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STATE PREDATION: RECOGNIZING AND DEALING WITH A NATIONAL SECURITY THREAT

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TCUP REPORT

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Ever since the fall of the USSR, across the former Soviet Empire, “raiding” or plundering of legitimate businesses has been a profitable activity undertaken by law enforcement agencies. It is one of the reasons that many of the states that replaced the USSR have not been as economically successful as they could have been. Raiding and other forms of state predation on the corporate sector undermine business activity, investment, and economic growth. After the Revolution of Dignity in 2014, Ukraine moved strongly against such predation. A mix of digitalization, transparency rules, and the creation of new institutions cribbed, crabbed, and curbed such predation. However, the onset of the full-scale invasion in February 2022 resulted in the suppression of many formal and informal checks on law enforcement agencies. The oligarchic groups which imposed some informal checks were undermined by the ravages of war and, due to the exigencies of wartime security, the media and Parliament lost some of their ability to hold law enforcement agencies to account. As a consequence, law enforcement agencies appear to have expanded their operations against business. Over the first two years of war, this has become so significant that Ukrainian businesses banded together to set up the Manifesto 42 organization to seek to protect their rights to undertake legitimate business activity. The initial response of law enforcement agencies appears to have been to attack the messenger, as a number of business executives involved in Manifesto 42 were targeted for investigation.

These predatory attacks on legitimate Ukrainian businesses are not just a hangover from the Soviet era. They are a current threat to the security of the state. They threaten the tax revenue of the state in time of war, suppress foreign and domestic investment, and undermine economic growth. Such predation on business also undermines Western confidence in Ukraine’s capacity to sustain the fight, and its path to EU accession and postwar reconstruction. It is also a propaganda gift to the Kremlin. Kyiv needs a fundamental rethink on predation by law enforcement agencies. It needs to be ready with the support of its allies to take decisive root and branch measures to terminate the predatory activity of state agencies to sustain the tax revenue and win the war.

1 Introduction

For Ukraine to successfully prosecute its war of national survival, it must ensure external funding support and generate sufficient domestic revenues to sustain the war effort. To do so, it must address the widespread predatory actions of politicized law enforcement actors that are undermining business activity across the country. At the very highest levels of the Ukrainian government, there must be a recognition that these predatory activities are damaging the war effort, the prospects for EU accession, and the potential for attracting resources to rebuild the country postwar.

Western allies, led by the United States, are now providing additional funding and arms to help Ukraine fight and ultimately expel Russian forces from its territory, albeit far too slowly and with far too many delays. It is nevertheless clear that the majority of the funding that will sustain the operations of the Ukrainian state through the war will be derived from Ukraine itself. It is therefore a vital national security interest for Ukraine to ensure its business sector can function effectively and develop enterprises to invest and grow and thereby strengthen, via their tax revenues, the capacity of the state to finance the war effort. Ukrainian businesses and foreign investors overwhelmingly want to contribute to the war effort by operating, investing, and growing their businesses.

However, the unintended effect of the collapse in wartime of the traditional (and informal) checks and balances between oligarchic interests and the central state institutions are exposing businesses to new rounds of predation. While the centralization of power in the hands of the Presidential Administration, martial law, and control over the media in time of war is entirely justifiable, it has enabled state actors and actors connected to the state administrations to ramp up their attacks on businesses in the absence of the majority of formal or informal checks and balances.[1]

In the summer of 2023, the scale of this raiding led to the establishment of the Manifesto 42 group (referencing article 42 of the Ukrainian constitution, which guarantees the right of private economic activity). Manifesto 42 is run by Ukrainian business executives campaigning against the predatory actions of state officials, which undermine the functioning of their businesses and reduce the prospects for growth and investment. The targeting of some of the leaders of Manifesto 42 triggered a crisis in January 2024 with the so-called Mazepagate affair, in which one of the leaders of Manifesto 42 was arrested on flimsy grounds for alleged economic crimes that were roundly condemned by leading figures in the business community and members of the Verkhovna Rada (Ukraine's parliament). The government reacted swiftly with a number of measures to deal with this crisis, elaborated below. While these measures were welcome, they did not match the scale of the problem that Ukraine faces.

The thesis of this paper is that the scale of predation on business by state or state-connected actors is such that it is a clear threat to national security. Every day this predation is unaddressed adds to Western doubts as to the wisdom of supporting Ukraine's cause, fuels Russian disinformation narratives, and undermines the prospects for Ukrainian EU accession and postwar reconstruction.

This paper is divided into five parts. Part 2 recalls past and looks at present predation practices. Part 3 gives some detailed examples of predation in wartime; part 4 looks at the business reaction, and particularly Manifesto 42, which has been targeted by predatory state actors; and part 5 considers some potential solutions.

2 Predation: Past and Present

Following independence in 1991, Ukraine developed a power structure operated by industrial groups and elite state officials that was focused on serving their own economic and political interests. This structure ensured that while they were able to enrich themselves and obtain significant economic and political power, the nation itself was not enriched. Economic growth and development

1 It is beyond the scope of this paper to discuss the motivations for these attacks. Some are likely to be actors within the law enforcement agencies seeking to just take advantage of the opacity and limited accountability that exists in wartime to seize assets and obtain resources. There may well be other actors within the more senior levels of the state who are seeking to control key assets and markets as well as generate revenues.

were lost, and governance systems remained weak.[2] This power structure included a predatory bureaucracy of officials in agencies, government departments, law enforcement, lawyers, notaries, and individuals within the judiciary. This bureaucracy was initially able to adapt the complexities of Soviet legislation to trap and harass business for its own benefit. Over the following decades, as further discussed below, this bureaucracy was able to refine its methods to plunder major businesses and exercise political control over many firms.

