

ILLICIT FINANCIAL FLOWS AND ASSET RECOVERY In Ukraine

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Foreword

Illicit Financial Flows (IFFs) impact a country's economic and social development in a myriad of ways. Undocumented flights of wealth to and from - as well as within - a country have severe repercussions on government revenues, wealth that could otherwise be invested in public spending and other forms of economic and social reforms. Illicit financial flows, particularly those related to organised crime, also withdraw funds from the legitimate economy and may force the State to divert more resources to prevent and respond to criminal activity or to treat or compensate victims. The drain on resources and tax revenues caused by IFFs blocks the expansion of basic social services and infrastructure programs that are targeted at improving the wellbeing and capacities of all citizens, in particular, the very poor.

IFFs in many developing countries mean fewer hospitals, schools, police, roads and job opportunities, as well as lower pensions. It is for these reasons that States must place significantly higher priority on seizing and confiscating illicitly-obtained assets, and to channel such recovered assets to high-priority development needs.

New paradigms and policies to counter IFFs must be established to produce an unbroken chain of work from tracing, freezing, seizure, confiscation and recovery of illicitly-obtained assets, through transparent management and liquidation of such assets, to distribution of the proceeds to high-priority development needs. It is this mechanism and paradigm that will enable countries to capture billions in assets and to directly channel them into, for example, more schools, hospitals, community clinics and infrastructure, as well as the much-needed payment of salaries for teachers, nurses and doctors. Such policies also can enable States to significantly reduce youth unemployment. All of these are key factors to a country's development.

In light of the above, the European Union and the United Nations Interregional Crime and Justice Research Institute (UNICRI) are proud to launch a series of studies on Illicit Financial Flows and Asset Recovery. These studies shed light on the significant damage being caused to States as a result of unchecked IFFs, and on the significant value of prioritising the capture of illicitly-obtained assets linked to such IFFs. The EU and UNICRI are committed to providing key support and expertise needed by States to more effectively respond to IFFs. In creating and implementing more effective responses, many of which are identified in the recommendations of these reports, States will be able to weaken the influence of organised crime, as well as inject significantly greater funding into high-priority development needs.



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In Ukraine

Executive Summary:

Organised crime produces significant amounts of illicit revenue and proceeds globally. Ukraine has implemented numerous measures to combat corruption, organised crime and IFFs in the country, providing a positive example for the region. Despite this progress, Ukraine still deals with active criminal networks inside and outside the country and remains a transit country for traffickers and launderers. The principal criminal activities in Ukraine include illicit drug trafficking, human trafficking, exploitation of natural resources, illicit arms trafficking, cybercrime and tax evasion. Additionally, Ukraine faces Russian military aggression, which is causing a large economic burden; the conflict is perceived to be a contributing factor for organised criminal activity.

Combating organised crime and IFFs, and recovering illicitly-obtained assets, requires multiple policy areas and transnational cooperation. Ukraine has invested in measures to combat the nexus of corruption, organised crime and IFFs, although events in 2020 and 2021 have created significant political tension. While there is a specific agency – the Asset Recovery and Management Agency (ARMA) – with a key role in tracing illicitly-obtained assets and managing recovered assets, additional measures are needed to ensure greater transparency and independence of this and other agencies, particularly on the sensitive issue of seizure and confiscation of large amounts of assets linked to criminal activity, and on the issue of transparently channelling such recovered assets to high-priority development needs.

While Ukraine is undergoing significant economic reforms, substantial development challenges persist, including in the education, health, agriculture, and infrastructure sectors. Improving mechanisms to seize and confiscate illicitly-obtained assets will contribute to such development initiatives, and may significantly improve the quality of life of many Ukrainians.

Key Findings:

- If Ukraine were to successfully seize and confiscate only 10% (approximately USD 1.16 billion) of illicitly-obtained assets circulating in the country, this would finance the construction of roughly 212 large schools (each for 1,700 students), or some 474 secondary schools (each with dedicated classrooms for computer science, physics, chemistry, languages, vocational training, assembly halls, gyms, dining halls, medical centres and administrative offices) throughout the country.
- Alternatively, such recovered assets would cover the salary costs of more than 35,000 teachers for four years, at an average monthly salary rate of UAH 18,600 (approximately USD 673), or some 35,000 teachers for three years, at an increased salary rate of UAH 25,000 (approximately USD 905).
- Likewise, these recovered and liquidated assets would cover the salary costs of over 28,000 nurses for a period of five years, at an average monthly salary of UAH 18,900 (approximately USD 684), or the salary costs of over 15,000 doctors for a period of three years, at an average monthly salary of UAH 56,400 (approximately USD 2,041).
- The Government of Ukraine should consider adopting civil confiscation as a modality for more effective seizure and confiscation of assets. Once such mechanisms are in place and are being implemented (still, with due process for any individual seeking to claim title over such assets), this can reduce the time to confiscate assets from a period of years to a period of several months.
- Consider strengthening operational efforts to seize and confiscate illegal assets at border crossings, particularly in areas of porous border control. Consideration should be given to strengthening customs officials' knowledge on the economic impact of smuggling on Ukraine, and better vetting mechanisms in the hiring and review of those involved in customs-related work, as well as bolstering salaries and other employment incentives for customs' officials.
- Consider strengthening the legal regulation of firearms. This may include bolstered programmes in which citizens are encouraged to forfeit (including "buy-back" programmes) illegal firearms or other mechanisms to reduce the circulation of firearms.

Acronyms and Abbreviations

AML/CFT/CFP	Anti-Money Laundering/Countering Financing of Terrorism/Combating the Financing of Proliferation
ARMA	Asset Recovery and Management Agency
AROs	Asset Recovery Offices
BSEC	Organization of the Black Sea Economic Cooperation
CARIN	Camden Asset Recovery Inter-Agency Network
CCU	The Criminal Code of Ukraine
CoE	Council of Europe
CPC	The Criminal Procedure Code of Ukraine
DCFTA	Deep and Comprehensive Free Trade Area
EaP	The Eastern Partnership
EBRD	European Bank for Reconstruction and Development
EU	European Union
EUR	Euro
Eurojust	The European Union Agency for Criminal Justice Cooperation
Europol	The European Union Agency for Law Enforcement Cooperation
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
GBP	Pound Sterling
GDP	Gross Domestic Product
GFI	Global Financial Integrity
IFFs	Illicit Financial Flows
IMF	International Monetary Fund
IOM	International Organization for Migration
Moneyval	The Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism
NGO	Non-Governmental Organisation
NPO	Non-Profit Organisation
NPU	National Police of Ukraine
NRA	National Risk Assessment
OECD	Organisation of Economic Cooperation and Development
OSCE	Organization for Security and Co-operation in Europe
SAPO	Specialised Anti-Corruption Prosecution Office
SBU	Security Service of Ukraine
SDGs	Sustainable Development Goals

SFMS	The State Financial Monitoring Service
UAH	Ukrainian Hryvnia
UK	United Kingdom
UN	United Nations
UNCAC	United Nations Convention Against Corruption
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNICEF	United Nations Children's Fund
UNICRI	United Nations Interregional Crime and Justice Research Institute
UNTOC	United Nations Convention Against Transnational Organised Crime
USAID	United States Agency for International Development
USD	United States Dollar
USSR	Union of Soviet Socialist Republics
WTO	World Trade Organization

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1. Overview of Illicit Financial Flows and the Recovery of Illicitly-Obtained Assets



1.1 Introduction

This study examines illicit financial flows (IFFs) generated from organised criminal activity in Ukraine. It provides an overview of organised crime and assets linked to organised crime in the country and outlines the legislative and operational frameworks in place to combat IFFs and to recover illicitly-obtained assets. Effective asset recovery policy is a fundamental component of combating IFFs and mitigating the harm produced by IFFs.

This study's main objective is to provide targeted recommendations to national authorities, as well as other key stakeholders, in order to create and strengthen mechanisms for the effective and efficient seizure and confiscation of assets linked to organised crime (and, where appropriate, high-level corruption). The study also provides recommendations to strengthen the effective and transparent management of any recovered assets, including recommendations with respect to directing such assets to high-priority development needs. High-priority needs in Ukraine include the employment, health, and infrastructure sectors.

The data collection for this study was undertaken from May through October of 2020 through open-source desk research, as well as feedback from public officials, members of civil society and other key stakeholders.

Definition of Illicit Financial Flows

There is no consensus regarding the definition of IFFs, as it covers a diverse set of activities and behaviours, reflecting the complex and multifaceted nature of illicit international trade and finance.¹ The absence of a comprehensible and universally adopted definition explains the difficulty in analysing it and, therefore, producing targeted responses. The United Nations Economic Commission for Africa (UNECA) stated that this lack of terminological clarity limits the emergence of effective policy measures.² Another reason for this struggle concerns the statistical feasibility of quantifying IFFs, which is extremely challenging. This is because IFFs, and related crimes, are purposefully hidden or disguised by criminals who are seeking to protect themselves from the interventions of law enforcement agencies. Consequently, attempting to gather reliable information to model criminal actions and the requisite data through which to produce accurate responses is also challenging.³

Notwithstanding these limitations, for purposes of this study and to assist States in developing holistic and useful

responses to the threat, IFFs are defined broadly as the revenue, proceeds and any other assets generated by the following activities:

- **Corruption**, including the proceeds of theft, bribery, graft and embezzlement of national wealth by government officials;
- **Illicit Commerce**, including the proceeds of tax evasion, misrepresentation, misreporting and mis-invoicing related to trade activities, and money laundering through commercial transactions; and
- **Other Serious Crime**, including the proceeds of criminal activities, including human and drug trafficking, smuggling, counterfeiting, racketeering (also known as criminal protection or extortion) and terrorist financing.⁴

This classification, which is a slight alteration from that used by UNECA in 2013, highlights not only the diverse and evolving nature of illicit financial flows but also the need for multifaceted (holistic) responses that tackle the threat from various angles – e.g., not just a criminal justice response.⁵ The classification also disregards the characterisation that IFFs should only be international in nature – significant losses and harms can occur to national economies, healthcare and education systems, and to employment opportunities, even if IFFs occur within a specific country. The dynamic of the forms of IFFs differs from country to country, depending on the illicit flows transiting into, through and out of the country. Still, higher-value illicit flows, such as the trade of narcotics, tend to correlate with higher levels of other criminality, such as corruption.⁶

This study concentrates on the revenue, proceeds and other assets generated from organised criminal activities in Ukraine. Due to the interdependent nature of IFFs, this study also examines assets generated from corruption and commerce to provide a useful framework on IFFs in Ukraine. Money laundering is a crucial tool used by organised criminal groups to move illicitly-obtained revenue and to fund criminal activity. There is also a strong link between corruption and organised crime as both are propelled by the same limitations of governance and the law.

