

## ISSUE BRIEF

# STOLEN FUTURE

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Russia, under President Vladimir Putin, has become a kleptocracy. The Russian President governs an economy controlled by insiders who pay him homage, and royalties, in return for favors. The takeover has been rapid and, in less than one generation, Russia's oligarchs have amassed some of the biggest fortunes in the world.<sup>1</sup>

When Putin took power in 2000, Russia was in economic turmoil following the banking crisis of 1998. Russia's class of oligarchs—political operators who became billionaires practically overnight in the 1990s—exerted immense control over politics. But in 2003, Putin began to take steps to consolidate and centralize political control by reigning in the oligarchs, particularly those involved in the energy sector.<sup>2</sup> Through the strategic ousting of the oligarchs from politics, Putin struck an unspoken deal with Russia's rich: Enriching yourself on state resources is condoned, but get involved in politics, and there will be a price to pay. Since then, Putin has become the undisputed “new tsar” of Russia.

In Ukraine, much like in Russia, homegrown oligarchs have profited from the exploitation of state resources. Corruption was rampant through the 1990s and 2000s, and it remains the greatest challenge to the current government.

“Stolen Future” examines in detail the symbiosis between criminals and the expropriation of governance in both countries. For Ukraine in particular, the battle with corruption will make or break the country's future as a liberal democracy. President Petro Poroshenko's democratically elected government is reform-oriented, but reigning in the oligarchs is no easy task. The government must push through the painful reforms needed to weed out corruption, or the country will continue to be beholden to economic interests and kleptocratic

The Dinu Patriciu Eurasia Center's mission is to enhance transatlantic cooperation in promoting stability, democratic values and prosperity in Eurasia, from Eastern Europe and Turkey in the West to the Caucasus, Russia and Central Asia in the East.

1 Karen Dawisha, *Putin's Kleptocracy* (New York: Simon & Schuster, 2014), p. 350.

2 One of Putin's early targets was Russia's richest businessman, Mikhail Khodorkovsky, CEO of the country's largest oil company, Yukos. In October 2003, Khodorkovsky was arrested on charges of tax evasion and fraud. Others, like Kremlin kingmaker Boris Berezovsky, were dealt with through threats and criminal investigations.

networks. As Swedish economist and expert on Russia and Ukraine Anders Åslund wrote in 2015, “Ukraine must reform hard and fast to survive or cease to exist as a nation. The question today is whether Ukraine can save itself.”<sup>3</sup>

### A Tale of Two Kleptocracies

Ever since Catherine the Great’s favorite minister Grigory Potemkin lined her travel route with sham villages and happy, prosperous peasants to please her, Russian leaders have developed an aptitude for window dressing. Vladimir Putin is very skillful in this regard and would have the world believe that Russia is a respectable democracy governed by the rule of law.

This is fiction. Under Putin’s administration, Russia is run for the profit of Kremlin insiders and a small business elite, whose methods would be prosecuted in G7 countries. Ukraine similarly suffers from the centralization of resources and political power in the hands of a few individuals. However, where Russia’s oligarchs were eventually brought under the control of the Kremlin, Ukraine’s elite has largely retained its freedom. Thanks to their wealth and connections, the most powerful oligarchs such as Rinat Akhmetov, Victor Pinchuk, Ihor Kolomoyskyi, or Dmytro Firtash continue to control the political agenda, often to their own financial benefit.

What began in each country as mass market reforms and privatization created unprecedented opportunities for politicians, as well as for unscrupulous and unsavory groups. They accumulated awesome wealth, and then proceeded to destroy governments, individuals, or laws in their way.

At the same time, both countries have struggled to modernize their economies. Russian incomes today are one third of those in energy-rich Saudi Arabia. Compared to other Eastern European post-socialist countries, Ukraine has fallen far behind economically. Between 1992 and 2015, Ukraine’s gross domestic product (GDP) per capita rose from \$428 to just \$2,109, even as GDP in Latvia soared from \$631 to \$13,729.<sup>4</sup> Meanwhile, as the ruble halved in value to the

dollar, many Russian oligarchs still managed to retain their wealth; in 2015, 1,815 individuals were worth \$50 million or more, and 93 were billionaires.<sup>5</sup>

In 2014, 80 percent of Ukrainians were impoverished while five were billionaires and ninety-eight were worth over \$50 million.<sup>6</sup> Ukraine has been so financially devastated by corruption and war with Russia that it requires life support from Western financial institutions, most notably the International Monetary Fund (IMF).