However, with the Revolution of Dignity and the annexation of Crimea in 2014, this corrupt power structure came under immense stress from reformers. A series of reforms put pressure on the elites and cribbed, curbed, and confined their powers. Increased transparency rules, particularly asset declarations, made it much more difficult for public officials and their families to hide ill-gotten gains.[3] Digitalization across large swaths of the public sector removed the opportunity for even demanding a bribe in a number of sectors.[4] In the years after the Crimean annexation, the banking sector was also cleaned up,[5] and the energy sector was significantly liberalized.[6] The state procurement service launched its online tendering platform Prozorro.[7] In addition, new anticorruption institutions were put into place, further limiting the power of predatory officials.[8]

Given the Soviet legacy, which has been compounded by continuing Russian influences in Ukraine, fighting corruption has remained an uphill battle. Nevertheless, there has been real change, and these positive changes have continued through the war. For example, the former chief justice of the Ukrainian Supreme Court, Vsevolod Knyazev, was arrested on bribery charges in May 2023. The pressure of war, as much as pressure from Ukrainian civil society and from international donors, has forced significant changes in the structure and transparency of defense procurement.[9] The impact of these prewar and wartime reforms is reflected recently in Ukraine's rise in the Transparency International Corruption Perception 2023 Index to 104th (out of 180).[10] One can also see how the demands of EU accession following Ukraine obtaining candidate status are likely to encourage further governance and rule of law reform.[11]

The onset of the full-scale invasion of Ukraine in February 2022, however, had a mixed impact on the process of removing corruption and state predation within Ukraine. On the one hand, many of the industrial groups who were part of the power structure were significantly weakened, as domestic and export markets collapsed, and enemy attacks destroyed their business assets. On the other hand, the inevitable centralization of power in wartime, particularly in the Presidential Administration, left few formal or informal checks and balances in place.[12] Traditionally, the warring industrial groups acted as a check on the central state institutions, alongside the checking and accountability roles played by the media and Parliament. Now with the industrial groups weakened, and in wartime the capacity of media and Parliament to hold power

2 John Lough, "Ukraine's System of Crony Capitalism: The Challenge of Dismantling 'Systema'," research paper, Chatham House, July 2021. See also Matthew A. Rojansky, *Corporate Raiding in Ukraine: Causes, Methods and Consequences* (Washington, DC: Kennan Institute, Wilson Center, 2014).

3 Dmytro Kotlyar and Laura Pop, "Reform of Asset and Interest Disclosure in Ukraine," in Rajni Bajpai and Bernard Myers, eds., *Enhancing Government Effectiveness and Transparency: The Fight Against Corruption* (Washington, DC: World Bank, 2020), ch. 8, case study 18.

4 Sławomir Matuszak, "The Digitisation of Ukraine: Anatomy of a Success Story," OSW Commentary 403, 23 August 2021.

5 Yuliya Bazhenova, "Effects of Banking Sector Cleanup on Lending Conditions: Evidence from Ukraine," working paper no. HEIDWP06-2023, Graduate Institute of Geneva, Geneva, 2023.

6 International Energy Agency, *Ukraine Energy Profile*, 2023, ch. 2, "Market Design," 25–33. The word "significantly" is key here. While unbundling has been undertaken across the gas and power networks, much of the retail sector is still subject to price controls and subsidy, and during the war additional price capping and other controls have been imposed.

7 For a discussion of the Prozorro procurement system and its impact see Christopher R. Yukins and Steven Kelman, "Overcoming Corruption and War: Lessons from Ukraine's ProZorro Procurement System," *NCMA Contract Management*, July 2022.

8 For a discussion of the history of anticorruption campaigns in Ukraine since independence and the impact of the war on anticorruption efforts, see Olha Chernovol, "Two Years into the War in Ukraine: the Status of Anti-Corruption and the Challenges Ahead," Corruption, Justice and Legitimacy Program blog, 24 February 2024.

9 Vitaly Shevchenko, "Ukraine Makes Gains in Its Other War - Fighting Corruption," BBC News, 22 May 2024.

10 For further details access the Transparency International page for Ukraine.

11 For a discussion of the rule of law and governance issues flowing from the accession process, see Maryna Rabinovych, "The EU's Rule of Law Promotion in Ukraine: External Leverage and Domestic Circumstances," *Zentrum Liberale Moderne*, April 2023.

12 John Lough and Orysia Lutsevych, "Building Long Term Resilience in Ukraine: The Battle with Corruption in Wartime," Chatham House, Wilton Park Conference pre-read, February 2024.

accountable being also limited, parts of the state administration sensed that they were no longer subject to much accountability. As a result, it appears from the evidence presented by the Manifesto 42 group and the observations of independent actors, such as the Ukrainian business ombudsman, that the traditional powerful groups within the law enforcement bureaucracy have returned to the practice of predation on a much wider scale than during the prewar reform years.[13]

These groups can draw upon numerous measures to be able to harass business. For example, the vagueness and complexity of state regulations, some inherited from the Soviet era, some developed specifically to assist the predatory bureaucracy post-independence, can be infinitely deployed as a lever against business. Cases can be creatively spun from vaguely worded regulations which give predatory officials the capacity to profitably spin out a case. A case developed from minimal allegations is then asserted, and favors extracted. The case disappears, and then some years later returns for a further extraction of yet more favors.

