2206.htm>.

February 23, 2006 – The Verkhovna Rada passed a law that amended the existing “Law on Combating Corruption”. The law tightened the accountability for corrupt activities by civil servants, all members of the cabinet of ministers, members of parliament, deputies in legislatures on all levels, officials of regional authorities, and military officials.⁸⁹

September 11, 2006 – The president signed a decree approving a new anti-corruption strategy for Ukraine called “On the Way to Integrity.” This document identified the main directions of anti-corruption policies of the Ukrainian government. Ukraine’s ministry of justice was tasked by Yushchenko to prepare the presidential strategy and the accompanying laws to implement the strategy. Several of these laws have passed the first reading in the Rada but have been held up by the political crisis. Representatives from the ministry of justice expect the laws to be passed once the parliament reconstitutes itself.⁹⁰

November 29, 2006 – The cabinet of ministers adopted a directive “On the state of financial and budgetary discipline, measures toward intensifying anti-corruption efforts and control over the use of state property and financial resources.” This directive effectively strengthened the role of the main control and revision office of Ukraine (MCRO) by limiting expenses of ministries and other government agencies for consulting and auditing services, advertisement services, acquisition and maintenance of cars, expenses on welfare assistance, and sponsoring activities.

November 30, 2006 - The cabinet of ministers approved the conclusion of an agreement between the U.S. and Ukrainian governments on implementing a program aimed at reducing corruption in the public sector (through the Millennium Challenge Corporation Threshold Program).

December 18, 2006 - The Verkhovna Rada ratified the UN Convention on Corruption.

March 5, 2007 - The president signed a decree creating a steering council for implementation of the \$45 million “Threshold Program” of the Millennium Challenge Corporation, which is aimed at combating corruption.⁹¹ Minister of Finance and First Deputy Prime Minister of Ukraine Mykola Azarov was appointed chairman of the council.

August 15, 2007 - The cabinet of ministers adopted a directive on an action plan, prepared by the ministry of interior, aimed at implementing the president’s strategy for combating corruption in Ukraine (“On the Way to Integrity”).

⁸⁹ “President’s decree on priority steps to economy’s deshadowization and countering corruption provides for eradicating corruption,” http://www.kmu.gov.ua/control/en/publish/article?art_id=24416261&cat_id=32598.

⁹⁰ Anti-Corruption Network for Eastern Europe and Central Asia. “Istanbul Anti-Corruption Action Plan for Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, the Russian Federation, Tajikistan and Ukraine. Ukraine: Monitoring Report.” Dec 6, 2006 P.11 <http://www.oecd.org/dataoecd/18/37/37835801.pdf>.

⁹¹ http://www.transparency.org/publications/newsletter/2007/march_2007/anti_corruption_work.

ANNEX II: List of Other Experts and Interlocutors

The following is a list of the experts, government officials, and others with whom members of the Atlantic Council Task Force met in the course of this study. Some of the research in this report is based on those conversations. The list does not represent an endorsement of the report or its conclusions by any of these individuals or the institutions which they represent.

Mykola Azarov, First Deputy Prime Minister of Ukraine
Yarema Bachynsky, Chief of Party, Ukrainian Standardized External Testing Initiative
Viktor Bezkorovaynyi, Head of the Anticorruption Department,
Secretariat of the President of Ukraine
Sergiy Chervanchuk, Head, Division for Investment & Innovation Development and
Foreign Economic Activity, Secretariat of the President of Ukraine
Valentyna Danishevska, Director, Commercial Law Center, Kyiv
Sergiy Garmash, Editor, Ostrov
Earl Gast, Head of Mission, USAID, Kyiv
Juhani Grossmann, Country Director, Promoting Active Citizen Engagement (PACE)
Daniel Kaufmann, Director, Global Programs and Governance, World Bank Institute
Tanya Khavanska, Deputy Director, ABA Rule of Law Initiative-Ukraine
Mykhailo Korniyenko, Deputy Minister for Internal Affairs, MIA
Yuriy Kostenko, Deputy Minister of Foreign Affairs
Ilko Kucheriv, President, Democratic Initiatives Foundation
Kyryl Kulikov, People's Self-Defense Bloc
Roman Kupchinsky, Editor, Crime, Corruption, and Terrorism Watch,
Radio Free Europe/Radio Liberty
F. Stephen Larrabee, Corporate Chair in European Security, RAND
Igor Lutsenko, Editor, Epravda
Ksenia Lyapina, MP, Nasha Ukraina
Volodymyr Makukha, Deputy Minister for Energy
Hryhoriy Nemyrya, Foreign Policy Advisor to Yulia Tymoshenko and MP (BYuT)
Roman Olearchyk, Financial Times Correspondent, Kyiv
Ellen Seats, Senior Advisor, MCC Threshold Country Plan, USAID
Oleksandr Shuynalskyi, Deputy General Prosecutor
William Taylor, U.S. Ambassador to Ukraine
Oleksandr Turchynov, Deputy Secretary, NSDC and MP (BYuT)
David Vaughn, Chief of Party, USAID/Ukraine Rule of Law Project
Bohdan Vivitsky, MCC Resident Legal Advisor, U.S. Department of Justice/U.S. Embassy
Shelley Wieck, Country Director, ABA Rule of Law Initiative-Ukraine
Yuriy Yehanuov, Former Prime Minister
Inna Yemelyanova, Deputy Minister of Justice
Igor Zhdanov, Our Ukraine