In Russia, the economic situation is also dire. Energy prices, which had been falling since 2014, pushed one in every seven Russians below the poverty line in 2015.<sup>7</sup>

Political instability in both countries incentivized businesses to stash vast quantities of cash abroad. From 2004 to 2013, an average of \$104.98 billion per year left Russia for a total of nearly \$1 trillion (\$981.57 billion). Ukraine loses an average of \$11.68 billion annually, and a ten-year total of \$115.642 billion.<sup>8</sup> “There are \$700 billion private Russian assets abroad,” Åslund said in September 2015, “\$100 billion to \$200 billion from government officials. That’s a guess, but it’s very substantial. These numbers are outside *Forbes*’ figures of the richest people in the world.”<sup>9</sup>

Russia is unlikely to change much in the near term thanks to the tight control established under Putin. Ukraine, however, is a more complex case. The country’s civil society is active and has a strong core of reformers

3 Anders Åslund, *Ukraine: What Went Wrong and How to Fix It* (Washington, DC: Peterson Institute for International Economics, 2015), p. 223.

4 IMF, “World Outlook Economic Database,” January 19, 2016, <http://www.imf.org/external/pubs/ft/weo/2015/02/weodata/index.aspx>.

5 “Global Middle Class Net Worth Doubled Since 2000 to USD 80.7 Trillion, 32% of Global wealth,” Credit Suisse press release, October 13, 2015, <https://www.credit-suisse.com/media/mediarelease-assets/pdf/2015/10/gwr-2015-global-press-release.pdf>, accessed April 28, 2016; Adam Withnall, “There Are Now 2,089 Billionaires in the World: This Is Who They Are, Where They Live And How They Made Their Fortunes,” *Independent*, February 5, 2016, <http://www.independent.co.uk/news/world/there-are-now-2089-billionaires-in-the-world-this-is-who-they-are-where-they-live-and-how-they-made-10026128.html>.

6 Systematic, “80% of Ukrainians Now Live Below the Poverty Line,” *Off Guardian*, May 30, 2015, <http://off-guardian.org/2015/05/30/80-of-ukrainians-now-live-below-the-poverty-line/>; “100 самых богатых людей Украины. Полный список,” Фокус, March 14, 2015, <http://focus.ua/ratings/328351/>.

7 Aditya Tejas, “Russians Living In Poverty Rise To Nearly 22M Amid Inflation, Falling Wages,” *International Business Times*, September 10, 2015, <http://www.ibtimes.com/russians-living-poverty-rise-nearly-22m-amid-inflation-falling-wages-2090650>.

8 Global Financial Integrity, “Average Annual Illicit Financial Outflows: 2004-2013,” <http://www.gfintegrity.org/issues/data-by-country/>.

9 Anders Åslund, remarks delivered at the conference “Illicit Financial Flows: The Most Damaging Economic Problem Facing the Developing World,” The National Press Club, September 22, 2015.



Old gas pipeline in Dnipropetrovsk, Ukraine. *Photo credit: g Tarded/Flickr.*

who cut their teeth on the Maidan Revolution of 2013-14, which, at its core, was a democratic movement against the rampant political corruption of former President Yanukovich's government. But Ukraine's economy has been further damaged by Russia's intervention in the Donbas and Crimea.

Russian meddling in Ukrainian politics has stymied political development. In an interview in the summer of 2015, former Ukrainian President Leonid Kravchuk blamed Russia for making the country a "hostage" state since its independence. "They [the Russians] took away the best assets."<sup>10</sup>

### Kleptocracy in Ukraine's Energy Sector

Before the Maidan Revolution of 2014, Ukrainian political elites worked hand in glove with the Kremlin—using state resources for political gains. The oligarchic system of governance began to take root in Ukraine

after the collapse of the Soviet Union, but was firmly established under the watch of President Leonid Kuchma in the second half of the 1990s. As Russian expert Karen Dawisha notes, "Putin leaned on [Ukrainian President] Kuchma in 2000 for campaign contributions—according to conversations taped by Ukrainian KGB. Kuchma says "Putin telephoned . . . during the campaign—Leonid well, at least give us a bit of money. Kuchma asked [state gas monopoly] Naftohaz to withdraw \$56 million from the Bank of Ukraine and Ukraine's Import-Export Bank and transfer it to Putin."<sup>11</sup>

Under Kuchma's administration, corruption flourished, with Ukraine's vast state enterprises used as personal and political piggybanks.

Along the way, Naftohaz was plundered and the Ukrainian treasury along with it. Ukrainian oligarchs

<sup>10</sup> Leonid Kravchuk, interview with author, July 2015.

<sup>11</sup> Dawisha, *Putin's Kleptocracy*, p. 239.

bought gas from the monopoly at far below market prices to fuel their industrial holdings, while the gas flows became an arbitrage dream, as company officials colluded to flip cheap gas offered by Russia for re-export at higher prices to Europe.