Recovery of Illicitly-Obtained Assets

The recovery of illicitly-obtained assets is essential to combating organised crime and IFFs as it deprives criminals of their financial gains and can act as a deterrence against future crimes (by removing the

financial motivation of crimes). The recovery of illicitly-obtained assets can also help mitigate the harmful impact of IFFs through the liquidation and reinvestment of those assets into public welfare and high-priority development needs. For this study, the asset recovery process includes the tracing, freezing, seizure, confiscation, and management of illicitly-obtained assets.

Worldwide progress in the recovery of illicitly-obtained assets has been, at best, modest. In 2012, the OECD launched a survey measuring assets frozen and returned between 2010 and June 2012. In this period, a total of approximately USD 1.4 billion of corruption-related assets had been frozen. In terms of returned assets, a total of USD 147 million were returned to a foreign jurisdiction in the 2010-June 2012 period. These figures pale in comparison to the widely quoted estimate that the aggregate size of money laundering in the world could be somewhere between two and five percent of the world's GDP. In 2009 alone, criminal proceeds were estimated to be at 3.6% of global GDP, with 2.7% (or USD 1.6 trillion) being laundered.⁷

European Union (EU) progress in the recovery of illicitly-obtained assets has also been modest. Europol estimates organised criminal groups have a profit of EUR 110 billion annually in the EU.⁸ Corruption is estimated to cost the EU economy some EUR 120 billion per year.⁹ Europol estimates that about EUR 1.2 billion is confiscated each year in the EU, which represents 0.009% of EU GDP. For a country with a GDP of EUR 200 billion (e.g., Finland in 2014), this amounts to about EUR 17.7 million; for a country with a GDP of EUR one trillion (e.g., Spain in 2014), the figure is about EUR 88.7 million; for a country with a GDP of about EUR 2.2 trillion (e.g., France in 2014), it is about EUR 195.2 million.

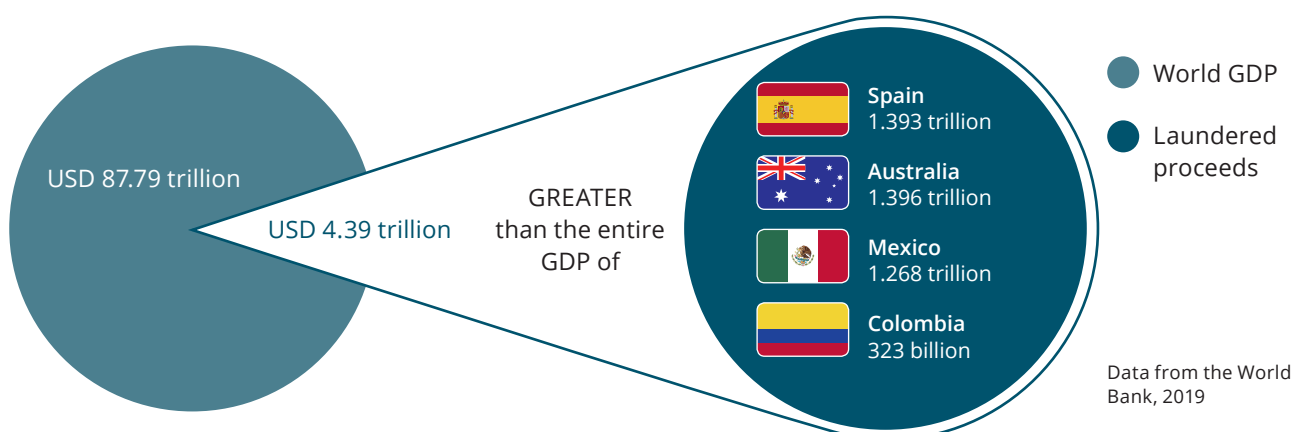
The most widely accepted estimate of global bribery puts the total at around USD 1.5 to 2 trillion each year.¹⁰

Corruption, bribery, theft and tax evasion, and other illicit financial flows cost developing countries USD 1.26 trillion per year. That is roughly the combined size of the economies of Switzerland, South Africa and Belgium, and enough money to lift the 1.4 billion people who get by on less than USD 1.25 a day above the poverty threshold and keep them there for at least six years.¹¹

A USD 1 million bribe can quickly amount to a USD 100 million loss to a poor country through derailed projects and inappropriate investment decisions which undermine development.¹²

Notwithstanding the above, such estimates should be treated with caution. They are intended to give an idea of the magnitude of money laundering, which represents only a portion of IFFs. Due to the illegal nature of the transactions, precise statistics are not, nor likely ever will be, available and it is therefore impossible to produce a definitive estimate of the amount of money that is globally laundered every year. The Financial Action Task Force (FATF) therefore does not publish any figures in this regard. Still, there is near-universal consensus that money laundering and IFFs worldwide undermine most economies as well as development.

Estimated annual amount of global laundered proceeds is greater than the entire GDP (2019) of the following countries combined



Mechanisms for Accelerated Conviction and Non-Conviction-Based Forfeiture

- Plea bargaining, reconciliation or other expedited settlement of criminal proceedings requiring the defendant to return illicitly-obtained assets in exchange for a reduced sentence (or information regarding assets illicitly-obtained by others);
- Mechanisms that allow courts to impose orders for extended confiscation
Example: issuing an order stating that all assets acquired, say, over the past five years by a defendant convicted of a serious crime, are presumed to have been illicitly-acquired, unless the defendant can rebut this presumption;
- Orders for the confiscation of legally-acquired assets of the defendant, where the State demonstrates that it has taken every reasonable measure to locate the illicitly-acquired assets, but has been unable to do so.

Additional valuable mechanisms may include a separate civil confiscation proceeding against assets that are considered to be illegally-acquired – such proceedings still place the initial burden on the State to prove that certain assets are the product of illicit activities, albeit at a lower burden of proof; civil confiscation proceedings, while they do not adjudicate the criminal culpability of any particular individual, or allow the judge to deprive anyone of their liberty, have the advantage of being able to be adjudicated over a span of months, and to recover assets more quickly, in stark contrast to, say, a criminal money laundering case, which typically takes several years. The initiation and adjudication of a civil confiscation case (against illicitly-acquired assets) does not necessarily preclude the initiation and adjudication of a parallel criminal case (against an individual).

Just as IFFs weaken development, the recovery of assets linked to IFFs can enhance development. The recovery of only a small portion of illicitly-obtained assets linked to serious criminal activity – both from abroad and from within a country – can provide developing countries with much-needed additional resources. In this context, prioritising the tracing, seizure, confiscation and recovery of illicitly-obtained assets can, aside from providing a useful deterrent to criminality, fund high-priority development needs, such as those in the health, education or infrastructure sectors.

Many obstacles, particularly in cross-border cooperation to recover assets, have allowed criminal organisations and corrupt officials to take advantage of such weaknesses. Proving that assets are linked to criminal conduct can be a complex and lengthy process, ultimately producing a lack of public confidence in state institutions. Nevertheless, countries that have had the most success in the tracing, freezing, seizure and confiscation of illicitly-obtained assets (whether located abroad or within that particular country) are those that have adopted mechanisms that can accelerate criminal justice processes for confiscation,¹³ as well as mechanisms for non-conviction-based forfeiture of assets.¹⁴

An increasing number of jurisdictions have adopted mechanisms for initiating proceedings for unexplained wealth or illicit enrichment.¹⁵ Many countries now recognise the value of establishing dedicated Asset Recovery Offices (AROs), essentially offices that house officials with access to multiple databases (e.g., vehicle registry, business registry, tax information, customs database, criminal records). Such AROs, once in place, can take a cross-institutional view of one's assets, as well as the assets held by family members or associates of those suspected of being involved in serious criminal activity – more often than not, when one launders illicitly-obtained assets, he or she does not place them in his or her name.

Additionally, the establishment and training of specialised forensic financial analysts, who support the role of prosecutors in proving financial crimes, have proven to be beneficial in both criminal proceedings as well as in civil confiscation proceedings. States that have developed strong inter-institutional cooperation mechanisms also have shown greater success in the recovery of illicitly-obtained assets.¹⁶

1.2 International Regulations and Recommendations

A broad set of international conventions, standards, and bodies have been developed in order to combat IFFs. These include UN conventions which establish standards that all countries are expected to meet to avoid providing a haven for various kinds of IFFs. They also include treaties or organisations with narrower membership, but which set out more detailed measures to be applied by their member countries; a number of these treaties allow for useful peer reviews to ensure adequate compliance.