As Business Ombudsman Roman Washchuk said recently, state administrations embrace a culture of noncompliance as a means to always have business on the hook for something. By that he means that in many areas of state licensing and administration, it is impossible to ever actually close a case: it can be always reopened.[14] He gave the example of the tax system, where it is virtually impossible to finally close any tax year, giving the tax authorities the capacity to always reopen a tax file. This "always open" approach hands immense power to the tax authorities to run investigations against businesses and creates opportunities for leverage and extortion. This approach is far from exclusive to Ukraine; it is a feature of countries with weak rule of law systems around the world. However, for a state needing every penny of tax revenue to wage a war of survival, such leverage and extortion games are an unaffordable luxury.

There are numerous other ways for a predatory state bureaucracy to profitably harass businesses. This can include excessive and disproportionate investigations. The actual allegation may involve a real or imagined minor infraction of regulations. However, on the basis of such a minor allegation, the state machinery can launch endless investigations, searches, and requests for information. This can be made to go away for a time for cash, assets, or a slice of the business. A similar modus operandi can be used in respect of generating an alleged minor infraction to consistently harass a business with multiple minor fines.

A different type of modus operandi is the excessive and disproportionate use of force to intimidate businesses. This scheme classically features a tax-paying business seeking to function effectively in the middle of a wartime economy being suddenly faced, without notice, with a large number of armed masked state officials arriving at its premises. With little due process, often without lawyers present and often without a court order, the masked officials turn over the premises and arrest executives. After the drama of the raid, with attendant media speculation pumped up by the authorities, the case disappears for a while because it had no legal substance to it in the first place (but of course, it can always come back, reused, in a slightly different form). Another accompanying tactic with such raids is to leak partial or false information alongside news of the raid, often via Telegram channels, to increase pressure on business.

Another tactic deployed by predatory officials is to launch cases with only ever a limited intent to bring a case to trial. According to Ukraine's business ombudsman, only 5% of cases launched by the Economic Security Bureau (ESB)[15] actually make it to trial. For other enforcement agencies the number is approximately 10%.[16] Given that the ESB is supposed to be the principal reformist law enforcement agency dealing with economic crimes, these statistics are uninspiring. They reinforce the case (discussed further below) that the ESB has operated substantially below expectations.[17]

13 Chernovol, "Two Years into the War in Ukraine."

14 Roman Washchuk, presentation at the conference organized by the Centre for Economic Strategy entitled *Government v. Business: How to Ease Pressure on Ukrainian Entrepreneurs,* Kyiv, Ukraine, 13 February 2024.

15 The official title of the ESB is the Economic Security Bureau of Ukraine. However, in many English-language documents it is referred to as the Bureau of Economic Security or BES. Throughout this paper it will be referred to as the Economic Security Bureau or ESB, even if there is a reference to a document which refers to it as the Bureau of Economic Security.

16 Alya Shandra, "Ukraine's Business-Police Relations Hit Crisis Point After Mazepa Arrest," *EuroMaidan Press*, 26 January 2024.

17 For an overview of the operation of the ESB, see Andriana Velianyk, "Economic Security Bureau: Fighting for Reform," *Svidomi*, 11 March 2024.

This low level of cases actually making it to trial has two benefits from the perspective of law enforcement interests. First, this approach allows pressure to be sustained on business over a lengthy pretrial period. During the pretrial period endless investigations, searches, minor fines, and media leaks can be deployed to extract benefits from the business. Second, as the case is never actually litigated in court, it means that officials never need to limit their operations to cases based on actual evidence in accordance with actual legal provisions, or indeed with much connection to reality. Speculation and smear are enough to run a case to sustain leverage and generate opportunities for profit.

The tactics deployed by predatory law enforcement officials are only limited by the extent of their creativity. They are also, however, assisted by the capacity of the state administration to ensure that no case can ever be really closed. This means that in looking for a means of leverage against a business, a predatory official can go back even decades later to reopen a case, give it a new shape, and then deploy a range of leverage tools.

3 Wartime Examples of Predation

One cannot possibly list every case of suspect predation by bad actors connected with or operating within the state administration and agencies since February 2022. However, the following cases give some sense of the type and extent of the operations being deployed against Ukrainian businesses.