In 2005, after the Orange Revolution, then-Prime Minister Yulia Tymoshenko (also considered an oligarch for her past gas trading profits) unraveled the scale of thievery under Kuchma for all the world to see when she called for the sale of privatized assets to be annulled. The year before, Kuchma's son-in-law Victor Pinchuk and oligarch Rinat Akhmetov acquired the Kryvorizhstal steel factory in 2004 for about \$800 million. A year later, the next government reversed the sale and held a televised, public auction that netted \$4.8 billion from Mittal Steel.<sup>12</sup>

Ukraine's predation was franchised, but sometimes cheaters cheated. In August 2006, Pavlo Lazarenko, one of Kuchma's Prime Ministers who was also close to Tymoshenko, was singled out for misdeeds, fled the country, and then was convicted and sentenced to prison in the United States for money laundering, wire fraud, and extortion. According to authorities, he transferred roughly \$114 million in funds embezzled from the government of Ukraine to banks in San Francisco from 1996 to 1997.<sup>13</sup>

The network of corruption hurt, most of all, the Ukrainian people, as the government shoveled in subsidies to keep Naftohaz afloat. "The subsidies to Naftohaz contributed about 50 percent of the deficit in 2014 and amounted to about \$7 billion. Of course these numbers do not include any direct subsidies that may have been given to industries, or the actual lost opportunity costs to state companies from forced sale at low controlled prices," said Ukrainian-Canadian academic Basil Kalymon.<sup>14</sup>

For instance, Naftohaz bought seventeen billion cubic meters of domestically produced gas at a set price

12 Kyiv Post, "Mittal Steel Strains Itself to Buy Kryvorizhstal," October 27, 2005, <http://www.kyivpost.com/content/business/mittal-steel-strains-itself-to-buy-kryvorizhstal-23407.html>.

13 David Kravets, "Former Ukrainian PM Sentenced for Fraud," *The Washington Post*, August 25, 2006, <http://www.washingtonpost.com/wp-dyn/content/article/2006/08/25/AR2006082500897.html>.

14 Basil Kalymon in discussion with the author, December 2015.

of \$53 per thousand cubic meters.<sup>15</sup> Deputy Prime Minister Volodymyr Groysman disclosed later that 40 percent of this—worth \$2.5 billion—was diverted through unknown intermediaries close to Yanukovych and sold at \$410 per thousand cubic meters.<sup>16</sup>

Those who dared report on political corruption, meanwhile, were intimidated by political and criminal forces. Between 1995 and 2001, three journalists covering corruption issues were murdered—Igor Hrushetsky, Igor Aleksandrov and *Ukrainska Pravda's* Georgiy Gongadze, who was abducted and beheaded in 2000, possibly with Kuchma's knowledge.<sup>17</sup>

In addition to intimidation, arbitration fraud and asset stripping were rampant. Naftohaz was restructured into regional power generation companies that were partially privatized for oligarchs' gain. One offshoot, Donbasenergo, was forced into near bankruptcy by Naftohaz subsidiaries, then forced to sell off power plants and privatize 60.8 percent for below market value in 2013.

The stake was purchased by an offshore Dutch holding company owned by Igor Gumenyuk, a man allegedly connected to Ukraine's richest oligarch, Rinat Akhmetov, and former President Yanukovych.<sup>18</sup>

In February 2015, a Ukrainian court agreed the sale was "illegitimate" because only a fraction of its value was realized.<sup>19</sup> It did not unwind the sale but referred the matter to a lower court. Victims included the European Bank for Reconstruction and Development (EBRD), which had loaned Donbasenergo \$113 million years before.

Another blatant asset strip was caught in 2011-12, involving Yanukovych's Minister of Energy, Yuriy Boyko, who ordered Naftohaz to buy two offshore

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15 Anders Åslund, "Why Ukraine is So Poor, and What Could be Done to Make it Richer," *Eurasian Geography and Economics*, vol. 55, no. 3, 2014.

16 Åslund, *Ukraine: What Went Wrong and How to Fix It*, p. 187.

17 Committee to Protect Journalists, "6 Journalists Murdered in Ukraine Since 1992," <http://cpj.org/killed/europe/ukraine/murder.php>.

18 Kyiv Post, "Donbasenergo Asset Strip Likely," May 24, 2001, <http://www.kyivpost.com/article/content/business/donbasenergo-asset-strip-likely-8676.html>.