Key International Parameters Regarding Illicit Financial Flows

- 1988 UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances
 - 1999 UN International Convention for the Suppression of the Financing of Terrorism
 - 2000 UN Convention against Transnational Organised Crime
 - 2003 UN Convention against Corruption
 - FATF 40 Recommendations
-

In 2015, the General Assembly of the UN adopted the Addis Ababa Action Agenda which invites “appropriate international institutions and regional organisations to publish estimates of the volume and composition of illicit financial flows”.¹⁷ Similarly, the [2030 Agenda for Sustainable](#)

[Development](#) and the Sustainable Development Goals (SDG) call on countries to:

- significantly reduce illicit financial and arms flows by 2030;
- substantially reduce corruption and bribery in all their forms;
- develop effective, accountable and transparent institutions;
- strengthen domestic resource mobilisation, also by supporting developing countries;
- enhance global macroeconomic stability;
- strengthen the recovery and return of stolen assets and combat organised crime.¹⁸

The UN also highlights the need for a methodology to estimate IFFs in order to comply with the data requirements stemming from the global SDG indicator framework.¹⁹

The EU and the OECD have also played key roles in defining priorities that countries need to consider to better address the threats of money laundering and IFFs, as well as the need to strengthen mechanisms for the seizure and confiscation of assets, and the need to tackle tax evasion.²⁰ Additional mechanisms such as the Camden Asset Recovery Inter-Agency Network (and similar networks) provide much-valued support and cross-border dialogue for police and prosecutors to better capture assets linked to organised crime and high-level corruption.²¹

2. Overview of Illicit Financial Flows and Organised Crime in Ukraine



2.1 Overview of the Country of Ukraine



- Population: 44.38 million²²
- Official language: Ukrainian
- Currency: Ukrainian hryvnia (UAH)²³
- Member of UN, EaP, OSCE, WTO, CoE, EBRD, IMF, BSEC²⁴
- 24 August 1991: independence from USSR
- Attractive transit country for organised crime due to its geographical position

Economy

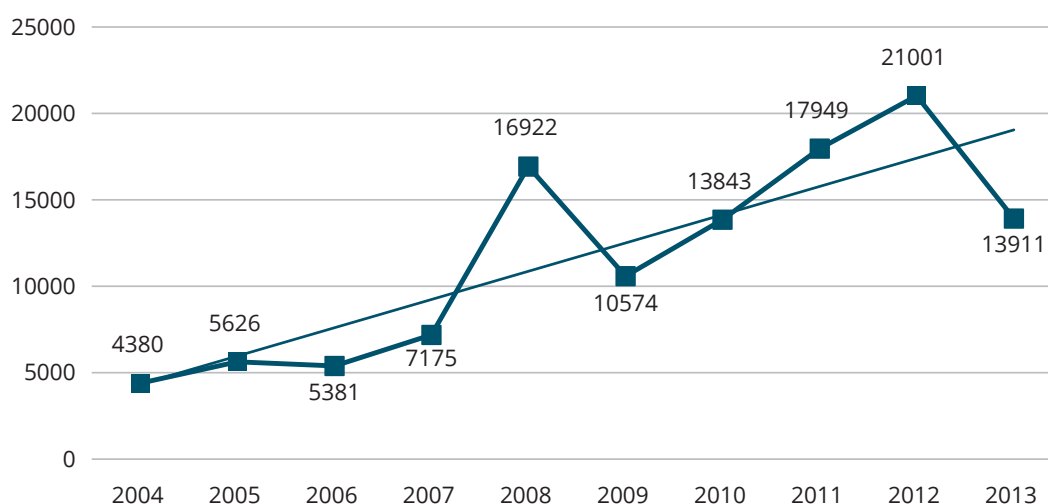
In 2018, the IMF had ranked Ukraine as the poorest country in Europe^{25,26} Following the dissolution of the Soviet Union in 1991, the GDP of Ukraine fell sharply for ten years and only began to grow rapidly from 2000 to 2008, after which, like many countries, it was negatively impacted by the global financial crisis. Ukraine's 2019 GDP was about USD 153.2 billion.²⁷ The main industries of the country consist of fuel,²⁸ mining,²⁹ aircraft and aerospace, agriculture and tourism. Other notable industries consist of chemical, automotive, and shipbuilding industries.³⁰

2.2 Overview of IFFs in Ukraine

Introduction

IFFs are prevalent and have a large impact on Ukraine's economy. According to an assessment by the international NGO Tax Justice Network, an estimated USD 167 billion have been illegally moved out of the country from 1991-2010.³¹ A report by Global Financial Integrity (GFI) also indicated that Ukraine was ranked 14 out of 148 developing countries in terms of producing IFFs over the 2004-2013 period, with average annual rates of approximately USD 11.6 billion.³²

Illicit Flows in Ukraine Between 2004-2013 in USD Million



Source: Kar, Dev, and Joseph Spanjers. *Illicit Financial Flows from Developing Countries: 2004-2013*. 2015.

2.3 Overview of IFFs Generating Sources

Corruption

Corruption poses an economic risk in Ukraine. It generates criminal proceeds and undermines the effective functioning of some state institutions and the criminal justice system.³³ In 2020, Ukraine scored 33/100 in the corruption index of Transparency International and was ranked 117 out of 180 countries.³⁴

This situation is recognised by Ukrainian authorities, who have put much effort into countering this dynamic; the country possesses multiple anti-corruption bodies with each agency having its own function – including the National Agency on Corruption Prevention (NACP), National Anti-Corruption Bureau of Ukraine (NABU), Specialised Anti-Corruption Prosecution Office (SAPO), Asset Recovery and Management Agency (ARMA), State Bureau of Investigations (SBI) and High Anti-Corruption Court of Ukraine (HACC).³⁵

Nevertheless, according to the results of the anti-corruption survey conducted by the “join-up” United States Agency for International Development (USAID) community support program in 2018, corruption is perceived as one of the three biggest problems in Ukraine. Political corruption at the highest level was indicated as the biggest threat by 73.2% of those surveyed. Similarly, 72.4% answered that corruption in the business environment was considered a serious problem. Moreover, the survey had shown that in sum, the public lacks the belief in the government institutions to mitigate corruption.³⁶

Similarly, a 2020 report by the European Union Anti-Corruption Initiative (EUACI) indicated that between 2017 and 2020, corruption was perceived to be on the rise in multiple sectors.³⁷

The biggest examples of corruption generating illicit financial flows in Ukraine include those involving former president Viktor Yanukovich. Cases involving the former President and other high-level officials revealed that the State had lost some USD 40 billion³⁸ as a result of their acts of corruption.³⁹

Additionally, significant political tension exists with respect to independence or transparency of key entities, such as the NABU, and the ARMA.⁴⁰

Risks of Cash Use

The main risks of an extensive cash use include the maintenance of a shadow economy, and therefore state budget losses from unpaid taxes, distortion of internal competition as a legitimate business are unable to compete with those in the shadow economy, and a higher potential for corruption, with a concomitant decline of public trust in state institutions.⁴¹ Ukraine has high cash use; it's estimated that the weight ratio of cash to GDP stood at 12.1% in 2017, which is a high amount for a developed country.⁴² Such significant use of cash brings risks to the economy as cash is the preferred method of illicit actors to launder money and fund their illicit activities with minimum detection.

The high cash circulation is also attributed to the significant presence of the shadow economy in Ukraine.⁴³ According to the 2019 Ukrainian National Risk Assessment (NRA), the 2018 level of the shadow economy stood at 30% of the GDP.⁴⁴ Although this is lower than the 42% measured in Moneyval's 2017 report, both figures allow for significant avenues of activity for those involved in organised crime, corruption and money laundering.⁴⁵

