

DEOFFSHORIZATION AS AN INSTRUMENT OF FINANCIAL SECURITY
OF THE STATE: LEGAL ASPECT

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Abstract. It has been determined that legalization (laundering) of proceeds from crime as a criminal offense is committed by individuals and legal entities using a criminal (corruption) mechanism for granting the status of legal origin to assets (funds, real estate, securities) knowingly acquired by criminal means, in order to conceal predicate offense and the acquisition of legal grounds for possession, use and disposal of these assets. According to the Association Agreement between Ukraine and the European Union, combating these crimes is recognized as an element of security policy, which determines the feasibility of further appropriate changes to existing legislation and the need to improve the organization and methodology of investigation of these crimes. The assessment of the impact of offshore zones on the indicators of financial security of Ukraine based on the construction of an econometric regression model has been carried out. In accordance with the obtained results, recommendations on deoffshorization as an effective tool for ensuring the financial security of Ukraine have been provided. It has been stressed that international cooperation in the field of criminal justice should become an effective process and, having got rid of cumbersome and lengthy formal procedures, be transformed into an operational process of interaction between authorized persons. Operational cooperation between law enforcement agencies of Ukraine and EU countries, which is provided for in the Association Agreement, is complicated by the factor of inadequate communication due to the fact that law enforcement officers do not speak foreign languages and need training (both professional and language training).

Keywords: financial security; legalization (laundering) of income; deoffshorization; indicator; criminal justice

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1. Introduction

Today, during the instability of both the macroeconomic and political situation, research and analysis of the concept of financial security is not only relevant but also very important for the economy of Ukraine. Financial security is a multi-faceted concept that requires a comprehensive and systematic study, which in turn allows to provide sufficiently reasoned and effective recommendations, under observance of which you can improve and optimize the economic situation and make a strategic plan of the development of the financial sector and the economy as a whole.

The urgency of the subject is due to a set of social, political, organizational and legal factors. The processes taking place in society in recent decades in connection with the transition from a rigid centralized model of governance to market relations have significantly changed the economic, social and legal systems. The rapid

development of foreign economic relations, foreign exchange market, the implementation of appropriate norms of international law – all this contributes to integration of Ukraine into the world economic space. At the same time, these processes have a number of negative consequences, such as: criminalization of society, commission of criminal offenses in the field of management, in particular, legalization (laundering) of proceeds from crime (Vigliarolo, F. 2020).

Legalization of proceeds from crime is associated with the commission of crimes of varying gravity and consequences, with the presence of offshore zones, with sophisticated tax evasion schemes, which has a devastating effect on the development of the national economy and the implementation of global international programs. Thus, according to the UN, on the accounts in offshore zones there were detected 32 trillion US dollars, of which 11.5 trillion US dollars belonged to private persons. This gives grounds to conclude that the annual non-payment of taxes is about 250 bln US dollars (the largest US corporations hold more than \$ 2.1 trillion offshore (2015)).

Today, due to the instability of the political situation, strong exchange rate volatility, cyber-terrorism, global economic influence and crisis, the financial security of Ukraine is an issue of paramount importance. In the current situation, the task is to balance the situation in the financial system of Ukraine. This revived the study of information on public debt and borrowing, opportunities for income diversification and restructuring of past and future expenditures, volumes and recipients of foreign direct investment from Ukraine. In this context, the process of deoffshorization is relevant to achieving the desired state of the financial system of Ukraine.

Thus, the level of crimes and the increase in the amount of damage caused by them necessitate the study and improvement of methods of investigation of legalization (laundering) of proceeds from crime.

2. Literature Survey

Along with the development of the global economy and international economic relations, the process of economy offshorization is growing, which is a sign of modern globalization and internationalization of world economic processes. An offshore zone is a certain territory (country or part of it) where an attractive tax regime prevails — low tax rates are legally fixed or absent at all (Tylchyk, O., Dragan, O., & Nazymko, O. (2018)). Such territories have simplified conditions for financial reporting, less complex process of registration of legal entities, relatively low or no income tax, no restrictions on the export of currency, as well as the ability to do business anonymously (Ijiaiih, E. E., & Bojitob, B. H. (2015); Kordík, M., & Kurilovská, L. (2017)). The above conditions make offshore areas very attractive for businesses. There are quite a few goals for creating offshore zones such as: attracting foreign capital (foreign exchange earnings), accelerating the development of a country (stimulating employment), and the introduction of new technologies (Fazilov, F. M. (2018)).

OCED classifies offshore zones depending on the level of legality and transparency of offshore. There are white, gray and black lists of offshore zones (<http://www.oecd.org/>) "White" list includes the countries that have already applied the standards of tax cooperation; "gray" list includes the countries that have undertaken to cooperate in the field of taxation, but have not yet taken any actual action; and "black" list includes the countries that have not adopted tax standards. In addition to the classification, it is recommended to avoid cooperation with "black" offshore companies preferring "white" and "gray" ones.

