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LONG-TERM CONSEQUENCES OF CAPITAL OUTFLOWS FOR TRANSITION COUNTRIES

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ABSTRACT

One of the most common and urgent problems for every country in the world is the problem of capital outflow abroad. This problem is especially serious for transition countries. These countries, moving away from the former economic systems, are trying to adapt their economies to the market conditions. So, the aim of the work is to analyze and study the basic principles of long-term consequences of capital outflows for transition countries, being based on the relevance of the subject of the scientific article. Theoretical and methodological principles of the research concerning the long-term consequences of capital outflows for transition countries in the scientific article are presented on the basis of such research methods as observation, analysis, comparison, description and generalization. The information base for comparing the trends of capital outflow for transition countries is The World Bank statistics, data from the independent international Tax Justice Network and data from the Wall Street Journal and Heritage Foundation. The presentation of practical results of capital *outflows from transition countries (some EU countries and some members of the Commonwealth of Independent States, Georgia and Ukraine) is given using the following indicators: 1) Growth rates of foreign direct investment from transition countries abroad, %; 2) Growth rates of foreign direct investment in the economy of transition countries, %; 3) the share of transition countries in the structure of the global offshore market in 2020, %; 4) index of economic freedom of transition countries. Based on the results of analysis and study of the theoretical and practical principles of capital outflows for transition countries, it is established that such actions will have the following consequences for transition countries. Here we are talking about: reduction of private investment; high rate of financial transactions with offshore jurisdictions; high level of political instability in the country; high level of corruption in the country at various levels of government; devaluation of the national currency; high level of speculation in the financial and particularly in the credit and foreign exchange markets; low level of lawfulness in the system of capital export in other countries. It was found that the share of transition countries (Bulgaria, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, Hungary, Croatia, the Czech Republic, Russia and Ukraine) in the structure of the global offshore market is only 0.94%. Estonia, Lithuania, the Czech Republic and Georgia have the highest levels of economic freedom among the transition countries under study, while Tajikistan, Turkmenistan, Uzbekistan and Ukraine have the lowest levels of economic freedom.*

Key words: Capital outflow, Transition country, Transition economy, Market economy, Offshore jurisdiction

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1. INTRODUCTION

In the period of globalization changes, which have a significant impact on the development of every country in the world, there are many problems that need to be solved urgently. The most common and most pressing problem for every country in the world is the problem of outflowing capital abroad. This problem is especially serious for transition countries, as these countries, moving away from the former economic systems, are trying to adapt their economies to market conditions.

So, the relevance of the topic of the scientific article is aimed at studying the features and main trends in capital outflowing from transition countries in the context of determining the impact of key effects of such actions on the development of transition countries.

2. LITERATURE REVIEW

The disclosure of the theoretical information of capital outflow abroad is presented today by many scientists and academics.

In [1] is interpreted the concept of capital outflow as: "the movement of assets out of a country". According to the scientist: “capital outflow is considered undesirable as it is often the result of political or economic instability” [1].

So, researchers in [2], considering the issue of capital outflows, argue that in order to determine the effectiveness of restrictions concerning capital outflows a "panel vector autoregression approach with interaction terms" should be used. However, scientists say that the application of such an approach to determining the effectiveness of restrictions will establish: "whether the outflow restrictions helps reduce net capital outflows" [2].

At the same time, in a study [3] of the peculiarities of the capital outflow abroad in the form of investment, states that the capital outflow abroad has a significant impact on reducing private investment. However, talking about the volume of public investment, the capital outflow abroad has no effect on the change in their trends [3].

Studying the issue of capital outflows in Poland, was pointed out that the inflow of capital into the financial system of Poland is an important factor of modernizing this system [4]. So, the results of the study that was conducted by the scientists have shown that the presence of foreign investors in the Polish financial market has influenced not only the development of this market, but also the liquidity of financial assets, as well as the development of the Polish banking sector [4].

At the same time, researcher in [5] studied the peculiarities of capital outflows from Russia. He proposes to the government to develop domestic production and increase the level of security and protection of the private sector in order to return them [5].