MacPaw. MacPaw is the Ukrainian Apple developer for iPhones and Mac computers, which provides software such as CleanMyMac X to users. It invested approximately $28 million in a recreation center outside Kyiv on the banks of the Dnipro for its employees between 2016 and 2021. In February 2023, the company's Kyiv headquarters and the home of the CEO Oleksandr Kosovan were raided.[18] The official reason for these raids were violations in obtaining the land for construction of the recreation center. The national police subsequently alleged that the MacPaw was illegally mining sand for construction around the recreation center. The CEO of MacPaw alleges that the entire criminal process is motivated by the desire of law enforcement officers to take possession of the land. One must at least ask why an internationally successful tech firm would seek to unlawfully acquire land. It is also noticeable that the Minister for Digital Transformation Myhailo Fedorov called the searches an approach that "kills the country's investment climate." The police subsequently apologized for their actions.[19]

Riviera Village. Another example is the Riviera Village saga. This was an exclusive residential community outside Kyiv developed in 2007 by two partners, Serhiy Slyusarenko and Volodymyr Limakov. In November 2023, the State Bureau of Investigation (SBI) and the National Police detained "leaders and participants of a criminal organization." The allegation was that they had illegally acquired land for their project around the Kyiv hydroelectric power plant (Kyiv HPP), which belonged to the state. Slyusarenko, his 73-year-old mother, and several senior managers at Riviera Village were arrested. It's difficult also to see how the SBI can make their case here when the project was commenced almost two decades ago, and in that period 200 homes have been constructed in the community. To construct those homes, thousands of state permits and permissions have been obtained without any indication that there is any question as to the legality of the land on which these houses had been built.[20] It is noticeable that the chair of the Verkhovna Rada's Energy Committee, Andriy Gerus, was utterly dismissive of the allegations of the SBI. Gerus was speaking specifically about the Mazepa case (see below). However, his words are wholly relevant, as Mazepa's "village project" is three miles from Riviera Village and also on land claimed to be part of the Kyiv HPP domain. According to Gerus, the land was not owned by the Kyiv HPP, "so this definition is more of a creative and imaginative approach, but not a legal one." He also went on to say that law enforcement agencies "should have enough legal evi-

18 Valentyna Dudko, "Oleksandr Kosovan Invested up to $28 Million in a Recreation Center for Employees, Which Was Searched," *Forbes Ukraine*, 23 February 2024. (In Ukrainian: "Олександр Косован інвестував до $28 млн у базу відпочинку для співробітників, через яку були обшуки. Ось як вона виглядає.")

19 "The National Police Searched the IT Company MacPaw," *Kyivschina*, 15 February 2024 (In Ukrainian: "Нацполіція провела обшуки в ІТ-компанії MacPaw: деталі справи.")

20 "Why Keep a 30-Year-Old Employee in a Cell and Arrest a 73-Year-Old Mother?, — the Co-Owner of Riviera Village in an Interview from Luk'ianivskyi SIZO," *New Voice of Ukraine*, 16 February 2024. (In Ukrainian: "Навіщо тримати в камері 30-річну співробітницю і арештовувати 73-річну маму?, — співвласник Riviera Village в інтерв'ю із Лук'янівского СІЗО.")

dence to avoid the need to come up with false allegations that sow fear and unrest among the public."[21]

In February 2024, Slyusarenko urged President Zelensky in an impassioned letter to address the corruption and violation of fundamental rights prevalent in the Riviera case.[22] Slyusarenko is now free on bail.

Raiding actions are not limited to wholly Ukrainian-owned businesses. They also appear to take place against companies which are foreign-owned or involve significant foreign investment. For example, take the cases of Synevo and Ferrexpo.

Synevo is a healthcare and diagnostic company with 340 laboratories operating across Ukraine. It is part of the Medicover group, which operates in 10 European countries and is listed on the Swedish Nasdaq. Its significant domestic Ukrainian diagnostic capacity permits it to undertake 800 different tests, and it performs 20 million such tests a year. In February 2024, the SBI seized the company's headquarters and central laboratory.[23] The SBI claims that the property was illegally acquired from the state between 2016 and 2021. Synevo says that the building was acquired in 2010 from a private owner and then subject to significant reconstruction.

What is clear is that this seizure was carried out with no notice to Synevo. There was no summons to the court where Synevo could make its case before it placed control of the property in the hands of state agents.

Ferrexpo is another example of the politicization of state prosecutors threatening firms with significant foreign investments.[24] Before the war, it ranked as the third largest exporter of iron ore pellets globally. It has been listed on the London Stock Exchange since 2007 and in the last year before Russia's full-scale invasion, it generated $2.5 billion in revenue. It has major institutional shareholders including BlackRock, Schroders Investment Management, Wellington, and the Norwegian sovereign fund. A Ukrainian businessman by the name of Kostyantyn Zhevago holds the remaining 49.3% of the shares.

The prosecutors argue that Finance and Credit, a bank Zhevago owned until 2015, went bust due to his actions. The allegation is, in effect, that he moved capital out of the bank to finance his other businesses, and subsequently the bank collapsed. An Interpol warrant was issued for his arrest and extradition in 2021. However, Zhevago challenged the extradition order in the French courts. Ultimately the Cour de cassation, the French supreme court, rejected the extradition order, ruling that Ukraine is unable to guarantee that it can provide basic procedural guarantees and protection of the rights of defense for the accused.[25]

In parallel to the issue of national and then international arrest warrants, the prosecutors also sought to bring proceedings against Ferrexpo itself. There are now a dozen significant civil and criminal cases open against the company. This appears to be an unlawful attempt to secure control over Ferrexpo by high-level political actors and their commercial allies, exploiting the judicial woes of Zhevago as a pretext. However, the alleged liability for the failed bank falls on Zhevago personally. There is no connection between Ferrexpo and the liabilities for the bank. Nevertheless, certain Ferrexpo assets in Ukraine have been frozen.[26] Ferrexpo's other shareholders surely should not be punished for the alleged actions of one shareholder. Ultimately, through legal process, the government may be able to make a case for obtaining Zhevago's Ferrexpo shareholding held outside of Ukraine, but they have not done this. No court processes have been commenced to seek control of just Zhevago's shareholding.