Assessing their role in developing the outlined issues, it should be noted that most studies were conducted on the methodological basis of the past, without taking into account the harmonization of domestic criminal procedure legislation, including current requirements of the current Criminal Procedure Code (CPC) of Ukraine and European standards of criminal procedure. Therefore, some problematic issues remained unresolved.

In the field of foreign economic activity, it is necessary to distinguish groups of fictitious and dubious export operations for the purpose of unjustified VAT refunds and legalization (laundering) of income. For example, enterprises export products that are not typical for their activities, through principals who are not persons responsible for financial regulation. The following are the most common methods of illegal operations in the field

of foreign economic activity:

- 1) acquisition of companies, securities of foreign companies and real estate abroad (Artemenko, D. A., Gurba, V. N., & Evnevich, M. A. (2019));
- 2) making payments for services provided to foreign partners (marketing, advertising, etc.);
- 3) use of structured financial operations (targeted transfer to one or more accounts in a foreign bank is divided into several transfers, each of which meets the limit set by national law, which is not subject to financial monitoring and mandatory notification of public authorities, the so-called “smurfing”) (Shashiashvili, G. (2017));
- 4) export of currency abroad using plastic credit cards (Şarco, V. (2016));
- 5) export of cash in foreign currency by individuals (Malanchuk, P. (2018)).

In particular, further development is required regarding the forensic characteristic of the crime, because, according to the current legislation, not only individuals, but also legal entities are defined as the subjects of this type of criminal offense; detection of signs of legalization with the use of information technology (cybercurrency, bitcoin); improving the tactics of carrying out certain investigative (search) actions, etc. A critical rethinking of the specifics of international cooperation in the search for and seizure of income and persons involved in the commission of a predicate offense and money laundering is needed.

These circumstances indicate the relevance of the subject, require a change in the direction of scientific studies and their reorientation to address the immediate problems of law enforcement practice, which meets the needs to develop the theory of criminology and the challenges of modern practice of investigating these crimes.

3. Methods

The methodological foundation of scientific work is a system of methods: method of scientific cognition, comparative, analytical, econometric analysis, computational method, analysis of articles and monographs, classification and prognostic methods through the use of modern information technology, etc.

In order to ensure the reliability and validity of the obtained scientific results, a complex of modern general philosophical, general scientific and special methods was used, namely: dialectical-materialistic method – to determine the object of study; comparative-legal method – to establish the general and special characteristics of the concept of legalization (laundering) of proceeds from crime, and the activities of law enforcement agencies to identify signs of this type of crime; system-structural method – to determine the place of forensic characteristic of legalization (laundering) of proceeds from crime in the system of forensic methods, its functional purpose in the pre-trial investigation; formal-logical method – for the analysis of current legislation and existing theoretical provisions of criminology, which relate to certain elements of the forensic characteristic of the crime under consideration; historical-legal method – to define the content of key elements of the formation of proposals for improving the criminal procedure legislation, which will ensure the effectiveness of the investigation of crimes, as well as the identification of proceeds from crime; dogmatic method – for the interpretation of legal categories, in-depth study and clarification of the conceptual and categorical framework; system method – to improve the interaction of law enforcement agencies of Ukraine and those of other states; statistical method – to study the areas of practical activity of law enforcement agencies and confirm the obtained theoretical conclusions with the data of the analysis of statistics of the Prosecutor General’s Office of Ukraine and the State Judicial Administration of Ukraine, as well as the SCFM of Ukraine.

The information base of the scientific work consists of legal documents, research periodicals, foreign sources, webinars of leading experts, statistics, materials of international organizations, statistical materials, information resources of the Internet, etc.

The empirical base of the study is the systematized statistical data of the MIA of Ukraine for 2007-2018 on the results of the investigation of money laundering; statistical information of the General Prosecutor’s Office of Ukraine; analytical reviews on the state of justice, reporting and accounting and statistical work of the State Ju-

dicial Administration of Ukraine for 2012-2018; summarized results of the study of 369 criminal proceedings, survey data of 206 law enforcement officers and 314 judges.

4. Results

It is recognized in the Strategy for the development of the system of prevention and counteraction to legalization (laundering) of proceeds from crime or terrorist financing for the period up to 2015 that the rapid development of the global financial system, continuous improvement of existing and application of new information and communication technologies make it possible to carry out financial transactions in the shortest possible time, which creates additional opportunities for laundering of proceeds of crime. For each state, the fight against laundering of proceeds of crime is a matter of national security. Laundering of proceeds of crime is not only a socially dangerous act, but also a systemic threat to financial markets and the national economy as a whole (On approval of the Strategy for the development of the system of prevention and counteraction to legalization (laundering) of proceeds of crime, or terrorist financing for the period up to 2015 (2011)).