In the process of disclosing the theoretical foundations of the capital outflows abroad, it should be noted that in [6] was proposed to implement the following measures in order to prevent the illegal capital outflows abroad. Here it is about:

- to promote the development of the institutional environment of the financial market;
- to improve the corporate governance system;
- to improve the system of currency regulation;
- to reduce the level of financial transactions with offshore jurisdictions;
- to motivate the return of national capital from other countries due to the usage of open market operations.

While in [7] researchers emphasize aspects such as capital outflows and government borrowing. The greater the outflow of capital from states, the more borrowing the state needs, which weakens its financial position [7].

At the same time, in [8] was stated that countries should not only diversify creditor countries, but also improve macroprudential policies concerning capital management in the country in order to avoid large volumes of capital outflows abroad.

3. MATERIALS AND METHODS OF RESEARCH

Theoretical and methodological principles of research on the long-term consequences of capital outflows for transition countries in the scientific article are presented on the basis of the usage of such research methods as observation, analysis, comparison, description and generalization.

The information base for trends comparing of capital outflows for transition countries is The World Bank statistics [9], data from the independent international Tax Justice Network [10] and data from the and Heritage Foundation [11].

The presentation of practical results of capital outflows from transition countries (some EU countries and some members of the Commonwealth of Independent States, Georgia and Ukraine) is given using the following indicators:

- Growth rates of foreign direct investment from transition countries abroad, %;
- Growth rates of foreign direct investment in the economy of transition countries, %;
- the share of transition countries in the structure of the global offshore market in 2020, % (according to [10]);
- index of economic freedom of transition countries (according to [11]).

4. RESULTS OF THE RESEARCH

The analysis of the dynamics and growth rates of foreign direct investment from transition countries abroad showed that the highest growth rate in transition countries in the period 2014-2018 generally occurred only in 2016. The increase compared to the previous year was 215.45% (Table 1). On the other hand, in 2014-2015 and in 2017-2018, compared to the same period of the previous year, the volume of foreign direct investment to other countries generally decreased in transition countries. So, the largest rate of decline in foreign direct investment abroad from transition countries occurred in 2018, where, compared to 2017, the decline in foreign direct investment abroad was 155.62%.

Table 1 Growth rates of foreign direct investment from transition countries abroad, % [9]

Country	2014	2015	2016	2017	2018
In general, in transition countries,	-3,94	-58,63	215,45	-61,56	-155,62
in particular:					
1. Members of the EU	635,57	-76,90	1404,96	-95,34	-1441,87
including:					
Bulgaria	151,00	-87,99	684,39	-38,59	70,95
Estonia	33,44	-150,63	-163,47	73,56	-138,03
Latvia	36,23	-78,40	56,92	157,57	-157,84
Lithuania	64,12	-34,58	127,78	-28,65	40,38
Poland	-299,33	-27,74	183,39	-71,80	-51,40
Romania	-544,76	1326,02	-67,29	-69,24	289,16
Slovak Republic	-78,13	407,96	187,22	-63,21	8,90
Slovenia	562,82	53,20	46,59	32,14	-30,95
Hungary	-339,09	-188,27	-917,67	-121,78	372,86
Croatia	-1490,10	-100,76	1604,19	-324,88	-30,57
Czech Republic	-47,34	-8,54	-15,75	199,45	-53,25
2. Member States of the Commonwealth of Independent States	-28,74	-51,39	-5,11	37,81	-28,21
in particular:					
Azerbaijan	34,45	61,51	-19,81	-0,36	-31,33
Belarus	-72,01	45,23	15,29	-44,83	-18,58
Armenia	-4,82	-0,18	145,27	-58,80	-75,87
Kazakhstan	33,21	25,93	4,77	-72,47	-585,49
Kyrgyz Republic	-1697,72	19,88	-70,17	-172,22	-117,04
Moldova	32,74	-82,10	82,35	-19,43	293,30
Russian Federation	-34,01	-61,31	1,04	64,72	-14,64
Tajikistan	101,13	29,40	-93,72	249,71	-123,05
Turkmenistan	33,85	-20,55	-26,28	-7,01	-4,83
Uzbekistan	19,33	-91,22	-91,25	55,07	-78,81
Other transition countries	71,28	-62,95	65,68	-24,35	-7,60
including:					
Georgia	219,38	-22,35	30,82	-49,33	40,29
Ukraine	27,44	-93,07	355,26	35,26	-50,43

If we are talking about territory, the largest volumes of foreign direct investment abroad are made by transitional members of the EU, in contrast to transitional members and countries of the Commonwealth of Independent States and other transitional states (Georgia and Ukraine). So, during 2014-2018, a significant (highest) increase in foreign direct investment abroad from transition member states of the EU occurred in 2016, where the growth rate was 1404.96% compared to the previous year.