In a parallel move, prosecutors have gone after one of Ferrexpo's senior Ukrainian managers, Viktor Lotous.[27] He was subjected to pretrial detention for thirty-eight days. The allegation is that he was responsible for removing waste from the mining process. The core of the allegation was that the waste was an asset. It is difficult to see how such a claim can be credibly pursued. According to Ferrexpo, the rubble is waste derived from the processing of iron ore. Nevertheless, the prosecutors are seeking

21 Markiian Klymkovets'kyi, "Pressure on Business or a Fair Investigation: What There Is to Know about the Case of Concorde Capital's Ihor Mazepa," *Hromadske*, 22 January 2024.

22 "Open Letter of Riviera Village Co-Owner Serhiy Slyuasrenko to the President of Ukraine," *Interfax-Ukraine*, 2 February 2024.

23 Mykola Maranchak, "ДБР арештувало головний офіс 'Сінево Україна'. В компанії відкидають звинувачення і говорять про ризик зупинки роботи усієї мережі," *Forbes Ukraine*, 27 February 2024.

24 Melik Kaylan, "For Ukraine Another Hidden Danger Looms," *Forbes*, 5 February 2024.

25 "French Court Rejects Appeal to Extradite Ukrainian Billionaire Zhevago," *Reuters*, 10 November 2023.

26 Ben Hall, "Ferrexpo Chair Urges Kyiv to Spare Miner in Anti-Oligarch Campaign," *Financial Times*, 25 October 2023.

27 Kaylan, "For Ukraine Another Hidden Danger Looms."

$4.3 billion in damages, which significantly exceeds total annual revenue, and values the waste significantly higher than the actual iron ore. Furthermore, Lotous was required to meet bail with almost UAH 1 billion ($26 million), one of the highest amounts ever requested in the history of Ukraine. This was eventually reduced by 50% before Lotous was released.

There is also the **Mazepa** case, known as Mazepagate. This involves the founder of Concorde Capital, Ihor Mazepa. The SBI allegations are that Mazepa was the principal actor in an exclusive river residential project, which involved the illegal seizure of land around the Kyiv HPP. On 18 January 2024, Mazepa was arrested at the Ukrainian-Polish border crossing in relation to his participation in this property development project. On 19 January, the Kyiv court imposed a bail condition of UAH 349 million, ten times the alleged loss to the state. Five days later the Kyiv Court of Appeal reduced the bail to UAH 21 million and Mazepa was released.[28]

The important context of these allegations is that Mazepa set up a rating system for law enforcement officers and judges who used their powers for illegal purposes in March 2023, and he subsequently was one of the principal founders of Manifesto 42 in June 2023. Manifesto 42 aimed to draw attention to the rising level of unlawful activity against legitimate businesses from state administrations and the judiciary. It appears that it was only after Mazepa launched Manifesto 42 that law enforcement revived, enlarged, and developed the allegations against him and against the executives of the nearby Riviera Village project.

The outcry from the business community over Mazepagate did elicit a response from the Presidential Administration. On 23 January 2024, President Zelensky announced a three-month moratorium on what are known as "mask shows," or unannounced inspections, without a court order and where officials are all masked. He also announced the establishment of an Entrepreneurship Support Council, alongside proposed amendments to the regulations applicable to the operation of the Economic Security Bureau (ESB).[29]

The Mazepagate scandal underlines another apparent feature of politicized law enforcement attacks on business: the willingness of state administrations to go after businesses and individuals that express concern at the raiding activities of law enforcement.

Take, for example, the medical products firm **Kyivhuma**, which has been subject to continual threats from various law enforcement arms of the state with varying allegations that eventually fizzle out. One of the latest allegations from the Security Service of Ukraine (SSU) was that of overpricing medical kits for the Ukrainian Armed Forces in 2021–2022. This led to a pretrial investigation in spring 2023. The difficulty with the allegation of overpricing was that the tender had been obtained via the electronic tendering platform Prozorro, and was for a NATO standard medical kit. Due to this transparency, it is difficult to see how any overpricing argument can be made. In this context it is perhaps not surprising that one of the owners of Kyivhuma, Andriy Ostrogrud, is one of the initiators of the Manifesto 42 movement.[30]

In January, Kyivhuma was raided by the SSU, and one of the cofounders of the firm was arrested. The allegation this time was that Kyivhuma had provided approximately €1 million of medical goods to Russia since the war began. Ostrogrud was interviewed about the latest allegations, and convincingly debunks them. In particular, one allegation was that Kyivhuma sold goods to Russia through its subsidiaries in the EU, yet it has no subsidiaries there.[31] The specific allegation was in relation to the selling of tactical medical products for battlefield use to an Estonian company, but no such products were supplied to the company.[32] And the figure of UAH 40 million, which the SSU claimed was the amount involved, was in fact the total amount of the order of the Estonian firm for all types of medical product. Perhaps equally disturbingly, contrary to any principles of due process, parts of the

28 Todd Prince, "A Ukrainian Banker's Arrest on a Decade-Old Deal Strikes a Nerve in Kyiv's Business Community," *Radio Free Europe/Radio Liberty*, 31 January 2024. Bail was only reduced and Mazepa released after Manifesto 42 proposed a symbolic strike across the Ukrainian economy.