In pursuance of this Strategy, the National action plan for the implementation of the second phase of the action plan on visa liberalization for Ukraine by the European Union was approved. It provides for the implementation of the Strategy for the development of the system of prevention and counteraction to legalization (laundering) of proceeds of crime or terrorist financing for the period up to 2015 and action plans for prevention and counteraction to legalization (laundering) of proceeds of crime or terrorist financing (para. 58) (On approval of the National action plan for the implementation of the second phase of the Action Plan on visa liberalization for Ukraine by the European Union (2014)).

On December 30, 2015, the Government of Ukraine approved the Strategy for the Development of the System of Prevention and Counteraction to Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism and Financing of the Proliferation of Weapons of Mass Destruction for the period up to 2020. (On the implementation of the Strategy for the Development of the System of Prevention and Counteraction to Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism and Financing of the Proliferation of Weapons of Mass Destruction for the period up to 2020 (2017)), in pursuance of which on February 11, 2016 there was approved the Action Plan for 2016 on prevention and counteraction to legalization (laundering) of the proceeds of crime, financing of terrorism and financing of distribution of the weapon of mass destruction (On approval of the action plan for 2016 on prevention and counteraction to legalization (laundering) of the proceeds of crime, financing of terrorism and financing of the proliferation of weapon of mass destruction (2016)) developed by the State Financial Monitoring Service of Ukraine. This Plan identifies legislative, organizational and practical measures aimed at ensuring the effective functioning of the national system for prevention and counteraction to legalization (laundering) of proceeds of crime, financing of terrorism and proliferation of weapons of mass destruction, as well as the implementation in national legislation of FATF Recommendations (Forty recommendations of Financial Action Task Force on Money Laundering (FATF) (2003)), as well as the provisions of EU Directive 2015/849 of the European Parliament and of the Council on prevention of money laundering and counter-terrorism (DIRECTIVE (EU) 2015/849 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, amending Regulation (EU) No. 648/2012 of the European Parliament and of the Council and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission (2015)).

The Plan also provides for a complex of measures aimed at preventing the emergence of preconditions for legalization (laundering) of proceeds of crime, financing of terrorism and financing of proliferation of weapons of mass destruction, minimizing the risks of using the financial system for legalization (laundering) of proceeds of crime, financing of terrorism and financing of proliferation of weapons of mass destruction, improving the efficiency of law enforcement and other government agencies, and developing international cooperation.

At the same time, in order to normalize new approaches to the prevention, counteraction, investigation and

prosecution of perpetrators of crimes in the economic sphere, the legal framework is being reformed. According to Directive 2005/60/EC of the European Parliament and of the Council of 26.10.2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, significant flows of “dirty” funds could damage the stability and reputation of the financial sector, threaten the single market, and terrorism can undermine the foundations of Ukrainian society. Along with measures criminal law, preventive measures through the financial system can yield results. In order to facilitate criminal activity, money launderers and terrorist financiers may try to enjoy the freedom of movement of capital and the freedom to provide financial services as provided for in the single financial zone, unless certain coordinated measures are taken at Community level (Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (2005)).

It is obvious that one of the most dangerous types of crimes, which leads to the economic decline of the state, is the legalization (laundering) of proceeds of crime. For the first time, the need to combat the legalization (laundering) of proceeds of crime was enshrined in law in the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 20 December 1988, which recognizes the relationship between illicit trafficking and other related forms of organized crime that undermine the legitimate economy and threaten the stability, security and sovereignty of states, and illicit trafficking provides high profits and financial resources, which allows transnational criminal organizations to infiltrate, dismantle and undermine government mechanisms, legitimate trade and financial activities and society at all levels.

The signing of the Association Agreement between Ukraine and the European Union opened the possibility of operational international cooperation in the field of criminal justice. For example, according to Art. 20 of the Agreement, the parties undertake to cooperate in order to prevent and combat legalization (laundering) of proceeds of crime and terrorist financing. To this end, the parties strengthen bilateral and international cooperation in this field, in particular cooperation at the operational level. The parties also ensure the implementation of relevant international standards, in particular the standards of the Financial Action Task Force on Money Laundering, and standards equivalent to those adopted by the European Union (ASSOCIATION AGREEMENT between Ukraine, of the one part, and the European Union, the European Atomic Energy Community and their Member States, of the other part (2014)).

International cooperation in the field of criminal justice should become an effective process and, without cumbersome and lengthy formal procedures, be transformed into an operational process of interaction between authorized persons. According to Global Financial Integrity, with every dollar coming to Ukraine, six leave its territory (Global Financial Integrity works to curtail illicit financial flows by producing groundbreaking research, promoting pragmatic policy solutions, and advising governments).