Instead, during the study period, the largest decline in foreign direct investment abroad from transition member states of the EU was in 2018, where the rate of decline was 1441.87% compared to the previous year. Among the transition countries of the EU, the largest increases during 2014-2018, compared to the previous year, were Bulgaria (151.00% in 2014 and 685.39% in 2016), Latvia (157.57% in 2017)), Poland (183.39% in 2016), Romania (1326.02% in 2015 and 289.15% in 2018), Slovakia (407.96% in 2015 and 187.22% in 2016) , Slovenia (562.82% in 2014), Hungary (372.86% in 2018), Croatia (1604.19% in 2016) and the Czech Republic (199.45% in 2017). Instead, the largest declines during 2014-2018, compared to the previous year, among the transition countries of the EU were Estonia (150.63% in 2015 and 163.47% in 2016), Latvia (157.84% in 2018), Poland (299.33% in 2014), Romania (544.76% in 2014), Hungary (339.09% in 2014, 188.27% in 2015 and 917.67% in 2016) and Croatia (1490.10% in 2014 and 324.88% in 2017).

Now let’s talk about the transition countries of the Commonwealth of Independent States. Armenia, Moldova and Tajikistan showed a significant increase in foreign direct investment abroad between 2014 and 2018. Instead, transition countries such as Kazakhstan and Kyrgyzstan have shown significant reductions in foreign direct investment. Compared to other transition countries, the largest increase in foreign direct investment during the study period occurred in Georgia (219.38% in 2014) and Ukraine (355.26% in 2016). At the same time, during this period of time there was no significant decline in foreign direct investment abroad in Georgia and Ukraine.

In the analysis of the dynamics and growth rates of foreign direct investment in the economies of transition countries, it was found that in the period of 2014-2018 the highest growth rate in the economies of transition countries occurred only in 2016, where the increase compared to the previous year was 254.11% (Table 2). On the other hand, in 2014-2015 and in 2017-2018, compared to the same period of the previous year, the volume of foreign direct investment in the economies of these countries generally decreased in transition countries. So, the largest rate of decline in foreign direct investment in the economies of transition countries occurred in 2018, where, compared to 2017, the decline in foreign direct investment was 106.21%.

The largest volumes of foreign direct investment in the regional structure were made in the economies of the transition countries of the EU, in contrast to the transition member states of the Commonwealth of Independent States and other transition states (Georgia and Ukraine). Thus, during 2014-2018, a significant (highest) increase in foreign direct investment in the economies of transition member states of the European Union occurred in 2014 and 2016, where the growth rate was 250.99% and 429.66%, compared to previous year.

Instead, during the period under review, the largest decline in foreign direct investment in the economies of transition countries of the EU was in 2018, where the rate of decline was 179.62% compared to the previous year. Among the transition countries of the EU, the largest increases during 2014-2018, compared to the previous year, were Latvia (241.08% in 2017), Lithuania (192.73% in 2015), Poland (2387.55% in 2014), Slovakia (211.95% in 2016), Slovenia (879.96% in 2014), Hungary (444.06% in 2018), Croatia (322.47% in 2014 and 1072, 76% - in 2016) and the Czech Republic (538.30% in 2016).

On the other hand, the largest declines in foreign direct investment in the economy during 2014-2018, compared to the previous year, among the transition countries of the EU were Estonia (140.16% in 2015 and 229.37% in 2016), Slovakia (519, 09% in 2015) and Hungary (464.14% in 2014, 140.32% in 2015 and 1423.12% in 2016).