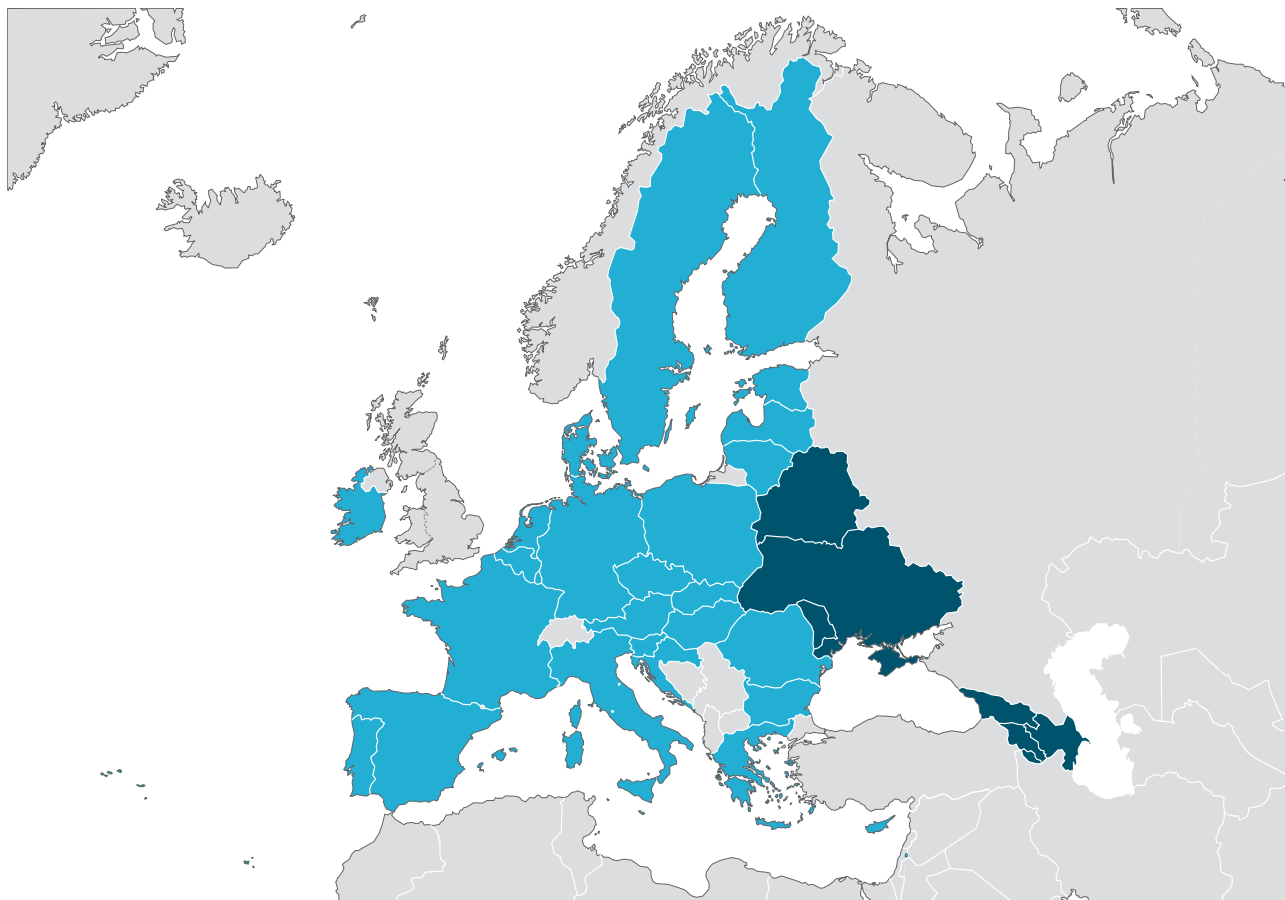
Tax Evasion, Tax Avoidance and Shell Companies

Tax evasion⁴⁶ costs Ukraine some UAH 180 billion annually. The modalities for tax evasion in Ukraine are similar to those in other countries and include smuggling, theft of value-added tax (VAT), counterfeit, moving profits offshore to “tax havens”, distortion of the tax base, abuse of tax privileges and preferences, and unofficial entrepreneurship and individual economic activity without registration.⁴⁷

Annual Budget Loss from Tax Evasion Connected to IFFS in UAH Million

	Annual Amount	Budget Loss
Off-Shore Schemes	230-260	50-65
Smuggling	80-230	25-70
Conversion Centres	40-50	Dec-15
Counterfeit	Unknown	10

Organised crime and the Eastern Partnership



Ukraine is a member of the Eastern Partnership (EaP), a joint policy initiative between the EU, its member states, and six eastern neighbouring countries: Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine.

During the 2017 EaP Summit, the partnership countries reiterated their commitment to the establishment and further development of sustainable structures to prevent and fight corruption, strengthen transparency, and combat money laundering. A Joint Declaration from the Summit established as key priorities 'effective systems of declaration of assets and of conflict of interest with easily searchable databases' and 'development of a legal framework and mechanisms for the recovery and management of assets and effective tools for financial investigations'.

Often serving as transit points for trafficking and smuggling, all six EaP countries are threatened by organised criminal groups in the region. These criminal groups and the illicit revenue generated from their crimes have a detrimental impact on the development and stability of the EaP region, the EU, and the Europe generally. It is imperative to implement a common strategy and operational responses between the EU and EaP countries, particularly on the issues of tracing, freezing, seizure, confiscation and return of illicitly-obtained assets.

The largest tax evasion schemes are caused by large corporations in the country which is unlike other countries where tax evasion is caused by the small unregistered business.⁴⁸

The use of shell companies by large corporations costs Ukraine's national budget an estimated USD 600 million. Some large corporations which seek to maximise their profit by lowering their taxes will resort to tax avoidance⁴⁹ schemes and will transfer their profits (estimated to be some USD three billion annually) to lower-tax jurisdictions.⁵⁰

Ukraine's recent policies⁵¹ to combat the latest economic crisis caused by the Covid-19 Pandemic could further facilitate illicit financial flows by tax avoidance.⁵²

Conversion Centres

Conversion centres are considered a major money laundering risk by Moneyval; such centres are often used by illicit actors to take proceeds out of the country, to convert proceeds into cash for increased perceived legitimate origin, and to siphon funds from the legitimate economy.⁵³

The State Financial Monitoring Service (SFMS) reported that some 2,193 proceedings involved conversion centres between 2013-2017.⁵⁴

Fraud

A survey by PriceWaterhouseCoopers (PwC) mapped the impact of fraud in Ukraine in 2018.⁵⁵ The results of the survey indicated that 48% of the organisations that responded had experienced some form of fraud in the said year. Some 46% of Ukrainian organisations had reported an estimated monetary loss of less than USD 100,000, while 19% had reported USD 100 thousand to one million, 4% had reported a loss of USD 1 million to 5 million and 8% had reported the largest monetary loss of USD 5 million to 50 million. The top five reported forms of fraud (broadly defined)⁵⁶ were bribery and corruption (73%), asset misappropriation (46%), procurement fraud

(33%), human resources fraud (33%) and cybercrime (31%).⁵⁷ Conversely, only 40% of the respondent organisations had conducted a general fraud risk assessment between 2016-2018.⁵⁸

Terrorist and Separatist Financing

Particular sectors, including the non-profit sector, remain areas of concern for Ukraine with respect to the financing of terrorism and separatist groups.⁵⁹ A number of factors contribute to this: significant cash use within the economy, poor regulation of NPO, weak control over the registration of legal entities and their actual beneficial owners, and a lack of control over specific parts of the state border.⁶⁰ Moreover, the threat of financing terrorist and separatist activities is increased due to the country's geographical location. These risks threaten the expansion of such groups within Ukraine and the illicit flow of weapons and ammunition, with concomitant illicit financial flows.⁶¹

Ukraine has also been reported to be a transit country for militants to war zones, and for possible terrorists seeking to hide from foreign law enforcement.⁶²

Armed Conflict in Donbas

The armed conflict in the Donbas region which started in 2014 is a conflict between the Ukrainian government and two non-state armed actors: the, so-called, Donetsk People's Republic (DPR) and the Luhansk People's Republic (LPR) – operating in "Separate, temporary occupied territories of Donetsk and Luhansk Oblasts of Ukraine".⁶³ This conflict is causing a significant economic burden on the government; it is estimated that the daily cost of the conflict is around USD five million.⁶⁴ In addition, the conflict is perceived to be a contributing factor to the activity of organised crime in the country.⁶⁵ The main illicit flows that are reported to be connected to the conflict are trafficking of small arms,⁶⁶ smuggling of goods and counterfeit products,⁶⁷ human trafficking⁶⁸ and the financing of terrorism.⁶⁹

3. Overview of Organised Crime in Connection to IFFs



3.1 Introduction

In its 2017 report, Moneyval indicated that organised crime is on the rise in Ukraine, and this is having an impact on the country's economy.⁷⁰ The situation was further confirmed by the Ukrainian 2019 National Risk Assessment.⁷¹ The World Economic Forum had ranked Ukraine 113th out of 137 countries in the world in terms of the organised crime impact on business.⁷²

Most organised criminal gangs uncovered by the authorities operate in Crimea and the eastern regions of Donetsk and Luhansk, as well as in the regions of Zaporizhzhia and Odesa.⁷³ The groups are involved in human trafficking, drug trafficking and the smuggling of goods and counterfeit products, as well as cybercrime, among others.⁷⁴

Ukraine borders Russia in the East, Belarus in the North, the Black Sea in the South and the European Union in the West and Southwest. This geographical position has resulted in Ukraine being a transit country for organised crime groups which operate across and within the country's borders.⁷⁵

3.2 IFFs Generating Activities of Organised Crime

Human Trafficking

In 2014, Ukraine was ranked 106 out of 167 countries by Walk Free Global Slavery Index⁷⁶ in terms of modern-day slavery⁷⁷ However, this ranking improved significantly in 2018, to 49 out of 167 countries.⁷⁸ Conversely, the International Organization for Migration (IOM) has estimated that, since 1991, over 260,000 Ukrainians have been victims of human trafficking.⁷⁹ Economic and other conditions expose many more to the victimisation of this form of organised criminal activity.⁸⁰

Ukraine is considered a country of origin, transit and destination for human trafficking.⁸¹ Most victims have been reported to be from rural areas where there are fewer employment opportunities.⁸² Economic instability within the country has led many Ukrainians to seek an improved quality of life, either by moving from rural to urban areas within the country or by seeking employment in neighbouring EU countries.⁸³ The lack

of adequate employment opportunities has rendered many susceptible to exploitation by organised criminal groups.⁸⁴

The US State Department, in its 2020 report on Trafficking in Human Beings, indicated that although Ukraine does not fully meet the minimum requirements to combat human trafficking, the government has made significant improvements.⁸⁵ Such efforts include increasing the number of investigations and doubling the number of traffickers convicted, increasing the number of cases investigated regarding forced labour, proposing draft legislation to eliminate recruitment fees, increased granting of victim status to persons who were incarcerated abroad and committed crimes under duress of their traffickers, allocated a larger budget (UAH 548,000) to anti-trafficking measures than previous years,⁸⁶ and increased training for public officials.⁸⁷