In recent years, the economy of Ukraine has experienced a rapid outflow of capital to offshore zones, instead, these funds could be used to repay public debt (Table 1).

Table 1. Direct investments from Ukraine to the countries of the world in the period from 2014 through 2017

Country name	Direct investment volume, USD mln			
	2014	2015	2016	2017
Cyprus*	5,811.0	5,818.5	5,819.0	5,930.8
Russian Federation	292.6	362.4	196.9	153.0
Latvia	95.5	98.8	85.0	69.8
Poland	52.3	54.3	52.6	49.6
Georgia	33.0	42.1	36.4	1.8
British Virgin Islands (BVI)*	25.8	25.8	24.2	58.2
Total	6,462.6	6,554.5	6,852.2	6358.7

Source: based on State Statistics Service of Ukraine, * – offshore zone

The question arises: why do investors withdraw money from Ukraine? Everything is explained simply – through ineffective public policy. In Ukraine business does not feel the support of the state, in a crisis the tax burden only increases, which leads to the sale of almost all portfolio investments in Ukraine. Moreover, almost 90% of the capital was exported to Cyprus. The attractiveness of Cyprus is explained by the fact that for many years Ukraine and Cyprus have had an agreement to avoid double taxation, in addition, the proximity of Cyprus plays its role. On the other hand, according to the State Statistics Service of Ukraine (UkrStat), Cyprus is the main investor (Table 2).

Table 2. Direct investments of the countries of the world into the economy of Ukraine from 2014 through 2017

Country name	Direct investment volume, USD mln			
	2014	2015	2016	2017
Cyprus*	17,725.6	12,769.4	10,239.5	9,690.1
Netherlands	9,007.5	6,986.7	6,184.7	5,948.4
Russian Federation	3,525.9	2,338.9	3,036.9	4,317.4
British Virgin Islands (BVI)*	2,275.9	1,988.3	1,715.0	1,683.1
Switzerland	1,351.0	1,391.5	1,390.8	1,451.9
Belize*	1,026.6	652.5	535.1	604.2
Total	53,704.0	40,725.4	36,154.5	37,513.6

Source: based on State Statistics Service of Ukraine, * — offshore zone

In spite of the fact that legally Cyprus is not a offshore zone, the island authorities have created a favorable tax system so as not to lose profits. Today, Ukraine and Cyprus have revised bilateral tax agreements (rates) to prevent the export of capital to this offshore zone.

Thus, offshore zones form structural distortions in the budget, make the economy of a country even more dependent and tied to foreign loan tranches. All of this has a negative impact on the competitiveness and economic security of a country.

It is already clear that offshore zones have a significant impact on the economy of a state, but we consider it necessary to demonstrate this impact in terms of financial security indicators (Table 3).

Table 3. Financial security indicators of Ukraine

Indicators	2012	2013	2014	2015	2016	2017
State budget deficit (surplus), UAH bln	-53.5	-64.7	-78.1	-45.6	-70.1	-47.8
GDP, UAH bln (nominal)	1,405	1,465	1,587	1,980	2,383.2	2,982.1
The ratio of the budget deficit to GDP, %	-3.8	-4.4	-4.9	-2.3	-3	-1.6
Public and state-guaranteed debt, UAH bln	515.5	584.1	1,100.6	1,571.8	1,929.8	2,025
The ratio of public debt to GDP, %	36.7	39.9	70.2	79.4	81	98.2
Gross external debt (GED), UAH bln	135.1	142.1	126.3	118.7	113.6	115.4
Inflation rate (until December of the previous year), %	99.8	100.5	103	143.3	112.4	113.7
International reserves, USD bln USA	24.5	20.4	7.5	13.3	15.5	18.1
The ratio of international reserves to GED, %	18.1	14.4	5.9	11.2	13.6	15.7

Source: calculated by the author based on the data of the State Statistics Service of Ukraine, Ministry of Finance of Ukraine, National Bank of Ukraine

Of course, not only offshores have a detrimental effect on the level of financial security of Ukraine: for example, high inflation rates also significantly worsen the situation. Potential threats to the economic security of Ukraine include events that will occur according to forecast data, which due to their impact will threaten the coordinated functioning and development of a complex of state policies – economic, social and political ones.

Since the threats to financial security are divided into two groups (external and internal), probable threats have already been outlined in many works of security experts. Internal threats: too low level of technological development of industries, incompatible high costs for the production of goods of low quality, which as a whole leads to a low level of competitiveness of the state. External threats: irrational structure of exports and strong dependence on imported goods, “brain drain” (process of mass emigration to more developed countries), inefficient tax policy and customs control, insufficiently established foreign economic relations, etc.

