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Capital flight from sub-Saharan Africa: linkages with external borrowing and policy options

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Abstract

Even as African countries became increasingly indebted, they experienced large-scale capital flight. Some of this was legitimately acquired capital fleeing economic and political uncertainties; some was illegitimately acquired wealth spirited to safer havens abroad. This paper presents new estimates of the magnitude and timing of capital flight from 33 sub-Saharan African countries from 1970 to 2004. We then analyze its determinants, including linkages to external borrowing. Our results confirm that sub-Saharan Africa is a net creditor to the rest of the world, in that the subcontinent's private external assets exceed its public external liabilities: total capital flight amounted to $443 billion (in 2004 dollars), compared to the external debt of $195 billion. Econometric analysis indicates that for every dollar in external loans to Africa in this period, roughly 60 cents flowed back out as capital flight in the same year, a finding that suggests the existence of widespread debt-fueled capital flight. The results also show a debt-overhang effect, as increases in the debt stock spur additional capital flight in later years. In addition to policies for recovery of looted wealth and repatriation of externally held assets, we discuss the need for policies to differentiate between legitimate and odious debts, both to ease current burdens on African countries and to improve international financial governance in the future.

Keywords:

capital flight external debt stolen assets odious debt

JEL Classifications:

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Notes

1. For discussions of the methodology for the computation of capital flight, see Lessard and Williamson (1987), Ajayi (1997) and Boyce and Ndikumana (2001).

2. Boyce and Ndikumana (2003) report estimates of capital flight for the period 1970–96 for a sample of 30 countries included in this study. For these countries and this period, we simply convert these series to 2004 dollars, and add the further adjustments for debt write-off and unrecorded remittances. A detailed description of the algorithm

we use to compute capital flight and a dataset on annual flows are provided in a working paper available from the authors.

3. Of course, some of Africa's flight capital has been dissipated in consumption. For this reason, the cumulative stock reported in Table 1 can best be regarded as a measure of the opportunity cost of capital flight rather than assets actually available today. By counting imputed interest earnings, we obtain a measure that is comparable to the external debt stock, since the latter includes interest arrears and debt contracted to service previous debt.

4. The study by Hermes and Lensink (1992) covers six countries (Congo-Zaïre, the Ivory Coast, Nigeria, Sudan, Tanzania and Uganda) over the period 1976 to 1989. They used the somewhat narrower 'non-bank' definition of capital flight proposed by Morgan Guaranty Trust (1986), which excludes assets held abroad by domestic banks.

5. For a more extensive review, see Ndikumana and Boyce (2003).

6. Kahn (1991, iv) suggests that in the South African case, in some periods 'the need to finance capital flight might account for all the accumulation of external debt'.

7. Predicted inflation is obtained from a linear regression of inflation on time.

8. 'Fuel exports' consist of 'mineral fuels' (SITC Section 3) as reported in the World Bank Africa Database (World Bank 2006b) (and World Development Indicators [World Bank 2006c]).

9. As a proxy of governance we used the Polity2 index from Polity IV Project's database which ranges from −10 (strongly autocratic) to +10 (strongly democratic).

10. We also experimented with various measures of natural resource endowment, including the share of various natural resources in total exports as well as a dummy taking the value of one if the share of natural resources in total exports is greater than 75% and zero otherwise. These too yielded weak results.

11. Again the use of country fixed effects, which masks inter-country differences in the polity index, may be part of the explanation. Summary statistics for our sample show that capital flight is lowest in countries with either the most democratic or the most autocratic regimes, and highest in countries in the intermediate range.

12. These data are published by the Bank for International Settlements (2007).

13. This proxy of capital flight is positively correlated with our broader measure of capital flight. The correlation coefficient (using the panel data) between capital flight and foreign bank liabilities is 0.33 (significant at 1% level); the correlation of the two variables as ratios of GDP is 0.08 (significant at 10% level).

14. A good example is the case of debt issued to the apartheid regime in South Africa which was used to consolidate the oppressive regime. See Walker and Nattrass (2002) for a discussion of the South African case.

15. For discussion, see Jochnick (2006) and Buchheit, Gulati, and Thompson (2007).

16. Referring to domestic law, Buchheit, Gulati, and Thompson (2007, 1252) write: 'We believe that governmental corruption in some countries is so suffocatingly ubiquitous that a U.S. court could legitimately shift onto the plaintiff [i.e., a creditor seeking redress for non-repayment] the burden of showing that a particular transaction was not tainted by corruption…. Against a showing of pervasive corruption, is it unreasonable to ask the plaintiff/lender to explain how it alone had managed to preserve its virtue in dealing with the corrupt regime?'

17. For discussion, see Hoeflich (1982) and Ndikumana and Boyce (1998).

18. Howse (2007, 15); for discussion, see also Buchheit, Gulati, and Thompson (2007).

19. The Norwegian government has called for the creation of an 'international debt settlement court' for this purpose. See the Soria Moria Declaration on International Policy, October 2005, available at http://www.dna.no/index.gan?id=47619&subid=0. In making a case for an ex ante instead of ex post odious debt strategy, Jayachandran and Kremer (2006, 83) express the worry that 'any adjudicating body that had the power to declare debt void might nullify legitimate debt if it placed a high value on the welfare of the debtor country', thereby shutting down access to legitimate loans and presumably harming the country. But actions yielding this result would seem to be a rather perverse form of favoritism.

Odious Debt
Source: Unknown Repository
International Financial Statistics2003317International Monetary Fund. International Financial Statistics. Washington, DC, 1993 to date; updated monthly. Pricing table located at http://ifs.apdi.net/imf/prepurchase.asp URL: http://imfstatistics.org Last visited March 2003
Source: Reference Reviews
Congo's Odious Debt: External Borrowing and Capital Flight in Zaire
Source: Development and Change
Capital Flight Repatriation: Investigation of its Potential Gains for Sub-Saharan African Countries*
Source: African Development Review
The Legal Case for Debt Repudiation

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