19 Concorde Capital, "KyivPost: Donbasenergo May Join Wave of Reprivatization," March 16, 2015, <http://concorde.ua/en/about/press-center/press-about-us/kyivpost-donbasenergo-may-join-wave-of-reprivatization-13887/>.

rigs for Black Sea drilling at a cost of \$800 million. A television documentary uncovered that the seller in the United Kingdom was a company that belonged to Boyko and had paid only \$470 million recently for the rigs. Despite the revelation, Boyko remained Minister until Yanukovich fled Ukraine in 2014. He then ran successfully for election that October as a member of parliament, thus providing himself with parliamentary immunity from prosecution.

Naftohaz's former CEO Yevhen Bakulin, appointed in 2010 by Yanukovich, was arrested in March 2014 as part of an investigation into major gas industry corruption. "According to investigators the monopoly [Naftohaz] supplied oil products and natural gas worth 1.9 billion Hryvnia [\$72.2 million] to two companies . . . effectively free of charge [because invoices were never paid]," wrote the *Kyiv Post*. In September 2014, the investigation was scrapped after records of the transactions could not be found. Bakulin was released and his accounts were unfrozen. A public outcry ensued, forcing the Prosecutor General's Office to announce resumption of its probe.<sup>20</sup>

In October 2014, however, the Prosecutor General's Office reversed its statement and said it was not investigating Bakulin. As the *Kyiv Post* wrote, "The comments contradicted a statement released by the Prosecutor General's Office in September that it had resumed the case against Bakulin."<sup>21</sup>

The case was dropped against Bakulin, who, like Boyko, had won a seat in Parliament in October 2014, giving him parliamentary immunity from future prosecution.

Corruption in the gas sector benefited Ukrainian oligarchs loyal to Putin. In 2004, Kuchma and Putin gave exclusive rights to intermediary RosUkrEnergo to sell all gas to Ukraine. The intermediary was the brainchild of Dmytro Firtash, a Ukrainian trader with reportedly close connections to the Kremlin. Firtash allegedly owned 50 percent of the company with a junior partner and Gazprom the other 50 percent.

20 Oleg Sukhov, "Prosecutors Office Puts Former Naftohaz Chief Back Under Investigation," *Kyiv Post*, September 20, 2014, <http://www.kyivpost.com/article/content/ukraine/prosecutors-office-puts-former-naftogaz-chief-back-under-investigation-365337.html>.

21 Oleg Sukhov, "Prosecutors Not Investigating Case Against ex-Naftohaz Head," *Kyiv Post*, October 10, 2014, <http://www.kyivpost.com/article/content/ukraine/prosecutors-not-investigating-case-against-ex-naftogaz-head-367642.html>.

Evidence points to the fact that RosUkrEnergo was set up to funnel funds into the hands of Firtash and his allies. A 2014 investigation by *Reuters* quantified its magnitude: During a four-year period, RosUkrEnergo bought twenty billion cubic meters of gas from Russia at below market prices and paid \$230 per thousand cubic meters, or one-third of what Gazprom charged Naftohaz Ukrainy. The price was so low that the gas was flipped at three times the initial price, making RosUkrEnergo a yearly profit of \$3 billion, or \$12 billion in four years. (Firtash negotiated the same arrangement in Cyprus and made another \$3.7 billion in profit selling Russian gas there in just two years.)<sup>22</sup>

"The evolution of intermediaries was to siphon the profits of gas earned between Gazprom and Ukraine," said Bill Browder, an American-British investor whose fund was once the largest operating in Russia. "The crux of the matter was that Gazprom management abused their position for years in terms of the export of gas to Ukraine by selling the gas to intermediaries at a low price [and] then having those intermediaries resell at [a] higher price. Ukrainians, Gazprom managers, and Russian government officials were involved."<sup>23</sup>

Firtash told the highest-ranking US diplomat in Ukraine in 2008 that a shadowy character also lurked behind the arrangement. In a secret memo, made public by WikiLeaks, former US Ambassador to Ukraine William Taylor wrote, "He [Firtash] acknowledged ties to Russian organized crime figure Semon Mogilevich, stating he had needed Mogilevich's approval to get into business in the first place." Taylor said the "softly spoken" Firtash had come to see him on December 8, 2008 and "spoke at length about his business and politics in a visible effort to improve his image with the USG [United States government]."<sup>24</sup>

The Ukrainian press had reported that RosUkrEnergo's beneficiaries included Mogilevich, who is on the Federal Bureau of Investigation's most wanted list and lives openly in Moscow. Firtash said it was impossible to interact with a government official "without also meeting an organized crime member," wrote Taylor

22 Stephen Grey et al., "Putin's Allies Channeled Billions to Ukraine Oligarch," *Reuters*, November 26, 2014, <http://www.reuters.com/article/russia-capitalism-gas-special-report-pix-idUSL3NOT-F4QD20141126>.