29 Volodymyr Zelenskyy, "The NDSC Issued a Decision on Economic Security and Economic Stability During Martial Law - Address by the President of Ukraine," statement by the President of Ukraine, 23 January 2024.

30 Mykhailo Orliuk, "'Suppressing Powerful Domestic Producer in Interests of Chinese Imports': Kyivhuma Owner Andrii Ostrohud on SSU Searches," *Censor.Net*, 9 January 2024.

31 Ibid.

32 Ibid.

alleged documentation from the January SSU search flooded Telegram with a range of further allegations.[33]

It is difficult to avoid the sense here that Mazepagate and Kyivhuma are both attempts to use law enforcement to pressure critics to stop criticizing the state administration and the judiciary. There is a real sense that parts of the state administration are trying to shut down criticism of their activities, reinforced by the recent ESB raid on the CEO Club of Ukraine on 26 April 2024.[34] The CEO Club has been critical of the operation of the ESB and has supported reforms to ensure it does not become "an instrument of bribery and political pressure." The ESB conducted the search, nothing was found, nothing was taken away and no one was charged. However, as with the Kyivhuma case, allegations began to appear on Telegram channels that appeared to smear the CEO Club. The raid was carried out on 26 April. On 30 April the ESB announced it had carried out raids in Kyiv at several addresses, where it had uncovered an illicit casino and fraudulent call center. Telegram channels then sought to link the raid on the CEO Club with these other raids. Serhii Haydaichuk, president of the CEO Club, dismissed these as smears and as "false and absurd."[35]

4 Business Reaction: Manifesto 42

Given the ramping up of illegitimate enforcement activity against Ukrainian business, one can understand why, in the summer of 2023, a group of business executives came together to launch Manifesto 42. They included Serhiy Pozniak, the head of the Association of Entrepeneurs of ATO Veterans; Ihor Mazepa, General Director of Concorde Capital; Yakov Gribov, co-owner of Nemiroff; Vasyl Danyliak, CEO of OKKO; Oleksandr Slobodian, President of Obolon; Oleh Kalashnikov, co-owner of Dobrobut Clinics; Farmak head Filya Zhebrovska; Astarta head Viktor Ivanchyk; Serhiy Sypko, owner of Agrofusion; and Andriy Ostrogrud, co-owner of Kyivhuma.

The first step of Manifesto 42 was to adopt Mazepa's idea of a register for officials who abused their power to pressure and loot Ukrainian business. To be included on Manifesto 42's register involved a three-step procedure comprising of verification by external experts, followed by further investigations by reputable journalists, and ultimate approval by the supervisory board of Manifesto 42. Once on the register, Manifesto 42 would seek to prosecute the person so registered.[36]

The fact that a business association should even have to contemplate such a procedure in a functioning democracy, even in wartime, is remarkable. It suggests an extremely high level of concern among business leaders regarding the operations of state enforcement agencies. The positively explosive reaction of the business community in response to the arrest of Ihor Mazepa, one of the founders of Manifesto 42, is not surprising. When representatives of business, including Manifesto 42, met with the government to discuss the Mazepa case and the broader "raiding environment" against business, the atmosphere was one of total indignation. Following that meeting, Manifesto 42 published a statement in which it said, "We need to end the nightmare stories of businesses that work and pay taxes."[37]

Roman Waschuk, the Ukrainian business ombudsman and former Canadian ambassador to Ukraine, expressed dismay at such attacks on leading business executives: "It is disturbing that we are returning to the practices not of 2016 but of 2013,"[38] referring to the scale of corporate raiding under the pro-Russian former president Viktor Yanukovych.

The scale of business reaction did result in a response from the Presidential Administration and action from Zelensky. This included a three-month moratorium on raids, save in cases involving national security, and the establishment of an Entrepreneurship Support Council. It is open to question how effective these measures have been. It is true that the Deputy Prosecutor General Dmitry Verbytsky closed 19% of the criminal cases against

33 Orliuk, "'Suppressing Powerful Domestic Producer.'"
34 Martin Fornusek, "Business Association CEO Club Says It Was Searched, Complains of Smear Campaign," *Kyiv Independent*, 6 May 2024.
35 Ibid.
36 "Manifesto 42 Launches Register of Individuals Who Abuse Power to Put Pressure on Business," *Interfax-Ukraine*, 14 December 2023.
37 Sofiia Telishevska, "Entrepreneurs Met with the Authorities against the Background of the Arrest of Ihor Mazepa – There Was 'Total Outrage' Due to the Actions of the SBI," *Babel'*, 22 January 2024.
38 Prince, "A Ukrainian Banker's Arrest."

businesses after conducting an audit of these cases.[39] However, Manifesto 42 notes that the closed cases did not include a single high-profile case. It also noted that its members reported that corrupt pressures from state administrations continue. It recommended that the government continue the moratorium on all procedural measures in criminal proceedings, save on grounds of national security. It also recommended that the enforcement agencies be required to carry out an audit of all restrictive measures taken against business to determine their legitimacy and legality, as well as providing monthly reports on cases. It also argued for providing additional support for the business council so it could effectively engage with the issues that business faced.[40]

Clearly the business executives involved in Manifesto 42 do not appear to have much faith in their recommendations being adopted by government.[41] The organization appears to be stepping up its activities by working with veterans' groups to provide security for businesses under attack. It is also seeking to work with anticorruption organizations to undertake systematic investigation of those arranging raids by state agencies.[42]