In 2019, IOM identified some 1,345 victims of which 68% were men and 32% women, with most of their exploitation being through forced labour;⁸⁸ some 5.6% were victims of sexual exploitation.⁸⁹ Overall, from 2000 to 2019, 690 victims were identified as children.⁹⁰ Key destinations of victims were the Russian Federation, Poland, Italy, and Germany; internal trafficking was also prevalent.⁹¹ In addition, in 2018, the Counter Human Trafficking Unit of the National Police (NPU) identified 21 organised criminal groups, launched 276 criminal investigations and 109 people were ultimately charged.⁹²

Drug Trafficking

Ukraine's proximity to the European Union, developed infrastructure and availability of airports and seaports, make it attractive to those involved in transnational organised crime. The country is utilised for three main drug transport routes.⁹³ The "Northern Route" mostly consists of heroin supplies and goes from Afghanistan through Tajikistan, Kyrgyzstan, Kazakhstan, Russia to Ukraine and finally to EU countries; much of this transit through the Donetsk, as well as the Sumy regions. The "Balkan Route" is another key route for transporting Afghani Heroin⁹⁴ into the EU via the Islamic Republic of Iran, Turkey and south-east European countries.⁹⁵ The "Black Sea Route" involves all the countries surrounding it, and is used to transport cocaine, heroin, and psychotropic substances.⁹⁶

Inside Ukraine, the main drug trafficking hubs are in industrialised cities. In the central-eastern areas, the hubs are in Dnipropetrovsk, Kharkiv, Zaporizhzhia

Although Ukraine is not a major drug source country, its location astride several important drug trafficking routes into Western Europe leaves it vulnerable as an important transit country. Ukraine's numerous ports on the Black and Azov seas, its extensive river routes, and its porous northern and eastern borders make Ukraine an attractive route for drug traffickers into the European Union's (EU) illicit drug market.

Heroin from Afghanistan is trafficked through Russia, the Caucasus, and Turkey, before passing through Ukraine. Latin American cocaine is moved through Ukrainian seaports and airports for both domestic use and further transit to EU countries. Ukrainian law enforcement occasionally interdicts large shipments of drugs in commercial shipments transiting southern ports. Usually, however, drugs are found in small quantities, ranging from several grams to several hundred grams. Russian aggression in eastern Ukraine, including arming, training, and fighting alongside separatists, has created a new vulnerability for drug transit through the region.

The use of synthetic drugs and psychotropic substances, especially amphetamine-type stimulants, has been rapidly increasing in Ukraine over the past decade, following international trends. Synthetic drugs are trafficked to Ukraine primarily from Poland, Lithuania, and the Netherlands, but they are also produced locally in small clandestine labs.

Most domestic drug abuse, however, continues to be focused on drugs made from illicit drug crops (cannabis and opium poppy) grown in the region. These account for more than 90 percent of the total drug market in Ukraine. In most instances, these drugs are either locally produced or supplied from Russia and Moldova.

During the first 10 months of 2018, Ukrainian law enforcement agencies (National Police of Ukraine, or NPU) reportedly detected and disrupted 37 international drug trafficking routes, dismantled 115 clandestine labs, and eliminated 63 organized criminal drug trafficking groups. Approximately 3.89 metric tons of narcotics, psychotropic drugs, and other controlled substances were seized, including 38.9 kilograms (kg) of cocaine and 32 kg of psychotropic drugs.

Source: *International Narcotics Control Strategy Report*, U.S. Department of State. <https://www.state.gov/wp-content/uploads/2019/04/INCSR-Vol-1-1.pdf>, 2019, p. 264

regions as well as Kyiv. In the western areas, they are reported to be in the Transcarpathian, Volyn, Lviv, and Rivne regions. In the south, the principal hub is Odesa.⁹⁷ The source of this information, however, has been questioned.

New trends of buying drugs online may become a concern.⁹⁸ Online drug trafficking is, for the moment, evolving faster than the tools to fight it; cyberspace provides anonymity both for buyers and sellers, and the ease of purchase through a click on a smartphone are simplifying, expediting and expanding the market. Traffickers use hard-to-detect "contactless" (no contact between them and the buyers) methods such as sending drugs contained in small parcels or leaving the package in a location which the buyer is instructed to later collect.⁹⁹ Drug trafficking is highly profitable for organised crime groups in Ukraine. In March 2019, the Ukrainian police seized over half a tonne of heroin with an estimated worth of USD 60 million in separate investigations. During the same month, the Security Service (SBU) seized USD 51 million worth of cocaine in a South American cargo ship docked in the seaport of Odesa.¹⁰⁰

In 2018, the NPU counter-narcotic units facilitated indictments of 63 drug trafficking syndicates.¹⁰¹ In the same year, Ukrainian courts also ordered the seizure of assets valued at some UAH 72 million.¹⁰²

Smuggling

Smuggling of goods, such as cigarettes and alcohol, also generates a large amount of IFFs in Ukraine; one-third of Ukraine's external trade is reported to be the result of smuggling.¹⁰³ According to the 2019 NRA report, the volume of potential smuggling in 2018 was estimated to be between UAH 209 to 311 billion annually, with respective national budget revenue loss of UAH 63 to 93 billion per year.¹⁰⁴

Similarly, Ukrainian authorities report large-scale smuggling of various commodities arriving from the EU. For example, exports from Poland to Ukraine are frequently reported to be almost 30% higher than imports arriving from Poland,¹⁰⁵ suggesting that sophisticated smuggling networks are deeply involved.¹⁰⁶

Ukraine's porous border with Russia also poses a challenge, creating illicit streams of income. The open flat landscape of the southern steppe makes the task of fighting with contraband rather difficult. In summer, smugglers can take small roads or go through the fields. Part of the population in the near-border area make their living from smuggling vodka, cigarettes, sugar, and petrol.¹⁰⁷

Globally, illicit tobacco trade represents a multifaceted crime that may involve counterfeiting, cross-border smuggling, and tax evasion; tobacco smuggling has been identified as a source of revenue for terrorist activities in several areas.¹⁰⁸ Cigarettes can produce high-profit margins and are among the most commonly traded products on the black market due to relative ease of production and movement, along with low detection rates and penalties.¹⁰⁹

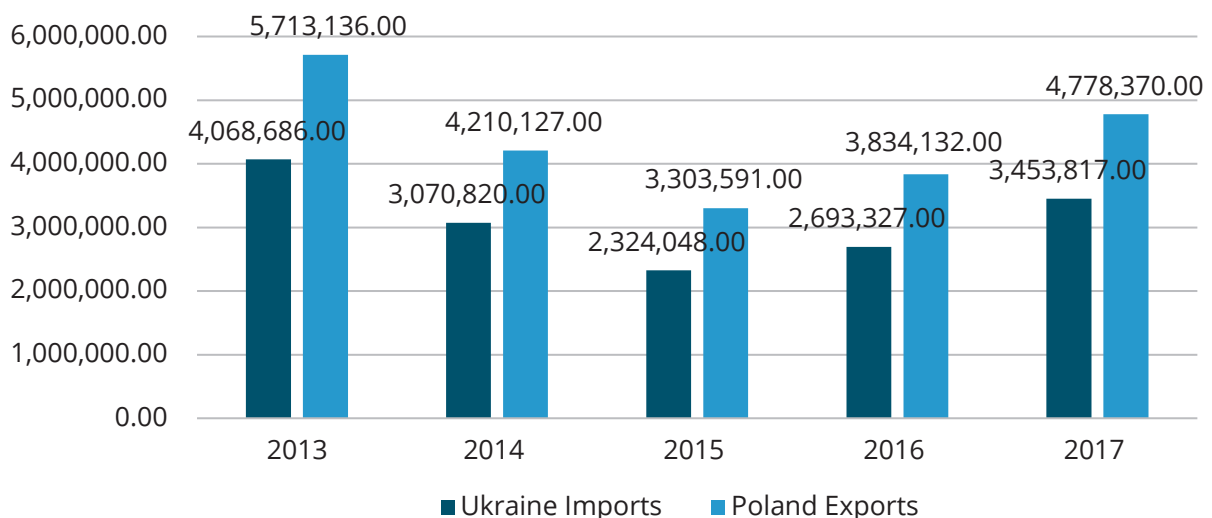
Tobacco products are one of the top commodities for illicit trade and smuggling. According to the European Border and Coast Guard Agency, Frontex, tobacco products are the most smuggled excise goods to the EU across its Eastern borders. In Italy, the potential revenues of Ukrainian smugglers in 2016 are reported to have been as high as EUR 471 million, which is more than a quarter of the related export of legitimate goods.¹¹⁰ Ukraine has displaced China as a major

supplier of illicit cigarettes to Italy, due to the low cost and efficiency of its smuggling networks.¹¹¹ Eastern European countries, with limited law enforcement resources and serious problems of poverty and corruption, lack adequate capacity to deal with the massive smuggling emanating from Ukraine.¹¹²

In 2018, the level of illegal trade in cigarettes in Ukraine reached a historic high; the volume of legal sales of cigarettes fell by 19% and circulation of illegal products increased by 70%. Excise tax revenue loss on tobacco products amounted to almost UAH five billion, which represented a massive ten percent of the State's budget in 2018.¹¹³ In both 2017 and 2018, Ukraine was ranked first among source countries of cigarettes smuggled to the EU.¹¹⁴ More than 4.8 billion cigarettes were smuggled from Ukraine in 2018, accounting for almost 11% of the total volume of smuggling to EU countries and over EUR one billion in lost revenue to Ukraine.¹¹⁵

Due to the ever-increasing excise duty rates, combined with low purchasing power, Ukrainians are increasingly buying cheap counterfeit or smuggled cigarettes, likely fuelling this form of organised criminal activity.¹¹⁶ In 2018, illegal trade in cigarettes increased by 3.7% which is three times greater than that reported in the previous year; in monetary terms, this represents approximately UAH 2.5 billion in lost tax revenue to Ukraine.¹¹⁷

The Difference Between the Value of Exports Reported by Poland to Ukraine, and the Value of Imports Reported by Ukraine from Poland



Exploitation of Natural Resources

Environmental crime is the third most profitable crime in the world.¹¹⁸ Global reports estimate that illicit profits from environmental crime range from USD 110 to 281 billion annually.¹¹⁹ Ukraine is rich with natural resources¹²⁰ and as such is vulnerable to organised criminal groups who seek to participate in the profitable market of environmental crime. The main exploited resources in Ukraine are timber, amber and charcoal.¹²¹

The high quality of Ukraine's amber makes it valuable and sought after globally, including by organised criminal groups seeking to make a profit.¹²² Economic instability in the country has facilitated the creation of "Amber Mafias".¹²³ From 2014 to 2018, illegal amber production was recorded in four regions of Ukraine.¹²⁴ The country further experienced an illegal mining boom from 2016 to 2017.¹²⁵ Official annual production in recent years has ranged from 2.5 to 5 tons, while illegal mining is reported to be between 70 and 350 tons a year. The monetary equivalent of the annual loss as a result of the production and sale of illegal amber in Ukraine is estimated to be USD 4.38 and 21.9¹²⁶ billion¹²⁷.