23 Bill Browder in discussion with the author, November 2015.

24 *Guardian*, "US Embassy Cables: Gas Supplies Linked to Russian Mafia," December 1, 2010, <http://www.theguardian.com/world/us-embassy-cables-documents/182121>.



Former Ukrainian President Viktor Yanukovich pilfered state assets and built Mezhyhirya, his lavish estate.  
*Photo credit: Roberto Maldeno/Flickr.*

in his cable. The memo also noted that the gas trade had made Firtash staggeringly rich: “By 2006, Firtash’s estimated worth was over \$5 billion, but most experts believed that Firtash had lowballed his true worth and estimated it was in the tens of billions. In his conversation with the Ambassador, Firtash gave no indication of the scope of his wealth.”<sup>25</sup>

In addition to being a tool to enrich both Russian and Ukrainian elites, RosUkrEnergo was also used to extend Russian political influence. Gazprombank, a bank not affiliated with Gazprom but tied to Putin ally Yuri Kovalchuk, financed Firtash’s business transactions, according to *Reuters*. “Banks close to Putin granted Firtash credit lines of up to \$11 billion. That credit helped Firtash, who backed Yanukovich’s 2010 bid to become Ukraine’s President, to buy a dominant position in the country’s [Ukraine’s] chemical and fertilizer industries and [to] expand his influence.”<sup>26</sup>

<sup>25</sup> Ibid.

<sup>26</sup> Grey et al., “Putin’s Allies Channeled Billions to Ukraine Oligarch,” November 26, 2014, *op. cit.*

Yanukovich, like Kuchma before him, proved to be immensely corrupt. During his presidency, Yanukovich and his cronies grabbed tens of billions of dollars. For instance, Yanukovich’s son, a dentist, became a billionaire in three years, winning 50 percent of all government tenders while his father was in office.<sup>27</sup> And Yanukovich enriched himself to such an extent that he built a lavish \$200 million estate outside Kyiv, hidden from the public with four hundred servants and a thirty-four kilometer perimeter fence twenty feet high topped with barbed wire.

Yanukovich’s ministers were openly on the take. Ecology Minister Mykola Zlochevsky became a major player in the production of oil and gas in Ukraine during his tenure. He claimed to have cornered a quarter of the country’s private hydrocarbon market. He put “trophy foreigners” on his board of directors, such as Hunter Biden, son of US Vice President Joseph Biden, and the

<sup>27</sup> Orysia Lutsevych, “Ukraine Crisis: Oligarchs are Yanukovich’s Weakest Link,” *BBC*, February 20, 2014, <http://www.bbc.com/news/world-europe-26277970>.

former President of Poland, Aleksander Kwaśniewski. He abused his ministerial position to give a Cypriot company, which he controlled, extraction licenses without tendering for them. He fled after Yanukovich's fall and is on Ukraine's wanted list for alleged financial corruption, but he has gone missing, along with an estimated \$156 million.<sup>28</sup>

Those who profited from corruption schemes under Yanukovich have not been prosecuted. Yanukovich and Mogilevich live in Russia. Firtash, although initially arrested in Austria under an extradition request from the United States concerning a US grand jury corruption case in India, has since been released under an Austrian judge's ruling that the request was politically motivated.<sup>29</sup>

Even in Austria, Firtash has found support from Russia. Consider that, for instance, Firtash's bail was set at a staggering 125 million euros, and that a Russian oligarch paid it immediately. According to Browder, "Russian oligarch [Vasily] Anisimov put up his . . . bail money," he said. "There's the linkage. This is about Putin controlling everything."<sup>30</sup>

What's more, Firtash, at least according to his own admission, continues to influence Ukrainian politics. Firtash told the Austrian court that before the 2014 fall election, candidates Petro Poroshenko and Vitali Klitschko flew to Vienna for a meeting with him. "I can say we achieved what we wanted," Firtash said at the hearing. "Poroshenko became President and Klitschko became Mayor of Kyiv."<sup>31</sup>

Perhaps Firtash's self-aggrandizing was simply bravado, but perhaps not. Some experts maintain that the meeting was about Poroshenko granting immunity to former Energy Minister Yuriy Boyko and Yanukovich's Chief of Staff Serhiy Lyovochkin. This involved "immunity from prosecution in exchange for

the oligarchs' support—in the form of money, media and connections—for their political ambitions," wrote Ukraine expert Taras Kuzio. "It would have been impossible for the Yanukovich regime to carry out its corrupt schemes without Lyovochkin's involvement—but today he is untouchable because of the Vienna immunity deal that he helped to broker."<sup>32</sup>