Given the scale of predation that business have been subject to, one can understand their lack of faith in government promises. This has been reinforced by the saga over the Economic Security Bureau (ESB).[43] The idea behind the ESB was a good one. One of the compelling complaints of business was the potential for several agencies—from the intelligence services such as SSU, to the criminal investigation agency SBI, to the tax police—to investigate a business in turns. The aim with the ESB was to ensure that only one agency could investigate economic crime, and that would be ESB. Unfortunately, as it was constituted the ESB became little more than a rebrand of the tax police which it was supposed to replace. Eighty per cent of ESB staff came from the tax police, and the ESB appeared to engage in the same raiding practices. In addition, contrary to the objective of setting up the ESB, other agencies were still permitted to undertake economic crime investigations.[44] After the Mazepa case, reforms to ESB were promised. However, draft legislation to ensure the independence and integrity of ESB has been slow to be adopted. And even now the current bill to reform ESB does not meet the standards of independence and integrity recommended by the G7/EU and the IMF, as well as most Ukrainian business associations.[45]

5 Time for a Ukrainian Metanoia?

It is understandable that the focus of the Ukrainian government in a war of national survival is on waging the actual war. However, given the scale of state predation of business and the consequent damage to done to the state's capacity to fund the war, this issue has to be addressed.

Such levels of predation by state officials are a direct threat to the security of the Ukrainian state and its capacity to wage war. The onset of the full-scale invasion in February 2022 had a devastating impact on the economy, which contracted by almost a third. From that very low basis there has been economic growth of around 3.2% in 2023, according to the IMF. However, exports have fallen significantly. This has been obscured in the statistics by the inflows of international aid. Public debt to GDP is now over 100% of GDP, which is extremely high for a developing economy. The IMF projection is that, should the war go on beyond 2024, then these figures would all become significantly worse. And this is all before one considers the cost of reconstruction. The direct war damage alone at this stage of the war sits at $486 billion, according to the IMF.[46]

39 Anyta Prasad, "'Манифест 42' призвал Зеленского ввести постоянный аудит дел против бизнеса и запрет на 'маски-шоу'," *Forbes Ukraine*, 25 April 2024.
40 "Manifesto 42 Movement Appeals to President with Proposals to Prevent Law Enforcement Pressure on Business," *Interfax-Ukraine*, 25 April 2024.
41 "'Маніфест 42' оголосив про перехід підприємців до організованого спротиву тиску силовиків," Manifest 42 website, accessed 19 July 2024.
42 "Manifesto 42 Movement Appeals to President."
43 For a discussion of the controversies surrounding the ESB, see Maksym Havryliuk, Karyna Stepanovych, and Ivan Kozlovskyi, "What to Expect from the ESB Reform: Analysis of Draft Laws," *VoxUkraine*, 11 March 2024.
44 Velianyk, "Economic Security Bureau: Fighting for Reform."
45 Ukrainian Business Council, "Joint Appeal of Ukrainian Business on BES Reboot," 11 April 2024.
46 Drazen Rakic, "Two Years of War: The State of the Ukrainian Economy in 10 Charts," European Parliament Briefing, February 2024.

Clearly the US, the EU, and other Western allies have provided macroeconomic and military budget support for Ukraine. Despite Western support, inevitably the far greater part of the resources to fight the war will come from the Ukrainian economy. Yet the scale of state predation across the economy is now undermining the capacity of business to generate the tax revenue that permits the government to fund the war. In addition, that predation sends a terrible signal to Ukrainian businesses not to further invest, further reducing the productive capacity of the economy and thereby the state's tax revenue. It is also pushing businesses to the very limits of their tolerance for such predation when they are bearing the burdens of functioning in wartime and are themselves providing money and material directly to the front line. When they see cases like Synevo and Ferrexpo, it also sends a terrible message to foreign investors to keep out and away from Ukraine.

These levels of state predation also endanger Western aid support. One can see critics of such aid in the West ask why their states should step up to support Ukraine, if the Ukrainian state undermines its own capacity to fund itself by permitting such levels of state predation across its economy. This issue is likely to become more acute as the EU scrambles to find additional resources to support Ukraine. It is noticeable that half of the €50 billion the Union allocated to Ukraine in February 2024, and which was supposed to support Ukraine over the following four years, will have been spent by the end of this year. Such are the budgetary pressures on the Ukrainian state. These budgetary pressures are a major factor in growing EU support for finding ways of making use of frozen Russian assets to support Ukraine.[47]

And clearly this issue can also be enlarged and weaponized by Russian disinformation actors against Ukraine if decisive action is not taken to close it down.

Such levels of state supported predation are also likely to affect the capacity of the Ukrainian state to handle reconstruction. One can see that at the end of the war, with the removal of capital controls and controls on freedom of movement, but with the continuation of state predation, many Ukrainian businesses may just leave the country. Their reasoning would be compelling: Better to move capital, knowhow, intellectual property, and talented personnel out of the country rather than try to deal with the predatory bureaucracy. Equally, faced with state predation, foreign investors may well avoid Ukraine, and Western states will be far less willing to provide funds for reconstruction.