Ukraine is also a major exporter of illegal timber into the EU; in a review of 18 logging sites by the international NGO "EarthSight", it was observed that 67%-78% of all logging was illegal.¹²⁸ This situation undermines the legal logging sector of Ukraine, which generates an income of USD 1.7 billion (around 4% of GDP) annually.¹²⁹

Cybercrime

In Ukraine, common types of cyber-crime include black market distribution of counterfeit movies and related material, card sharing, fake online auctions, spamming, online gambling, development of viruses and theft of personal data and information.¹³⁰

In 2017, Ukraine was ranked 59 in terms of its global cybersecurity commitment score.¹³¹ In 2012, five Ukrainian

nationals stole USD 72 million US bank accounts;¹³² in 2013, Ukrainian hackers stole 40 million sets of debit and credit card data from the U.S. retail chain "Target".¹³³

In a joint Europol-Ukrainian investigation, five hackers were arrested after having stolen some USD two million from banks around the world.¹³⁴ Ukraine has also been a target of cybercrime; in 2014, hackers with unknown origins stole some UAH 65 million from a relatively new online banking system.¹³⁵ Still, Ukraine has increased its capacity to fight cybercrime, having created a dedicated "Cyber-Police" department within the National Police.¹³⁶ In 2018, the Office of the Prosecutor General produced some 1,330 indictments related to cybercrime.¹³⁷

Small Arms Trafficking

Small arms trafficking is a significant issue for Ukraine. Regulatory obstacles related to obtaining a firearm in the country remain low, making it easy for illicit actors to traffic in small arms. According to at least one report, up to three to five million residents in Ukraine possess unregistered firearms.¹³⁸ Ukraine is reported to have a large black market dedicated to the sale of firearms.¹³⁹ For example, an AK-74 can be sold for approximately UAH seven to eight thousand (or USD 265), while its modernised version, the AKS74U, can be sold for approximately UAH 15 thousand (or USD 530); the price for PM and TT pistols reportedly range from UAH five to ten thousand and grenades are sold at around UAH 300 to 500 each.¹⁴⁰ In 2016 the Donbas police seized some 176 pieces of firearms, 260 pieces of grenade launchers and almost 3,000 grenades.

In September 2019, Belarusian authorities thwarted a cross-border arms smuggling network from Ukraine to Russia via Belarus and Lithuania.¹⁴¹ The network was transporting weapons, weapon parts and ammunition.¹⁴² According to authorities, a large number of small arms and ammunition were later seized in the territory of the Russian Federation.¹⁴³

4. Combating Illicit Financial Flows



4.1 Introduction

Ukraine possesses a complex operational system to fight financial crime. The State Financial Monitoring Service (SFMS) was created as a financial intelligence unit (FIU) and is designed to counter money laundering and the financing of terrorism.¹⁴⁴ The SFMS is composed of three main departments - including the Department for Financial Investigations, Information Technologies Department and Financial Monitoring System Coordination Department. Each department contains subdivisions that are individually in charge of countering different aspects of financial crimes in the country.¹⁴⁵ In 2019, the SFMS reported to law enforcement some 893 separate cases of suspicious transactions involving assets valued at approximately UAH 92.2 billion.¹⁴⁶

4.2 Institutional Response to Organised Crime, Illicit Financial Flows and the Seizure and Confiscation of Assets

Multiple State entities facilitate Ukraine's efforts to respond to organised crime and to seize and confiscate assets linked to such activity. These include, among others, the Security Service of Ukraine (SSU), National Police of Ukraine (NPU), State Migration Service of Ukraine, the State Border Guard Service the State Fisheries Service and the Foreign Intelligence Service of Ukraine.¹⁴⁷

The Criminal Code of Ukraine (CCU)¹⁴⁸ defines and criminalises key activities which produce illicit financial flows.¹⁴⁹ The comprehensive addition of such activities into the criminal code indicates that there is a clear institutional awareness regarding the harms caused by illicit financial flows and the political will to counter it.

In 2016, Ukraine created the National Asset Recovery and Management Agency (ARMA) to facilitate the tracing and management of assets linked to acts of corruption and other serious crimes.¹⁵⁰ Since 2016, a significant number of human and other resources have been provided to the ARMA.

The Criminal Procedure Code of Ukraine (CPC) allows for the freezing of assets of individuals and legal entities at any stage of an investigation if such assets may be evidence,

proceeds or instruments of crime, or may be subject to use by courts for compensation a committed crime.¹⁵¹ Article 323 of the CPC allows courts to conduct *in absentia* trials if it recognises that the defendant is abroad, or is trying to evade justice, or if the defendant is listed in an international wanted list.¹⁵² Moreover, Article 170 of the CPC allows the court to temporarily confiscate assets if such is ordered by a ruling in a civil case.¹⁵³

The CCU outlines forfeiture in Article 59, applying it to a number of serious offences, such as smuggling, human trafficking and copyright violations. Article 59 allows confiscations of all or part of any property directly belonging to the convicted person regardless of the property's origin.¹⁵⁴

Moreover, the CCU allows special confiscation under Article 96-2; this form of confiscation applies to direct or indirect proceeds of a crime. The integration of special confiscation as a method of asset forfeiture into the CCU is a significant and positive step, but this mechanism needs to be in standard operating procedure in many criminal cases. In addition, in 2019, Article 368-5 of the CCU was introduced. The purpose of the new article is to reinstate criminal liability for unjust enrichment. To complement the article, new amendments to the CPC were introduced, granting the High Anti-Corruption Court the legal authority to order the confiscation of assets linked to the unjust enrichment¹⁵⁵ and recover them in favour of the State.¹⁵⁶

Updated AML/CFT Law

In December 2019, the Ukrainian Parliament adopted a new AML/CFT law, for which the SFMS provided inputs. The law facilitates improved implementation of FATF recommendations, provisions of the 4th EU Directive (2015/849) on "...the prevention of the use of financial system for the purposes of money laundering and terrorist financing" and Regulation 2015/847 of the European Parliament and of the Council of 20 May 2015 on "... information accompanying transfers of funds". The law also contributes to the implementation of recommendations mentioned in the Moneyval's fifth round Mutual Evaluation Report. Moreover, the law extends the range of entities that must report suspicious financial transactions and the requirements for identifying beneficial owners.¹⁵⁷ Still, adequate secondary legislation is not yet in place.

Aside from improvements in legislation, mentioned above, Ukraine has produced some key, concrete operational achievements in addressing illicit financial flows. Between 2016-2018, 634 organised groups were identified,

2,976 persons who committed criminal offences were identified as being tied to organised crime or organised groups. In 2018, authorities initiated some 780 criminal proceedings against organised criminal groups, and some 722 indictments (against 3,245 persons) were handed down. Monetary damages by those groups were estimated to be almost UAH 3.8 billion. Assets valued at UAH 2.6 billion were seized, of which UAH 158 million was recovered.¹⁵⁸

The 2019 NRA estimates that the total amount of assets recognised as legalised as a result of consideration by criminal courts, based on information provided by the SFMS 2016 through 2018, was UAH 39.4 billion.¹⁵⁹ During this period, the same amount was transferred to the State budget.¹⁶⁰

In March 2019, Ukraine's ARMA indicated that the country was among the top five in terms of international inquiries regarding the tracing and recovery of illicitly-obtained assets, processing some 1,685 requests from Ukrainian law enforcement agencies.¹⁶¹ In 2019, 1,240 assets were transferred to ARMA to be managed by the agency. In 2018, assets managed or sold off by ARMA produced a profit for the State of approximately UAH 170 million.¹⁶²

4.3 IFFs and Key Development Sectors in Ukraine

IFFs are by nature intended to be hidden. Therefore, measurements of illicit flows can only be made indirectly using related data, which makes such measurement imprecise. Additionally, there are many forms of illicit flows that cannot be detected using available economic data and methods (e.g., cash transactions).¹⁶³ For these reasons, the estimates presented here are likely to be conservative. However, they still provide one measure of the largely

unobservable IFFs problem. Moreover, even a conservative estimate of this dynamic indicates a significant degree of impact on Ukrainian society.