To analyze the impact of capital outflows on the level of financial security indicators, it was decided to build an econometric regression model using AP EViews. It was decided to take the indicators of Cyprus, as, firstly, these data are legally public, and secondly, this jurisdiction is still a key element in money laundering schemes through offshores. In addition, investment from Cyprus and in Cyprus accounts for more than half of total foreign direct investment (FDI). As a result of substitution of all variables and search of regression using STEPLS method, we obtained the following dependence (Figure 1).

Variable	Coefficient	Std. Error	t-Statistic	Prob.
X2	0.000249	1.05E-05	23.78084	0.0268
X3	6.623198	0.002543	2604.864	0.0002
X4	-0.038211	9.92E-06	-3852.855	0.0002
X5	0.719836	0.000268	2681.442	0.0002
X6	-0.294780	0.000279	-1056.368	0.0006
X7	0.392202	0.000147	2675.881	0.0002
X8	1.277542	0.000713	1792.523	0.004
X9	0.200300	0.001045	191.6653	0.0033
C	-346.8385	0.185111	-1873.682	0.0003
Y	0.046985	2.46E-05	1913.344	0.0003
R-squared	1.000000	Mean dependent var		-45.96364
Adjusted R-squared	1.000000	S.D. dependent var		23.24609
S.E. of regression	0.002754	Akaike info criterion		-9.531285
Sum squared resid	7.58E-06	Schwarz criterion		-9.169562
Log likelihood	62.42207	Hannan-Quinn criter.		-9.759301
F-statistic	79168026	Durbin-Watson stat		3.096977
Prob(F-statistic)	0.000087			

Figure 1. Regression model of dependence of indicators of financial security of Ukraine on the volume of capital outflows to Cyprus

Source: built by the author based on calculated indicators

Notes: X1 – deficit (surplus) of the state budget, UAH bln; X2 – GDP, UAH bln (nominal); X3 – ratio of the budget deficit to GDP, %; X4 – public and state-guaranteed debt, UAH bln; X5 – ratio of public debt to GDP, %; X6 – gross external debt (GED), UAH bln; X7 – inflation rate (until December of the previous year), %; X8 – international reserves, USD bln; X9 – ratio of international reserves to GED, %; Y – volume of foreign direct investment (FDI).

Before drawing conclusions about the results of the model, it should be noted that it is adequate. The value of Prob (F-statistic) is less than 0.05, which indicates the adequacy of the model and the significance of the regression as a whole. Moreover, the regression coefficient is significant, as the p-value near t-Statistic is less than 0.05.

The indicator Rsquared is a coefficient of determination that indicates the density of the relationship between the factor (FDI) and the effective feature (indicators). In this model, it is equal to 100%, which indicates the presence of an absolute relationship between these factors – the change in the level of indicators depends entirely on the change in the capital outflow. S.E. of regression (average approximation error) = 0.002754, which indicates the high quality of the model.

We check the model for the presence of autocorrelation. Autocorrelation is a statistical relationship between sequences of single-row values taken with an offset. That is, in the time series, preliminary results affect the future ones.

The presence of autocorrelation of random errors in the regression model leads to erroneous estimates of regression parameters, which in turn leads to overestimation of test statistics, which are used to check the quality of the model (that is, an artificial improvement in model quality compared to its actual level of accuracy is created).

To determine the residual autocorrelation, you can use the Durbin-Watson statistic = 3.09 – it falls into the uncertainty zone, which implies the presence of autocorrelation. That is, we confirmed that the increase in FDI in the n-year affects the level of financial security in the n + 1 year.

The next step in verifying the model is to determine the homogeneity of the variance of random deviations during the study period. In the case when the model has the phenomenon of heteroskedasticity (inconsistency of the value of the variance of the variable under study), this leads to the ineffectiveness of the estimates obtained using LSXY.

To determine heteroskedasticity, we use the Breusch-Pagan-Godfrey test (Figure 2).

Heteroskedasticity Test: Breusch-Pagan-Godfrey				
F-statistic	0.369897	Prob. F(9,1)	0.8655	
Obs*R-squared	8.459043	Prob. Chi-Square(9)	0.4886	
Scaled explained SS	0.142235	Prob. Chi-Square(9)	1.0000	
Test Equation:				
Dependent Variable: RESID^2				
Method: Least Squares				
Date: 02/05/19 Time: 22:55				
Sample: 1 11				
Included observations: 11				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-5.37E-05	0.000149	-0.360533	0.7797
X2	5.90E-09	8.43E-09	0.699094	0.6116
X3	-1.15E-06	2.05E-06	-0.562876	0.6736
X4	-1.72E-09	7.98E-09	-0.214918	0.8652
X5	-1.26E-07	2.16E-07	-0.582678	0.6641
X6	2.06E-08	2.25E-07	0.091610	0.9418
X7	6.31E-08	1.18E-07	0.534755	0.6874
X8	-3.92E-08	5.74E-07	-0.068282	0.9566
X9	7.38E-08	8.41E-07	0.087762	0.9443
Y	6.78E-09	1.98E-08	0.342722	0.7898

Figure 2. Breusch-Pagan-Godfrey heteroskedasticity test

Source: built by the author based on calculated indicators

After analyzing the results, we can conclude that the model has no heteroskedasticity, as Prob (F) and Prob. Chi-Square are greater than 0.05. Therefore, we accept the null hypothesis about the absence of the phenomenon of heteroskedasticity in the model. Accordingly, the model is characterized by the phenomenon of homoskedasticity.