A further question which faces the Ukrainian state from its EU partners is this: If in the middle of a war of national survival, where every penny of tax revenue counts, and where Ukraine's allies are providing substantial military and domestic budget support, the governing elites cannot break the back of corrupt law enforcement agencies, will they ever do so? Or in other words, if Ukraine cannot fundamentally clean up its act in this crisis, will it ever be able to clean up its act sufficiently to meet the standards to become an EU Member State?

The central question here is, what should the Ukrainian state do to deal with this problem of state predation effectively? The first step, it is argued here, is for there to be a moment of *metanoia*, of rethink and recognition of the true gravity of the situation and the need for decisive action.

The second step is for the state to follow through on some of the proposals made by international partners and Ukrainian business associations. These would include reforming the Economic Security Bureau on the lines the IMF, G7, EU, and Manifesto 42 have proposed. That would mean there would be one principal investigator for economic crime, all existing officials would be properly vetted, and there would be international oversight of the ESB. Following on the insight of the Ukrainian business ombudsman, there is also a compelling argument to clean up the tax service. In the first place, this would mean being able to actually and finally close tax years which cannot then be reopened, and secondly, it would mean cleaning up the legislation so the vagueness of tax provisions cannot be used as a lever against business. With its G7/EU partners, Ukraine should also develop a throughgoing deregulation and administrative simplification program. Such a program would remove much of the legislative and administrative apparatus that is deployed to harass business.

What is argued here, however, is that Ukraine needs to go above and beyond existing proposed reform to cut off the capacity and incentives for the state bureaucracy to prey on business. To that end, two additional reforms are proposed. Both reforms discussed below seek to deploy the tactics of the predatory state law enforcement against itself.

47 Gregorio Sorgi, "The EU's Fund for Ukraine Is Already Running Low," *Politico*, 15 May 2024.

The first would be to set up a G7-funded rule of law task force. It would have a small board consisting of G7, Ukrainian civil society, and Ukrainian veteran representatives, along with a task force with a staff of Ukrainians and G7 representatives. The board and staff would monitor the state of the rule of law in Ukraine, bring critical issues to the authorities, and publish regular reports on the state of the rule of law. The board would meet regularly with the president and prime minister to provide advice and support to address abuses of the rule of law.

The second proposal would seek to deal with specific problems emanating from the predatory behavior of state law enforcement operations. This proposal first envisages the establishment of a special prosecutor's office. That office would be governed by a board consisting of a majority of international representatives, with the Ukrainian board members consisting principally of civil society representatives and veterans. Ideally, the special prosecutor would be a veteran and the office would be staffed significantly by veterans all vetted and appointed by the board. The special prosecutor would empanel grand juries of veterans before whom draft indictments would be submitted before any indictments could be laid.

This second proposal then envisages that all economic crimes from any Ukrainian agency, such as ESB, SBI, or SSU, that are still ongoing for more than five years from the date when the special prosecutor's office described above comes into operation, will be transferred to this special prosecutor. The point here is that so much of state law enforcement predation is about running bogus criminal cases for years just in order to develop leverage. By transferring cases that have been running for five years or more, illegitimate prosecutions can be halted in one fell swoop. And the special prosecutor can then focus on dealing with the genuine older cases at some speed.

Together with the proposal for the rule of law taskforce, the transformation of the ESB, and regulatory simplification, these reforms would make it much more difficult to sustain the predatory instincts of state law enforcement.

What these proposals would also do is release an enormous amount of law enforcement resource to go after actual criminal and national security cases. The critical point that is often lost in the debate over state officials' predatory attacks on business is that these attacks are not just unjust and illegitimate and undermine state revenue, but they also reduce the capacity of the state to deal with actual crime and security cases.

The other advantage of the Ukrainian state undertaking a fundamental reassessment of the damage state predation does to business and thereby its revenue is that it makes it possible to deal with three key external issues. First, clearly decisive action on this issue allows Kyiv to further underpin Western support for the war. It reassures allies that corruption is being decisively dealt with, and makes it easier for its allies to make the case for further funding and broader political support for Ukraine. Second, by dealing with this issue decisively, it removes the capacity of Russian actors or Russian-supported actors to spin a disinformation line on Ukrainian corruption.

Third, such decisive action against predatory state actors permits Kyiv to reinforce its argument for greater air defense and air cover support across Ukraine. Clearly this should be provided in any event for humanitarian reasons, given the scale of missile and drone attacks across Ukraine. In addition to the humanitarian argument, Kyiv would now be able to argue that by implementing the proposals that have been discussed above, it is doing all in its power to ensure that business can flourish and to generate its own revenues to fund the war. However, the major barrier that remains to business operations and further investment across Ukraine is the lack of air defense across the country. Kyiv can now say: Ukraine has stepped up to maximize its revenues and put its house in order. It can contribute financially much more to the war effort and not place so much strain on the finances of its allies if the skies over Ukraine are better protected. The West should now step up to ensure that sufficient air defense is in fact put in place. Ukrainian businesses and foreign investors would be able to step up investment and grow the economy, making it easier to fund the war effort and then win the peace.

Fundamentally, Ukraine cannot go on like this. The state needs to maximize tax revenue to fight the war. Corporate plundering by law enforcement agencies is weakening the tax base and weakening Ukraine's capacity to wage war. The government needs to recognize the scale of the threat, and with the support of allied countries seek to address this problem root and branch. It is as important as ensuring Kyiv has the shells, missiles, and F-16s to sustain the fight at the front.

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