Estimates about IFFs in developing countries vary significantly, and while work has been done by the United Nations to estimate the proceeds of various transnational criminal activities, there remain considerable knowledge gaps, including on the extent to which these proceeds flow through the international financial system.¹⁶⁴ However, because the question is critical to the future of Ukraine's population, any indication of the collective significance of IFFs is helpful to policymakers, citizens, and other stakeholders in the country.

In developing countries, total IFFs grew at an average annual rate between 7.2% and 8.1% over the period 2005 to 2014, reaching estimated levels between USD 620 billion and USD 970 billion in 2014.¹⁶⁵

IFFs in developing countries, such as Ukraine, mean fewer hospitals, schools, police, roads, and pensions, as well as fewer job opportunities.¹⁶⁶ The UN¹⁶⁷ has indicated that there is clear "collateral damage" of outflows produced by embezzlement, the diversion of public property, and the plundering of the public treasury.

Increased focus on the seizure and confiscation of only a portion of assets linked to IFFs would have a significant impact on accelerating development within Ukraine, assuming that recovered assets are liquidated and effectively distributed to high-priority development needs. The following presents the development challenges for key sectors, as well as the development opportunities in Ukraine if the government were to prioritise the recovery of only 10% of assets lost through IFFs in the country.

As previously mentioned, the most recent annual monetary assessment of IFFs by GFI stood at USD 11.6 billion between 2004-2013.¹⁶⁸

Education Sector

The most prominent issues in the Ukrainian education sector are that even though Ukraine usually spends around six percent of its GDP,¹⁶⁹ schools facilities and modern teaching equipment remain wanting, especially in rural areas.¹⁷⁰ Moreover, effective education is jeopardised due to the low salary of teachers,¹⁷¹ making them more susceptible to take an offered bribe in exchange, for example, for giving better grades. This situation facilitates inequality among students with different socio-economic status.¹⁷² In addition, low salaries deter young professionals from seeking a career in teaching.¹⁷³ Furthermore, education programs provided to students at secondary and vocational schools often are not aligned with the skills needed by employers in the 21st century.¹⁷⁴ The education sector is, however, currently undergoing many reforms to make it sustainable,¹⁷⁵ and the 2020 budget had allocated UAH 136.4 billion for the education sector.¹⁷⁶

If Ukraine were to successfully prioritise the seizure and confiscation of only 10% of IFFs circulating within the country and channel this to the education sector, this would cover some 25% of the entire education sector budget. If only a portion of these confiscated and liquidated assets were channelled to the education sector, this could cover the cost for the development of higher education institutes (UAH 300 million).¹⁷⁷ These

recovered assets would also cover the cost of annual financial support to motivate young teachers, as well as programs to incentivise graduates to enter the teaching profession.¹⁷⁸

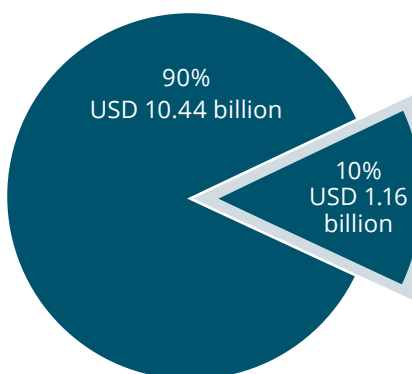
In 2016, a “New Ukrainian School” (NUS)¹⁷⁹ system was introduced; the NUS presented a radical reform in the structure of the school system and is expected to be fully implemented by 2029. If Ukraine were to successfully seize and confiscate only 10% (approximately USD 1.16 billion) of illicitly-obtained assets circulating in the country, this would easily cover key costs (UAH 1.3 billion in 2018) of the NUS reform system.¹⁸⁰

Alternatively, directing such recovered assets to the education sector would finance the construction of roughly 212 large schools (each for 1,700 students), or some 474 secondary schools (each with dedicated classrooms for computer science, physics, chemistry, languages, vocational training, assembly halls, gyms, dining halls, medical centres and administrative offices) throughout the country.¹⁸¹

Alternatively, such recovered assets would cover the salary costs of more than 35,000 teachers for four years, at an average monthly salary rate of UAH 18,600 (approximately USD 673), or some 35,000 teachers for three years, at an increased salary rate of UAH 25,000 (approximately USD 905).¹⁸²

How Recovered Assets Can Strengthen Education in Ukraine

Ukraine’s average annual losses due to IFFs linked to criminal activity (estimated total USD 11.6 billion)



IF ONLY 10% OF IFFs IN THE COUNTRY WERE SUCCESSFULLY RECOVERED, THIS WOULD FUND:



212 large schools (each housing 1700 students)

or

474 secondary schools (each with classrooms for computer science, physics, chemistry, gyms, dining halls, medical centres and administrative offices)

or

The annual salary costs of: 35 000 teachers for four years (current salary rate)

or

35 000 teachers for three years (an increased salary rate)



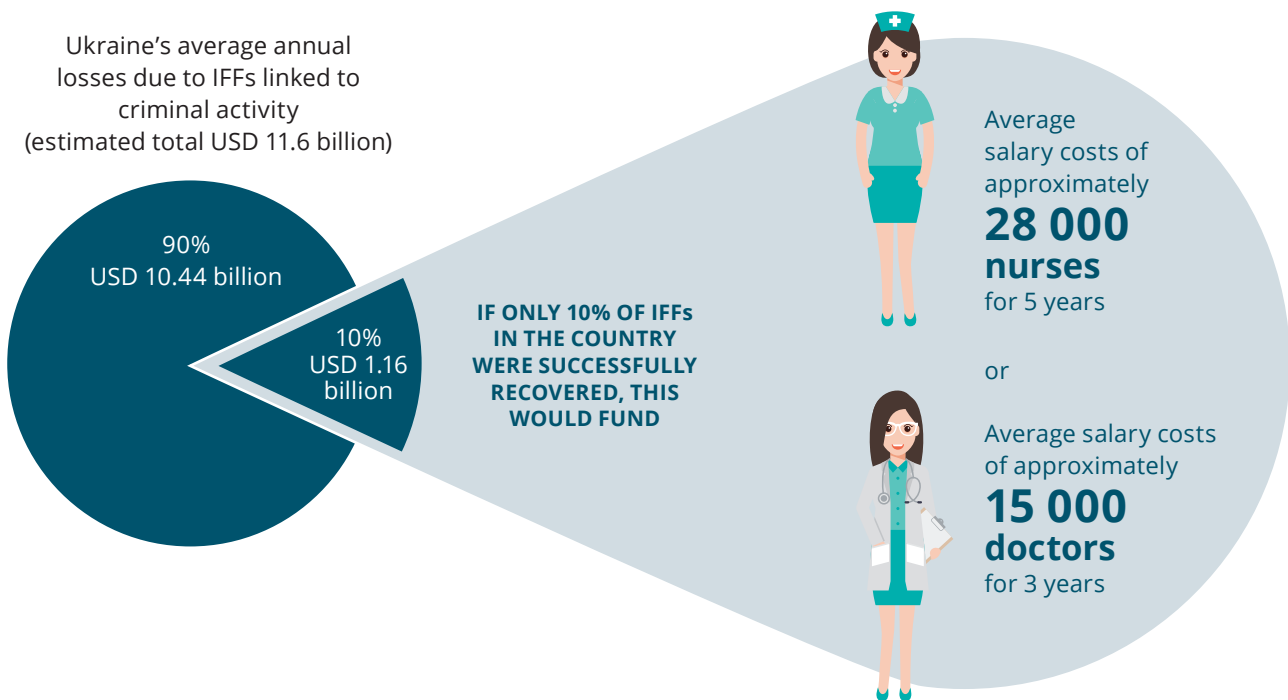
Healthcare Sector

The healthcare system of Ukraine was mostly built around the former Soviet system – the system is highly centralised, and contains inefficient hospital financing policies, with low doctor and nurse salaries.¹⁸³ These policies have resulted in informal payments by patients for procedures that were intended to be free of cost; Ukrainians can be forced by healthcare facilities to purchase medicine and vaccines that have already been subsidised by the Government.¹⁸⁴ Many Ukrainians face economic hardships due to the current “free” healthcare system.¹⁸⁵ Moreover, former policies and practices entail low quality and inefficient services, directly impacting the health of Ukrainians. Ukraine has one of the highest amounts of beds in hospitals in the European region, and has a large network of healthcare facilities overall; conversely, Ukrainians approach doctors and visit hospitals more frequently than

citizens within the EU, they stay in hospitals longer and have worse health indicators, including higher mortality rates and lower average life expectancy.¹⁸⁶

The total expenditure on healthcare amounted to UAH 108 billion out of the 2020 state budget. If Ukraine were to successfully prioritise the seizure and confiscation of only 10% (approximately USD 1.16 billion) of IFFs circulating within the country and channel this to the health sector, this would cover one-third of the entire health sector budget. If added to the existing budget, these recovered and liquidated assets would cover the salary costs of over 28,000 nurses for a period of five years, at an average monthly salary of UAH 18,900 (approximately USD 684).¹⁸⁷ Alternatively, such recovered assets would pay the salaries of over 15,000 doctors for a period of three years, at an average monthly salary of UAH 56,400 (approximately USD 2,041).¹⁸⁸

How Recovered Assets Can Strengthen Healthcare in Ukraine



5. Conclusions and Recommendations



This study has examined the severe negative impact of IFFs and related crimes on Ukraine and has highlighted some of the sectoral needs that can be significantly addressed if the government prioritises the capture of IFFs and illicitly-obtained assets. Effective asset recovery policy is fundamental to mitigating and preventing future costs of IFFs on the country.