THE ATLANTIC COUNCIL'S BOARD OF DIRECTORS

CHAIRMAN

*James L. Jones

CHAIRMAN EMERITUS

*Henry E. Catto

PRESIDENT AND CEO

*Frederick S. Kempe

VICE CHAIRS

*Carol C. Adelman

*Chas. W. Freeman, Jr.

*Roger Kirk

*Geraldine S. Kunstadter

*Richard L. Lawson

*John D. Macomber

*Virginia A. Mulberger

*W. DeVier Pierson

*Paula Stern

*Ronald P. Verdicchio

TREASURER

*Jan M. Lodal

SECRETARY

*Walter B. Slocombe

DIRECTORS

David L. Aaron

*Robert J. Abernethy

Michael A. Almond

G. Allen Andreas

David D. Aufhauser

Nancy Kassebaum Baker

*Donald K. Bandler

Lucy Wilson Benson

*Julia Chang Bloch

Kathy Bloomgarden

Avis T. Bohlen

Beth A. Brooke

Harold Brown

Dan W. Burns

*Richard R. Burt

Kathryn Bushkin

Daniel J. Callahan, III

Sarah C. Carey

Michael P.C. Carns

*Daniel W. Christman

Wesley K. Clark

*Curtis M. Coward

Ralph D. Crosby, Jr.

W. Bowman Cutter

Brian D. Dailey

Kenneth W. Dam

Jaime Daremblum

Edwin Dorn

Lacey Neuhaus Dorn

William H. Draper, III

Stanley Ebner

Richard Edelman

Stuart E. Eizenstat

Robert F. Ellsworth

Barbara Franklin

*Ronald M. Freeman

*John L. Fugh

Carlton W. Fulford

Jacques S. Gansler

*Sherri W. Goodman

John A. Gordon

Janet Mullins Grissom

Marc Grossman

Kenneth H. Hannan, Jr.

Harry Harding

Rita E. Hauser

Marten H.A. van Heuven

James R. Hogg

*Benjamin Huberman

*Robert E. Hunter

Robert L. Hutchings

Mansoor Ijaz

Mercy Jimenez

A. Elizabeth Jones

Paul G. Kaminski

Arnold Kanter

Kathryn Dickey Karol

Francis J. Kelly

*James V. Kimsey

Henry A. Kissinger

*Franklin D. Kramer

Charles R. Larson

*Roderick K. von Lipsey

John R. Lyman

*Barry R. McCaffrey

James P. McCarthy

*Jack N. Merritt

*Judith A. Miller

*George E. Moose

Steven Muller

William A. Nitze

Hilda Ochoa-Brillembourg

Philip A. Odeen

Hilliard W. Paige

William J. Perry

*Thomas R. Pickering

Joseph W. Prueher

Norman W. Ray

Stanley R. Resor

Susan E. Rice

Robert W. RisCassi

Joseph E. Robert, Jr.

Jeffrey A. Rosen

Charles O. Rossotti

Marjorie M. Scardino

James R. Schlesinger

William O. Schmieder

John P. Schmitz

Jill A. Schuker

Brent Scowcroft

Patricia Sherman

Eric K. Shinseki

Matthew R. Simmons

Kiron K. Skinner

Anne-Marie Slaughter

William Y. Smith

*Helmut Sonnenfeldt

Delbert L. Spurlock, Jr.

George J. Stathakis

John Studzinski

William H. Taft, IV

Peter J. Tanous

Carl E. Vuono

Charles F. Wald

Roger W. Wallace

J. Robinson West

Togo D. West, Jr.

John C. Whitehead

R. James Woolsey

Dov S. Zakheim

HONORARY DIRECTORS

David C. Acheson

James A. Baker, III

Frank C. Carlucci, III

Warren Christopher

Harlan Cleveland

Russell E. Dougherty

Alexander M. Haig, Jr.

Christian A. Herter, Jr.

Robert S. McNamara

Bernard W. Rogers

Edward L. Rowny

George P. Shultz

William H. Webster

**members of the Executive Committee*



THE ATLANTIC COUNCIL
OF THE UNITED STATES

11th Floor, 1101 15th Street, N.W.
Washington, DC 20005

ADDRESS CORRECTIONS REQUESTED

Non Profit Org.
U.S. Postage
PAID
Washington, DC
Permit No. 8134