Table 2. Growth rates of foreign direct investment in the economy of transition countries, % [9]

Country	2014	2015	2016	2017	2018
Generally in transition countries	-10,81	-47,37	254,11	-57,87	-106,21
in particular:					
1. Member States of the EU	250,99	-59,56	429,66	-74,54	-179,62
including:					
Bulgaria	-17,10	-11,26	-24,54	2,36	11,77
Estonia	62,27	-140,16	-229,37	84,08	-30,73
Latvia	5,24	-21,92	-59,01	241,08	-60,67
Lithuania	-50,08	192,73	-7,78	23,79	-27,18
Poland	2387,55	-23,82	21,61	-35,80	41,96
Romania	0,37	11,59	44,80	-4,78	23,36
Slovak Republic	-136,14	-519,09	211,95	-10,91	-39,61
Slovenia	879,96	69,73	-16,41	-17,29	27,39
Hungary	-464,14	-140,32	-1423,12	-117,27	444,06
Croatia	322,47	-95,99	1072,76	9,45	-37,06
Czech Republic	9,94	-78,98	538,30	3,54	-24,40
2. Member States of the Commonwealth of Independent States	-53,98	-39,38	145,91	-30,20	-64,34
including:					
Azerbaijan	69,14	-8,64	11,17	-36,27	-51,07
Belarus	-45,02	99,30	-32,26	36,83	-39,49
Armenia	17,48	-54,71	81,25	-24,81	1,28
Kazakhstan	-27,00	-9,99	161,80	-72,63	-95,46
Kyrgyz Republic	-43,95	233,53	-45,87	-117,31	-234,52
Moldova	42,69	-34,64	-60,81	74,65	102,03
Russian Federation	-68,17	-68,89	374,81	-12,24	-69,24
Tajikistan	15,35	39,01	-46,78	-23,09	18,85
Turkmenistan	33,85	-20,55	-26,28	-7,01	-4,83
Uzbekistan	19,33	-91,22	2400,54	8,11	-65,24
Other transition countries	-51,69	78,30	6,52	-7,21	-21,88
including:					
Georgia	75,52	-5,53	-4,56	14,87	-35,94
Ukraine	-81,22	260,09	12,82	-17,84	-12,42

Concerning the transition countries of the Commonwealth of Independent States - Kazakhstan, Kyrgyzstan, Russia and Uzbekistan – they showed a significant increase in foreign direct investment in the economy in the period 2014-2018. At the same time, a significant decline in foreign direct investment in the economy took place in Kyrgyzstan. Compared to other transition countries, the largest increase in foreign direct investment during the study period took place in Ukraine (260.09% in 2015). There was no significant decline in foreign direct investment abroad in Georgia and Ukraine during the study period.

According to the results of [10], which was presented by the independent international network Tax Justice Network, it was found that the share of the offshore market represented in the ranking of transition countries, namely Bulgaria, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, Hungary, Croatia, the Czech Republic, Russia and Ukraine was only 0.94% in 2020 (Figure 1). Among the mentioned above transition countries, Russia, Poland, Hungary and the Czech Republic have a significantly higher share in the structure of the global offshore market. On the other hand, the share of Bulgaria and Slovenia is the lowest in the list of transition countries.

According to [11], Estonia, Lithuania, the Czech Republic and Georgia have the highest level of economic freedom among transition countries in 2013 and 2017, as well as in 2020 (Table 3). As for countries with a low level of economic freedom, it is present in Tajikistan, Turkmenistan, Uzbekistan and Ukraine.

According to research by the Corporate Finance Institute [12], one of the effective methods of reducing legal and illegal capital outflow abroad is the development of a number of rational programs by the government in each country where such trends are observed. So, in the context of preventing both legal and illegal capital outflow abroad, the government of each state needs to implement a clear policy of controlling the capital flowing.

In addition, the country needs to create a number of judicial and political institutions. The main goal of these institutions should be ensuring political stability in the country by reducing the level of corruption in the political sphere [12].