Thus, the built model turned out to be adequate, qualitative and reliable. We can acknowledge the fact that the state of financial security indicators has an absolute dependence on the volume of capital outflows to offshore jurisdictions.

In Ukraine, the strategic direction of development is largely due to socially oriented state policy, which is determined by the goals, objectives, directions and priorities for the short term. At the same time, many reforms do not, unfortunately, yield the desired result. Problems of formation and implementation in practice of effective public policy throughout the country are of particular importance.

An integral part of the world economy are offshore jurisdictions, which provide free access to the international market. The economic crisis is only exacerbating the problem of tax optimization and increasing the use of offshore zones. However, the use of offshore jurisdictions, which includes criminal activity, is becoming a threat to the world economy and, in particular, to Ukraine.

Offshore companies are used as the main tool for close communication between state, large private and foreign capital. Also, regardless of the political affiliation of the ruling parties, the Ukrainian executive is traditionally represented by the regulator of offshore relations, which protects the interests of large financial and industrial groups. This contributes to the further distribution of assets and capital abroad.

Depending on the specific offshore jurisdiction, an offshore company may have the following specifics and advantages:

Registration is fairly simple, and in some cases, the process can only take from 24 to 48 hours. Of course, this requires the preparation and submission of the necessary documentation before submitting a package of documents for registration to the relevant authorities.

Minimum commissions – the amount associated with this activity is low, after the cost of starting work; in many jurisdictions, the fee is \$200-300 per year.

Flexible management and minimum reporting requirements – minimum number of directors and shareholders. Financial statements, information on accounts and annual income are either not required at all or remain minimal.

Absence of currency control – most jurisdictions have no restrictions on foreign currency.

Favorable local corporate law. Favorable legal framework to encourage and stimulate the development of offshore industry and foreign investment, which supports and gives companies high flexibility.

High confidentiality. Owner information, accounting and financial information remain confidential, although to varying degrees depending on jurisdiction. Some of them have the least available information (Hong Kong and New Zealand), while others (Nevis, Panama, Seychelles) have absolutely no public information. The presence and use of nominal shareholders and directors give absolute anonymity.

Tax benefits. Most jurisdictions offer low corporate taxes. This category includes income, sales, capital gains, value added, property, succession, gift and state taxes.

Freedom of investment opportunities. It is not limited to business activity. Companies can conduct virtually any economic, financial or business activity. In some jurisdictions formalities and licensing are required to carry out certain types of business operations (such as banking, insurance, real estate operations).

Relocation opportunities. Smooth transitions between jurisdictions are offered without any necessary restructuring or complicated documentation.

According to the IMF and the World Bank, an average of \$11.7 billion has been laundered annually through shadow schemes in Ukraine since 2004, and \$14 billion 200 million has been withdrawn through shadow schemes in 2015, most of which through shadow offshore operations (Trends in the shadow economy (2019)).

Since 1991, when the shadow economy of Ukraine was estimated at 38.96% of GDP, the figure has been growing steadily until 1998 reaching a peak of 57%. The negative trend was observed until 2008, when the figure dropped to 36.65%. The financial crisis was the cause of this trend, and during 2009-2014 the level of the shadow economy ranged from 39.2% to 43.5%. In 2015, the shadow economy of Ukraine was estimated at 42.9%.

According to the calculations of the Ministry for Development of Economy, Trade and Agriculture in January-September 2016, the level of the shadow economy amounted to 35% of official GDP, which is 7.9% percentage points less than in the corresponding period of 2015 (Trends in the shadow economy (2019)). According to the calculations of the Ministry for Development of Economy, Trade and Agriculture in January-September 2017, the level of the shadow economy amounted to 33% of official GDP, which is 3 percentage points less than in the corresponding period of 2016 (Figure 3).