Poroshenko and Klitschko acknowledged that they met Firtash in Vienna but denied Firtash's insinuation that the meeting was about guaranteeing their elections. Klitschko denied the allegations, stating that Firtash was "incorrect," while a Poroshenko spokesman, Svyatoslav Tsegolko, said that the President had a "very simple position on the issue and had commented on the meeting during last year's election campaign."<sup>33</sup>

Poroshenko said later, "I do not think [Firtash] liked the outcome of the meeting." His spokesman later elaborated, saying that Poroshenko was a "president of de-oligarchisation" and had reformed the energy sector, noting the firing of Ihor Kolomoyskyi, the oligarch Governor of Dnipropetrovsk, in March.<sup>34</sup>

## The Clans

In 2005, a rare glimpse into the nature of clan management in Ukraine surfaced when Kolomoyskyi showed up at parliamentary hearings into reprivatizing Ukraine's government assets to help pay off its debts. His appearance was "to confess that he was one of the beneficiaries of the dirty privatization of the late 1990s [to] early 2000s that made many of Ukraine's oligarchs rich," reported the *Kyiv Post*. "He admitted, for example, that he paid \$5 million per month during an unspecified period of time to fellow billionaire Victor Pinchuk and his father-in-law, former President Leonid Kuchma, in order to keep them out of Ukrnafta, an oil and gas extractor in which Kolomoyskyi has a 43 percent stake."<sup>35</sup>

28 Ilya Timtchenko, "Prosecutors Put Zlochevsky, Multimillionaire ex-Ecology Minister, on Wanted List," *Kyiv Post*, January 18, 2015, <http://www.kyivpost.com/article/content/ukraine-politics/prosecutors-put-zlochevsky-multimillionaire-ex-ecology-minister-on-wanted-list-377719.html>.

29 Shaun Walker, "Caught Between Russia and the US? The Curious Case of Ukraine's Dmytro Firtash," *Guardian*, January 23, 2016, <http://www.theguardian.com/world/2016/jan/23/dmytro-firtash-ukraine-oligarch-exile-caught-between-russia-us>.

30 Bill Browder in discussion with the author, November 2015.

31 Johannes Wamberg Andersen, "Firtash claims kingmaker role in Ukrainian politics," *Kyiv Post*, May 7, 2015, <http://www.kyivpost.com/article/content/ukraine/firtash-claims-kingmaker-role-in-ukrainian-politics-388070.html>.

32 Taras Kuzio, "Money Still Rules Ukraine," *Foreign Policy*, August 25, 2015, <http://foreignpolicy.com/2015/08/25/mon-ey-still-rules-ukraine-poroshenko-corruption/>.

33 Shaun Walker, Katya Gorchinskaya, and Dan Roberts, "Ukraine Oligarch Claims US Extradition Request Is Political Interference," *Guardian*, May 5, 2015, <http://www.theguardian.com/world/2015/may/05/ukraine-oligarch-brokered-deal-petro-poroshenko-president-dmytro-firtash>.

34 Ibid.

35 Ilya Timtchenko, "Kolomoyskyi Makes Stark Confessions of Bribery as Privatization Debate Heats Up," *Kyiv Post*, March 15, 2015, <http://www.kyivpost.com/article/content/business/kolomoisky-makes-stark-confessions-of-bribery-as-privatization-debate-heats-up-383309.html>.

Kolomoyskyi explained that privatizations under Kuchma were reserved for a handful of his favorite oligarchs: himself, Pinchuk, and Akhmetov. Pinchuk denied the allegations and said Kolomoyskyi was trying to stir up trouble, in order to get Pinchuk to drop a \$2 billion lawsuit against Kolomoyskyi in London concerning an iron ore asset. Years later, in October 2015, the two supposedly settled their disagreement, and Kolomoyskyi was rumored to have paid Pinchuk \$500 million.<sup>36</sup>

Yanukovych, after coming back to power in 2010, ran a tight ship, according to journalist and member of the Ukrainian Parliament Serhiy Leshchenko. “Yanukovych was the ‘super oligarch,’ the main beneficiary of the regime. Below him came the traditional oligarchs, who had to share their profits. Rinat Akhmetov, for instance, was granted control of metallurgy and energy, Kolomoyskyi had the oil industry and Firtash and Lyovochkin controlled the gas, chemical and titanium sectors.”<sup>37</sup>