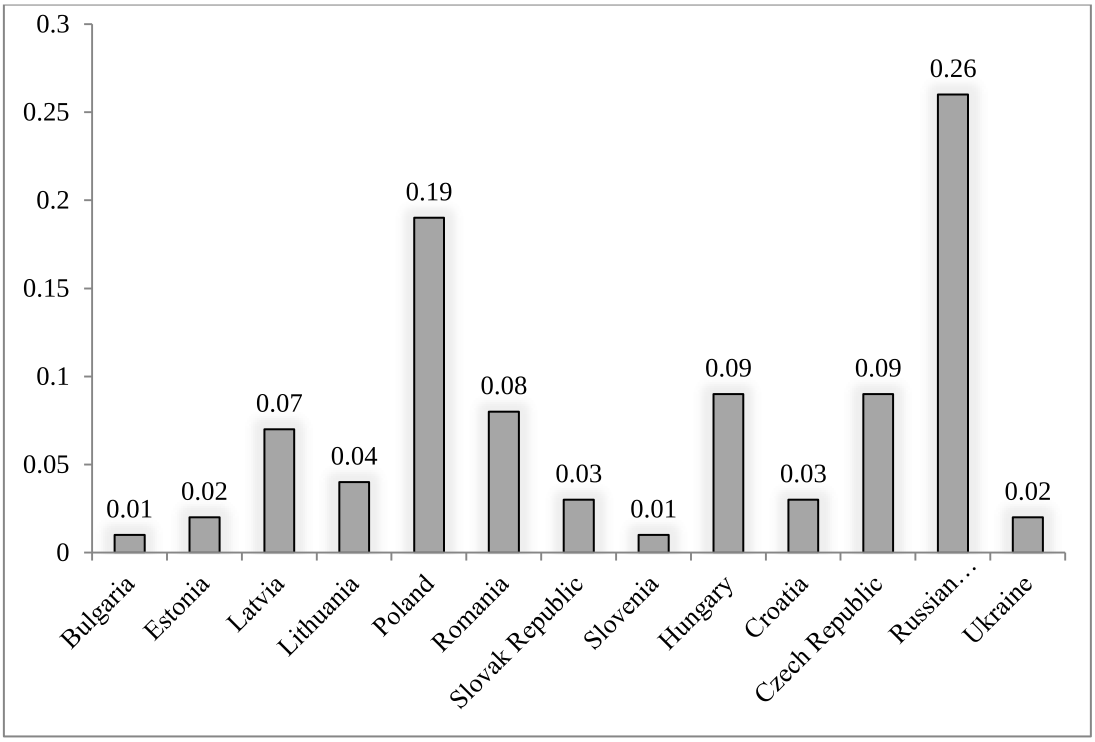

Figure 1. The share of transition countries in the structure of the global offshore market in 2020, % (according to [10])

Table 3. Index of economic freedom of transition countries (according to [11])

Country	2013		2017		2020	
	Rank	**Index of Economic Freedom**	**Ran k**	**Index of Economi c Freedom**	**Ran k**	**Index of Economic Freedom**
Members of the EU						
Bulgaria	60	65,0	47	67,9	36	70,2
Estonia	13	75,3	6	79,1	10	77,7
Latvia	55	66,5	20	74,8	32	71,9
Lithuania	22	72,1	16	75,8	16	76,7

Poland	57	66,0	45	68,3	46	69,1
Romania	59	65,1	39	69,7	38	69,7
Slovak Republic	42	68,7	57	65,7	60	66,8)
Slovenia	76	61,7	97	59,2	52	67,8
Hungary	48	67,3	56	65,8	62	66,4
Croatia	78	61,3	95	59,4	84	62,2
Czech Republic	29	70,9	28	73,3	23	74,8
Members of the Commonwealth of Independent States						
Azerbaijan	88	59,7	68	63,6	44	69,3
Belarus	154	48,0	104	58,6	88	61,7
Armenia	38	69,4	33	70,3	34	70,6
Kazakhstan	68	63,0	42	69,0	39	69,6
Kyrgyz Republic	89	59,6	89	61,1	81	62,9
Moldova	115	55,5	110	58,0	87	62,0
Russian Federation	139	51,1	114	57,1	94	61,0
Tajikistan	131	53,4	109	58,2	155	52,2
Turkmenistan	169	42,6	170	47,4	170	46,5
Uzbekistan	162	46,0	148	52,3	114	57,2
Other countries						
Georgia	21	72,2	13	76,0	12	77,1
Ukraine	161	46,3	166	48,1	134	54,9

In addition, in the study [12] of legal and illegal capital outflow abroad, has found that the most common forms of capital outflows are the forms presented in Figure 2.