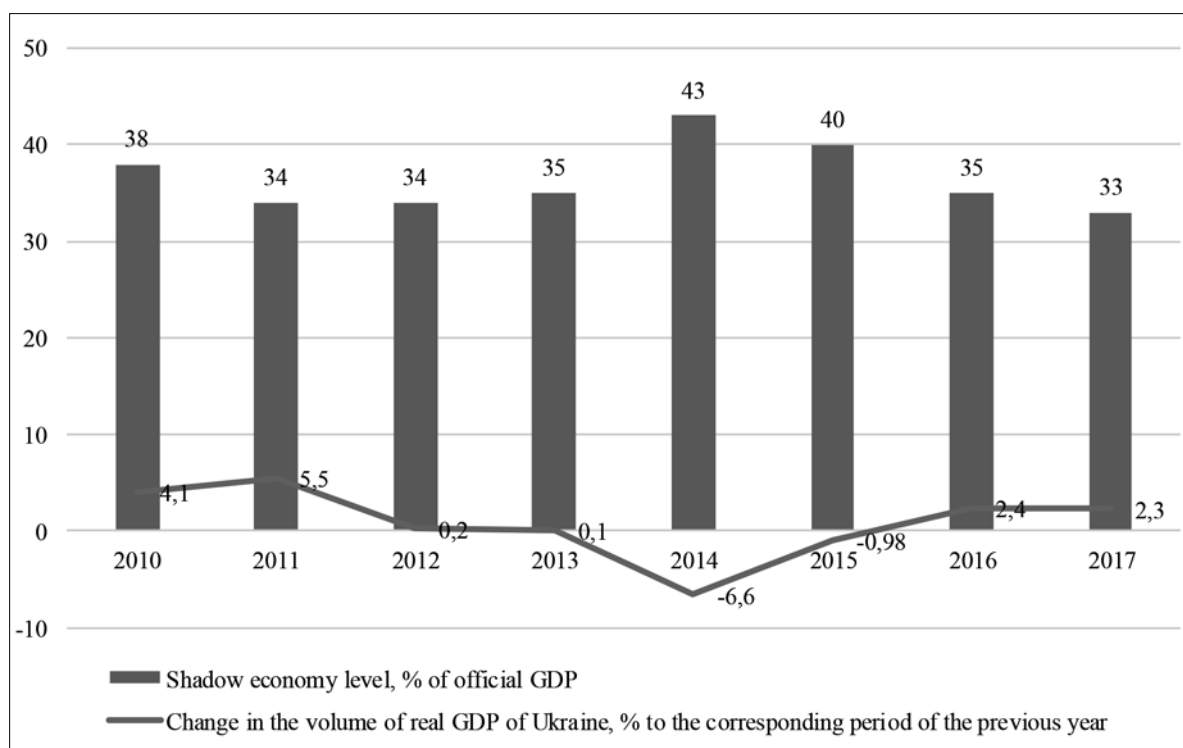


Figure 3. Integral indicator of the level of the shadow economy in Ukraine (in % of the volume of official GDP) and increase/decrease rates of the level of real GDP (in % to the corresponding period of the previous year)

Source: built by the author based on Trends in the shadow economy (2019)

Ukraine ranks the 16th in the world by the scale of shadow capital operations. In previous decades, the following criminal procedure of tax optimization has been developed. A Ukrainian company sells goods (metal, grain, etc.) at an excessively low price to its front company with offshore jurisdiction in Cyprus or other islands. In turn, the offshore company sells goods at higher world prices (by several times). The main reasons for the problem are export of capital through offshore companies, not only business but also government; low attractiveness for doing business; insignificant ability of the economy to productively attract investment; unstable macroeconomic situation.

First of all, it is necessary to legally recognize the lists of “black”, “white” and “gray” offshore zones made by the OECF, FATF, FinCEN and other companies. The next step should be a total ban on any economic relations with at least “black” and “gray” offshore zones. On the other hand, to improve the economy and financial security of the country, several reforms are needed, as it is impossible to eradicate the titans of international relations – offshore zones – completely, but they can be made less attractive to businesses.

If you think about why Ukrainian society is trying to avoid taxes and take money offshore, the answer is out in the open. A person will not evade taxes if he/she sees where the taxes go – to increasing the level of medicine (professional and quality of equipment), the quality of education, the general condition of cities, etc. By ensuring this the state will slightly reduce interest in offshores. In many works it is argued that taxes in Ukraine need to be reduced, that only this will help to improve the economic situation.

Of course, it would be a mistake to think that it is possible to remove the element of “offshore” from the international economic relations of Ukrainian businesses, but the goal of Ukraine is to optimize the amount of capital going offshore. If we reduce the outflow of capital by at least a third, it will be an additional 2.6 billion dollars in the budget. These additional funds (which, actually, should have been in the state budget) will allow to repay the state debt in a relatively short time, and to improve the situation with GDP – this will give the economy some stability. With economic stability, less volatile exchange rate will come, and the rate of inflation will also decrease, a comprehensive improvement of these indicators will lead to an improvement in the state of the financial security of Ukraine.

That is, the program of deoffshorization of the economy of Ukraine should be based on several systemic principles: cardinal improvement of the conditions for economic activity, including institutional and political reforms; increasing the degree of responsibility for violations of tax legislation in accordance with international practice; ensuring the transparency of all economic actors operating in Ukraine; access to a qualitatively new level of international cooperation in the exchange of tax information and the detection of fiscal violations.