Perhaps the oligarchs helped bring about Yanukovych’s demise because he went too far. “Despite the country’s Revolution of Dignity and continued Russian aggression against Ukraine, local oligarchs have become even more powerful and influential and pose a significant threat to Ukraine’s European development. Oligarchs control the state apparatus, mass media and whole sectors of industry. They can simply put the brakes on reform as soon as their financial interests are threatened,” Leshchenko added.<sup>38</sup>

## Looking Ahead

Influence peddling, graft, collusion, injustice, bribery, extortion, fraud, and asset stripping are systemic and have placed Ukraine in a Catch-22. As long as oligarchs control politics, reforms are impossible. International pressure has helped somewhat, as has Poroshenko’s appointment of outsiders as ministers and governors. The reform of Kyiv’s police force and improvements at

Naftohaz are also good signs: Naftohaz has significantly reduced Russian gas imports with supplies from European countries and, more importantly, jacked up domestic gas prices to world levels as a means to prevent arbitrage profiteering.<sup>39</sup>

The budget deficit has been brought under control and the most corrupt expenditures have been eliminated. Outside the legal sector, the gains have been significant. Ukraine’s former Finance Minister, Natalie Jaresko, restructured the country’s debts, got bailout help from the IMF, replenished reserves, verified social payments, put all treasury payments online, and implemented electronic value-added tax and excise tax systems, saving \$1 billion in fraud in 2015.<sup>40</sup>

But full tax reform is needed to capture revenue from the country’s vast underground economy, estimated to be equivalent to half of Ukraine’s official GDP.<sup>41</sup> Likewise, while then-Economy and Trade Minister Aivaras Abromavičius implemented the Naftohaz reforms and launched fully transparent procurement systems, many potential investors are still wary of entering Ukraine, due to doubts about the government’s ability to uphold the rule of law.

In a blow to the reform effort, Abromavičius resigned in February 2016, citing his frustration with entrenched, corrupt officials blocking reforms. He suggested that the only hope for Ukraine was if the new Finance Minister, Natalie Jaresko, led a new government of independent technocrats to push through needed reforms. “It’s a crisis of trust, of values,” said Abromavičius. “We need to use this opportunity to bring in a completely different set of people with a completely different mindset...I believe we are either two steps away from a breakthrough or two steps away from a breakdown . . . Reforms can only be as progressive as the people that do [them].”<sup>42</sup>

As Abromavičius’ resignation signaled, attempts to fix the country will continue to be rebuffed, stalled, or

36 *Kyiv Post*, “Pinchuk Concludes Amicable Agreement with Kolomoisky on Ferroalloy Case in London,” October 7, 2015, <http://www.kyivpost.com/article/content/ukraine/pinchuk-concludes-amicable-agreement-with-kolomoisky-on-ferroalloy-case-in-london-media-399523.html>.

37 Serhiy Leshchenko, “Sunset and/or Sunrise of the Ukrainian Oligarchs after the Euromaidan Revolution?” *Euromaidan Press*, June 2, 2015, <http://euromaidanpress.com/2015/06/02/sunset-and-or-sunrise-of-the-ukrainian-oligarchs-after-the-euromaidan-revolution/#arvlbdata>.

38 Ibid.

39 Aivaras Abromavicius, “Changing World. Changed Ukraine?” panel discussion at the *World Economic Forum*, January 22, 2016.

40 Diane Francis, “Ukraine Has Made Gains, but The Fight Isn’t Over,” *Financial Post*, January 24, 2016, <http://business.financialpost.com/diane-francis/diane-francis-ukraine-has-made-gains-but-the-fight-isnt-over-yet>.

41 Ibid.

42 Natalia Zinets and Alessandra Prentice, “Ukraine Needs New-Look Government, Says Outgoing Economy Minister,” *Reuters*, February 5, 2016, <http://www.reuters.com/article/us-ukraine-crisis-abromavicius-idUSKCN0VEIPU>.



sabotaged because control of the state has not been fully seized back from vested interests. The solution is removal of any politician from office who served the old regime before 2014; the end of immunity for politicians; reprivatization of state assets stolen in the past; antitrust laws to break up economic concentration; and replacement of all judges and prosecutors with independent jurists, investigators, and jury trials.

Without these radical steps, reforms will likely be slow and ineffective. The Ukrainian public is restive and for good reason. Two years after a bloody revolution and invasion by Russia, the same predators live inside and outside the country in Moscow, London, New York, and Vienna enjoying the proceeds of crime.