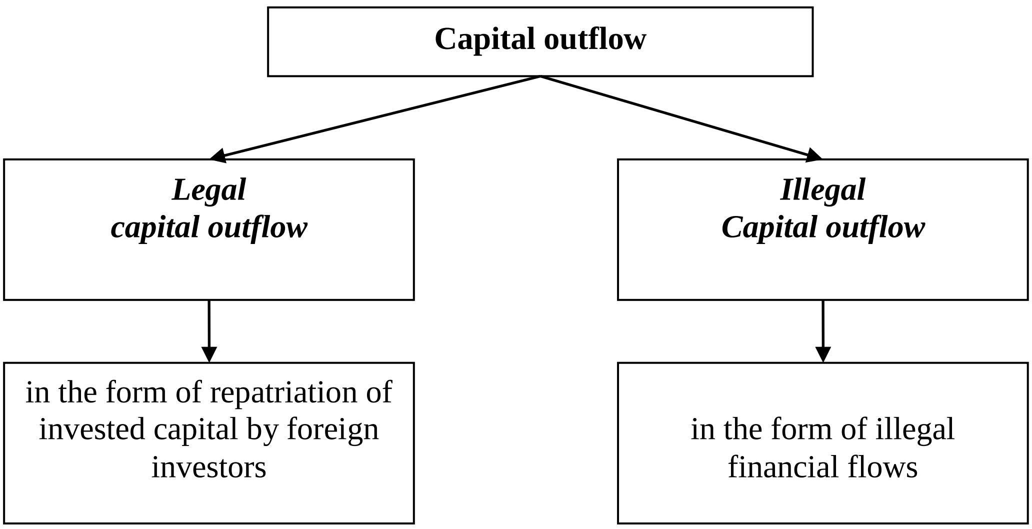

Figure 2 Forms of capital outflow [12]

According to [13], today the main long-term consequences of capital outflows are:

- political instability;
- significant levels of corruption in the country and political spheres;
- depreciation of the national currency due to significant inflation;
- low obedience to the law, due to which there is a danger to life and illegal violation of property rights;
- significant speculation in the financial and foreign exchange markets;

- changes in the activities of the state leadership;
- easy access to credit markets for the aim of further forgery of credit documents, etc.

5. DISCUSSION

Based on the results of analysis and study of theoretical and practical principles of capital outflows in transition countries, it is established that such actions will have the following consequences for transition countries. It is about:

- reduction of private investment;
- high level of financial transactions with offshore jurisdictions;
- high level of political instability in the country;
- high level of corruption in the country at various levels of government;
- depreciation of the national currency of the state;
- high level of speculation in the financial sphere, in particular in the credit and foreign exchange markets;
- low obedience to the law in the system of capital outflow abroad.

The study has also found that the share of transition countries (Bulgaria, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, Hungary, Croatia, the Czech Republic, Russia and Ukraine) according to the Financial Secrecy Index 2020, that is presented by an independent international Tax Justice Network, in the structure of the global offshore market is only 0.94%.

In addition, the results of the study [11] has shown that Estonia, Lithuania, the Czech Republic and Georgia have the highest levels of economic freedom among the transition countries that were under study in this work, while Tajikistan, Turkmenistan and Uzbekistan have the lowest levels of economic freedom and here we have also Ukraine.

6. CONCLUSIONS

So, a number of key indicators have been studied, which can be used in order to determine the main trends in the capital outflows abroad from transition countries as a part of the disclosure of the aim of this scientific work.

At the same time, the results of processing the data of the World Bank [9] have shown that there were significant changes in the dynamics of capital outflows abroad in the transition countries during the period 2013-2018.

The study of the results of the independent international network Tax Justice Network, Heritage Foundation and Corporate Finance Institute suggests that one of the key tasks today at the highest level of management of transition countries should be to development and implementing methods and measures in order to minimize and prevent capital outflows abroad. Moreover, the return of exported national capital from abroad to the economy of each of the countries is also very important.

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