5. Discussion

Based on the above principles, it is possible to form specific proposals for deoffshorization of the economy of Ukraine.

1. It is necessary to change the ratio of the factors that contribute to the attraction and withdrawal of capital from the country. To do this, it is necessary to improve conditions for doing business, create a favorable investment climate for both domestic and foreign investors. These changes will be systemic in nature and will provide for: increasing the transparency of court proceedings, stability of laws and compliance with them, proper protection of property, development of financial infrastructure, restoration of trust between the population and the authorities and much more.
2. It would be appropriate to develop legislation on national companies, that is, to expand existing legislation by introducing the concept of “national company”, which must meet the following criteria: being registered in Ukraine, being a major taxpayer (that is, forms at least 5% of the state budget), trading on the Ukrainian stock exchange (this still requires reforms in stock trading, which will ensure the real functioning of Ukrainian stock exchanges), having stable financial performance and spending on social projects at least 1% of revenue. These characteristics can be adjusted, however, in our opinion, such innovations can enable the state to reduce the risk of the transition of the national company under the control of foreign TNCs. At the same time, the legislation should provide certain privileges to companies that meet the established characteristics. For example, getting a certain interest rate discount when receiving a loan. The creation of a national company should help optimize the scope of cooperation with offshore jurisdictions.
3. State-owned companies should gradually reduce the use of offshore traders and asset purchase agreements with offshore companies or parent companies.
4. It is important to increase the effectiveness of control over transfer pricing, which is an important channel for legal and illegal movement of capital offshore. This will be possible subject to the introduction and functioning of changes in tax legislation. Since, according to expert estimates, in 2017 every seventh check of transfer prices in the world ended with the application of penalties for violations of transfer pricing rules, this issue requires a very deep and differentiated approach.
5. Deoffshorization cannot be effective without increasing liability for non-compliance with tax laws. Harmonization of anti-offshore and tax policies is one of the key processes.
6. Fighting corruption that destroys the economy of a country is also one of the components of the process of

deoffshorization. Effective measures should be taken regarding anti-corruption policy, in the fight against the “division” of the state budget. Corruption not only facilitates the outflow of capital to offshore areas but is also supported by offshore capital.

There is a trend of financial equality and transparency in the world, which can be achieved under the condition of real deoffshorization of the economy of Ukraine. It is necessary to create an attractive investment climate, and later the concept of national economic patriotism.

Conclusions

Offshorization is a process that began many decades ago and continues to evolve still improving today. Over time, the role of offshore zones has become increasingly important in the world economy. Today, offshorization has a detrimental effect on economies due to the rapid outflow of capital. This process has affected both developed countries with stable economies and countries with the opposite situation: unstable economic and political situation, high inflation, inefficient tax and customs policies. Thus, the problem of uncontrolled outflow of capital has become a threat to global financial security and financial security of Ukraine, in particular.

Over the past three years in Ukraine the outflow of capital has grown to almost 8 billion US dollars per year, with an increase in the so-called investment in leading offshore areas such as Cyprus, the Virgin Islands, etc. The state has been experiencing a budget deficit for the last ten years, and the state debt is only growing. Lack of capital results in a lack of receipts (taxes), which leads to a budget deficit.

At the international level, the problem of money laundering in offshores is already being actively combated. Such organizations as the OECD, FATF and others implement a very effective anti-offshore policy that allows to restrain and regulate the flow of capitals, preventing their outflow to offshores. At present, Ukraine needs to implement such a policy of controlling activities with offshore zones, because at the current rates, the outflow of capital would only increase thereby deteriorating the level of financial security. Reforms should be carried out to stimulate public awareness of the payment of taxes. Over time, understanding that taxes do not need to be avoided by taking capital offshore will contribute to improvement. With tax revenues, the main economic indicators that characterize financial security will be optimized. Therefore, anti-offshore policies should be implemented as soon as possible to improve financial stability.

Thus, the outflow of Ukrainian capital to offshore zones is primarily due to the prevailing unfavorable investment and tax climate. Such factors as instability in the economic and political spheres, low level of financial market infrastructure development, inconsistency and dynamic variability of legislation, form an unattractive investment climate in Ukraine. For these reasons, domestic and foreign investors invest in other countries, which are characterized by more favorable conditions. Today there are various opportunities for deoffshorization of the economy of Ukraine. According to international experience, firstly, it is impossible to achieve full deoffshorization, and secondly, it is not necessary. The use of offshore zones should be optimized so as to benefit the business sector without compromising the financial security of the state. Subject to introduction of systemic reform, which would contribute to the creation of an attractive investment climate and business environment, improvement of legislation and compliance with recommendations provided by international organizations, it is possible to achieve a stable state of financial security of Ukraine.

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