In light of the above, this study provides the following recommendations to national authorities and other key stakeholders to help strengthen the effective and transparent recovery of illicitly-obtained assets, inhibit IFFs and therefore to facilitate more accelerated development within the country.

1. Implement Mechanisms to Improve Efficiency in Seizure of Assets

Consideration should be given to identifying and implementing mechanisms that improve efficiency in seizure, confiscation of assets, liquidation of those assets, and the distribution of funds, in a highly transparent manner, to high-priority development needs (needs identified in close cooperation with civil society organisations and through regular feedback from citizens).

2. Publish Clear and Unambiguous Policy Statements on IFFs and Asset Recovery

Publish clear and unambiguous statements and policies with respect to IFFs / ML and the priority of the Government to seize and confiscate (with due process) assets linked to organised criminal activity.

3. Establish the Use of Civil Confiscation of Illicitly-Obtained Assets as a Common Practice within the Justice System

Consideration should be given to adopting civil confiscation as a modality for more effective seizure and confiscation of assets. Given that money laundering cases often take years to adjudicate and thus to produce a final order for confiscation, this produces an inherent, and often justified, perception by the public that the criminal justice system is too slow in the recovery of assets. Strong consideration should be given to the establishment and/or strengthening of non-penal mechanisms for the seizure and confiscation of assets (civil confiscation). Once such mechanisms are in place and are being implemented (still, with due process for any individual seeking to claim title over such assets), this can reduce the time to confiscate assets from a period of years to a period of several months, and thus bolster public confidence in the efficiency and integrity of the judicial system, as well as

facilitate the funding of high-priority development needs; expedited confiscations can also produce much-needed funding for law enforcement and judiciary entities charged with the fight against organised crime and corruption.¹⁸⁹

4. Strengthen Powers (or operational implementation of existing powers) of the Taxing Authority

Consideration should be given to strengthening the powers of the taxing authority to more effectively seize and confiscate assets linked to tax evasion and other unreported income and assets.

5. Tighten Controls on Financial Institutions

Consideration should be given to tightening controls on financial institutions to:

- a. Report suspicious transactions;
- b. Identify true ("beneficial") owners of bank accounts, companies and trusts; and
- c. Vigorously sanction financial institutions and other reporting entities which do not comply, including heavy fines and/or closure (temporary or permanent) of such financial institutions or reporting entities. Practical experience shows that once such sanctions are imposed, this often results in greater compliance across the sector.

6. Strengthen Dialogue with Civil Society on the Issue of Confiscated Assets

The Government of Ukraine should consider strengthening mechanisms for regular dialogue and feedback from civil society and citizens, particularly with respect to where recovered assets should be distributed. Involvement of CSOs on this issue can engender greater civil society confidence that priority needs are being heard and addressed.

7. Strengthen Cross-Border Cooperation with Respect to Freezing, Seizure, Confiscation and Recovery of Assets

While progress has been made in this area, greater consideration might be given to strengthening regional and international cooperation, particularly through regular face-to-face dialogue with police and prosecutorial focal points in other key countries regarding the tracing,

freezing, seizure, confiscation and recovery of assets linked to organised criminal activity (and corruption), and the speedy resolution of pending cases. Filed and operational experience has shown that regular face-to-face dialogue (and the relationship building that accompanies it), produces more tangible results. Such dialogue can include, on a case-by-case basis, agreements to share confiscated assets, as a means to incentivise cross-border cooperation.

8. Focus on Tangible Outputs of the Asset Recovery and Management Agency

Consideration should be given to ensuring that, regardless of the size of the Asset Recovery and Management Agency (ARMA), the focus remains on actual results – this includes improved measurables with respect to the number of seizures and confiscations of assets linked to those involved in organised criminal activity, tax evasion and corruption; and efficient and transparent liquidation of distribution (e.g., to high-priority development needs) of recovered assets.

9. Bolster Seizure and Confiscation of Assets Linked to Human Trafficking and other Forms of Labour Exploitation

Ukraine should consider strengthening institutional priorities to seize and confiscate assets linked to human trafficking – this should include properties and other instrumentalities used to facilitate exploitation. Given that much exploitation (labour and sexual) is the result of few employment opportunities, consideration should also be given to creating and implementing public policies that channel a portion of recovered assets into employment opportunities for vulnerable groups.¹⁹⁰

10. Bolster Seizures and Confiscations at Border Crossings

Consideration should be given to strengthening operational efforts to seize and confiscate illegal and undeclared assets at border crossings, particularly in areas of porous border control. In this context, consideration also should be given to strengthening customs officials' knowledge on the economic impact of smuggling on Ukraine.

11. Strengthen Transparency of Distribution of Seized and Confiscated Assets

Consideration should be given to improving the efficacy and transparency of the distribution of recovered assets (e.g., to high-priority development needs, ideally as a result of regular consultation with civil society or the general

public, as this would engender public confidence in the asset management process). Information should be readily available to the public with respect to how the State is optimising seized and confiscated assets, for the benefit of the Ukrainian people (e.g., are confiscated assets being timely auctioned off and are the proceeds going to, say, build clinics or schools?). While default should be given to liquidation of confiscated assets, and their distribution to high-priority development needs, practical experience shows that, if done in a transparent manner, some assets should not be liquidated – e.g., seized or confiscated businesses in which many innocent people could lose their jobs.

12. Strengthen Employment Incentives for Customs Officials, as well as Background Checks and Vetting of Key Officials (prior to and during employment) Who Play a Role in Seizure and Confiscation of Assets

Consideration should be given to effective mechanisms to conduct more in-depth background checks before and after the hiring of customs and other border officials, while also bolstering salaries and other employment incentives for customs officials. Strong consideration should also be given to adopting and implementing – as is increasingly being done in numerous countries – an effective “whistle blower” program to allow for reporting of possibly corrupt conduct by customs or other border control officials.

13. Strengthen Results-Oriented Regulation of Firearms

Consideration should be given to strengthening the legal regulation of firearms, to ensure that such regulations are clear, well-defined and that the general public is aware of these regulations; this would include ensuring that the public is made aware of which firearms are considered to be illegal, and of the sanctions applicable for violations. Strong consideration should be given to programmes (ideally national ones) in which citizens are encouraged to return or forfeit (including “buy-back” programmes) their illegal firearms to national agencies without legal implications, and this should be tightly monitored to ensure that such firearms are not corruptly diverted again, and are destroyed, ideally publicly.

14. Bolster Custom Official Capacity and Professionalism

Consideration should be given to strengthening custom officials' knowledge regarding the most common smuggled goods, such as amber, timber and cigarettes. Consideration

might be given to introducing or strengthening a “High Alert” policy in which customs officials would mark certain profiled goods¹⁹¹ as suspicious and temporarily block the movement of the person carrying them, until further inspection by an expert. Consideration should be given to strengthening customs officials’ knowledge on the various concealment techniques used by smugglers to avoid detection; given that smuggling modalities are constantly evolving, this should be countered by regular and ongoing training for customs officials (e.g., updated modalities to detect and confiscate smuggled goods). Additionally, consideration should be given to strengthening inspection capacity of large packages (as well as small packages of dubious origin) moving through customs/borders. Smugglers often mislabel packages to disguise the movement of illicit products. As discussed above, drug traffickers have shifted to the sale of products online and shipping via small parcels through post.

15. Stronger Enforcement against Natural Resource Exploitation

Consider strengthening operational efforts in areas where exploitation of natural resources occurs. This should include increased due diligence with entities dealing with those natural resources, such as requiring organisations to provide clearer proof of legal supply chains before granting permission to sell or transport natural resource products. Non-compliance enforcement mechanisms may include, where appropriate, bolstered seizure and/or confiscation of assets or instrumentalities linked to such natural resource exploitation (e.g., vehicles, real estate, bank accounts).

16. Tighten Compliance of Cash Exchange Centres

Consideration should be given to tightening regulations and enhancing regulatory enforcement on permits for the establishment and operation of cash exchange centres. Consideration should be given to increasing due diligence on individuals requesting to establish such businesses, and

ensuring that they are effectively identifying and reporting ultimate beneficial owner(s) before granting or renewing permits to operate and maintain their licenses to operate. To reduce the shadow economy, consideration should also be given to promoting widespread usage of cashless transactions. Such programmes should also consider mechanisms to significantly reduce the payment of salaries in cash.

17. Enhanced Technological Monitoring and Results-Oriented Crackdowns on Known Drug Routes

Consideration should be given to strengthening operational efforts in known drug routes, with the emphasis on improving technological security measures¹⁹² along these routes, with the overall aim of making it more difficult for traffickers to move drugs across and within the country’s borders.

18. Enhanced Monitoring of, and Compliance within, Free Trade Zones

Ukraine may wish to consider increasing proactive measures within free trade zones in Ukrainian ports. As discussed above, the city of Odesa is identified as having increased activity among organised crime groups; moreover, the port of Odesa is a known part of the “Black Sea” drug route. Bolstered inspection of goods moving through free trade zones would not only increase detection of illicit goods entering Ukraine but also deter organised crime from the misuse of such zones.

19. Serious and Organised Crime Threat Assessment

Consideration might also be given to conducting regular serious and organised crime threat assessments, with international technical advice where needed, in order to facilitate the adjustment or adoption of targeted policies that would effectively and efficiently hinder the influence of multiple forms of such criminality, and, by doing so, reduce the impact of IFFs in the country.

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The United Nations Interregional Crime and Justice Research Institute (UNICRI) was established in 1968 pursuant to Economic and Social Council Resolution 1086 B (XXXIX) of 1965, which urged an expansion of the United Nations activities in crime prevention and criminal justice. The Institute is an autonomous institution and is governed by its Board of Trustees.

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