In April 2016, the Panama Papers scandal erupted, portraying a \$2 billion trail hidden offshore, and leading to Putin, through the deployment of shell companies, secrecy havens, and proxies.<sup>43</sup> President Poroshenko was also caught in the controversy for setting up an offshore account in the British Virgin Islands for his confectionary business. Some demanded impeachment, but the special prosecutor said no tax evasion had occurred. An adviser to Poroshenko said that the transfer was to third parties in a blind trust as a step to divest the business, as promised in 2014.<sup>44</sup> These events followed a two-month showdown over the lack of reforms with Prime Minister Yatsenyuk that resulted in the Prime Minister's resignation on April 10, more threatened resignations, the resignation of Finance Minister Jaresko, and delays in IMF funding due to concerns about the slow progress of reforms.<sup>45</sup>

Two years after a bloody revolution and invasion by Russia, the same predators live inside and outside the country in Moscow, London, New York, and Vienna enjoying the proceeds of crime.

Reforming Ukraine's economic and political systems is a geopolitical priority, because Putin's economic and military war will continue to destabilize the region. His tactics have also spread to the Middle East and the Syria crisis, where he is sabotaging allied efforts. Likewise, if Ukraine implodes, millions of Ukrainian migrants seeking asylum could flood Europe in greater numbers than those from Syria caused by the war waged by Putin's pal, Syrian President Bashar al-Assad. George Soros repeated this possibility at Davos in January 2015. "If Ukraine collapses, another migration of a few million people to the EU will occur," said the financier during the panel discussion. "The German finance minister proposed an EU-funded Marshall Plan to help with its migration issues. That should include funds to help pay for Ukraine's important role in defending Europe against Putin."<sup>46</sup>

George Soros pointed out another imperative: "The political reforms center on establishing an honest, independent and competent judiciary and media, combating corruption and making the civil service serve the people instead of exploiting them. These reforms would also appeal to many people in Russia, who would demand similar reforms. This is what Putin is afraid of. That is why he has tried so hard to destabilize the new Ukraine."<sup>47</sup>

Fortunately, economic sanctions are damaging Russia. Soros believes that the country could go bust by 2017, due to the combination of low oil prices and sanctions.<sup>48</sup> Similarly, Putin's strategy of partial occupation—in Crimea and the Donbas—is turning sour. Both are troublesome and expensive, as is Russia's support of pro-Russian breakaway regions in Georgia and Moldova.

43 Luke Harding, "Revealed: The \$2bn Offshore Trail That Leads to Vladimir Putin," *Guardian*, April 3, 2016, <http://www.theguardian.com/news/2016/apr/03/panama-papers-money-hidden-offshore>.

44 Daryna Krasnolutska, "Ukrainian Leader Defends Offshore Assets Amid Panama Leak," *Bloomberg*, April 4, 2016, <http://www.bloomberg.com/news/articles/2016-04-04/ukrainian-leader-defends-offshore-assets-amid-panama-report-leak>.

45 Anders Åslund, "Prime Minister Yatsenyuk Resigns. Why Now? What's Next?" *New Atlanticist*, April 11, 2016, <http://www.atlantic-council.org/blogs/new-atlanticist/prime-minister-yatsenyuk-resigns-why-now-what-s-next>.

46 Diane Francis, "Ukraine Has Made Gains but the Fight Isn't Over," *National Post*, January 24, 2016, <http://business.financialpost.com/diane-francis/diane-francis-ukraine-has-made-gains-but-the-fight-isnt-over-yet>.

47 George Soros, "Ukraine and Europe: What Should Be Done?" *New York Review of Books*, October 8, 2015, <http://www.nybooks.com/articles/2015/10/08/ukraine-europe-what-should-be-done/>.

48 Diane Francis, "Putin Corners Himself in Ukraine. We Would Be Crazy to Placate Him Now," *New Atlanticist*, February 5, 2016, <http://www.atlanticcouncil.org/blogs/new-atlanticist/putin-corners-himself-in-ukraine-we-would-be-crazy-to-placate-him-now>.

Perhaps the tide will slowly turn against Russia. But the tide will only turn in favor of Ukraine if its oligarchy is brought to its knees, hopefully without further violence. Reform activist and Member of Parliament Igor Sobolev remains optimistic and said, “If people rise again, the next revolution will be much more bloody because so many people are upset about this war. This is, of course, a big risk for the whole situation. We have so many new active citizens who feel this can be a successful state without bribes and oppression from the government. They want dignity and I think this is the most powerful power in Ukraine now. That’s why we will succeed.”<sup>49</sup>

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49 Diane Francis, “Evolution, Not Revolution, Is the Way to Save Ukraine, Says Leading Anti-Corruption Crusader,” *New Atlanticist*, October 7, 2015, <http://www.atlanticcouncil.org/blogs/new-atlanticist/evolution-not-revolution-is-the-way-to-save-ukraine-says-leading-anti-corruption-crusader>.

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