CAPITAL FLIGHT, PUBLIC FINANCE AND DEVELOPMENT

SEERAJ MOHAMED & DUMISANI JANTJIES

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Why is capital flight a concern:
Development and fiscal implications

- States provide important services and infrastructure for societal and economic development.
- The developmental impact of capital flight is less money for public investment, social services and infrastructure
- Capital flight and the illicit export and concealment of wealth abroad leads to reduction in the tax base
- The link between corruption and capital flight is well established in many countries
- Nkurunziza (2015) estimated that African countries could have increased the annual average rate of poverty reduction by between 1.9 and 2.5 percent per annum period from 2000 to 2010 if flight capital had been invested

Development and growth implications

- Capital flight reduces public and private domes-tic investment and economic growth.

- Indeed, capital flight may be an important reason for low growth on the African continent over an extended period

- Ndikumana, 2014 says “Simula-tions indicate that had African countries been able to retain flight capital and invest it domestically at a rate of return equivalent to historical records, they would have recorded a substantially higher growth rate”

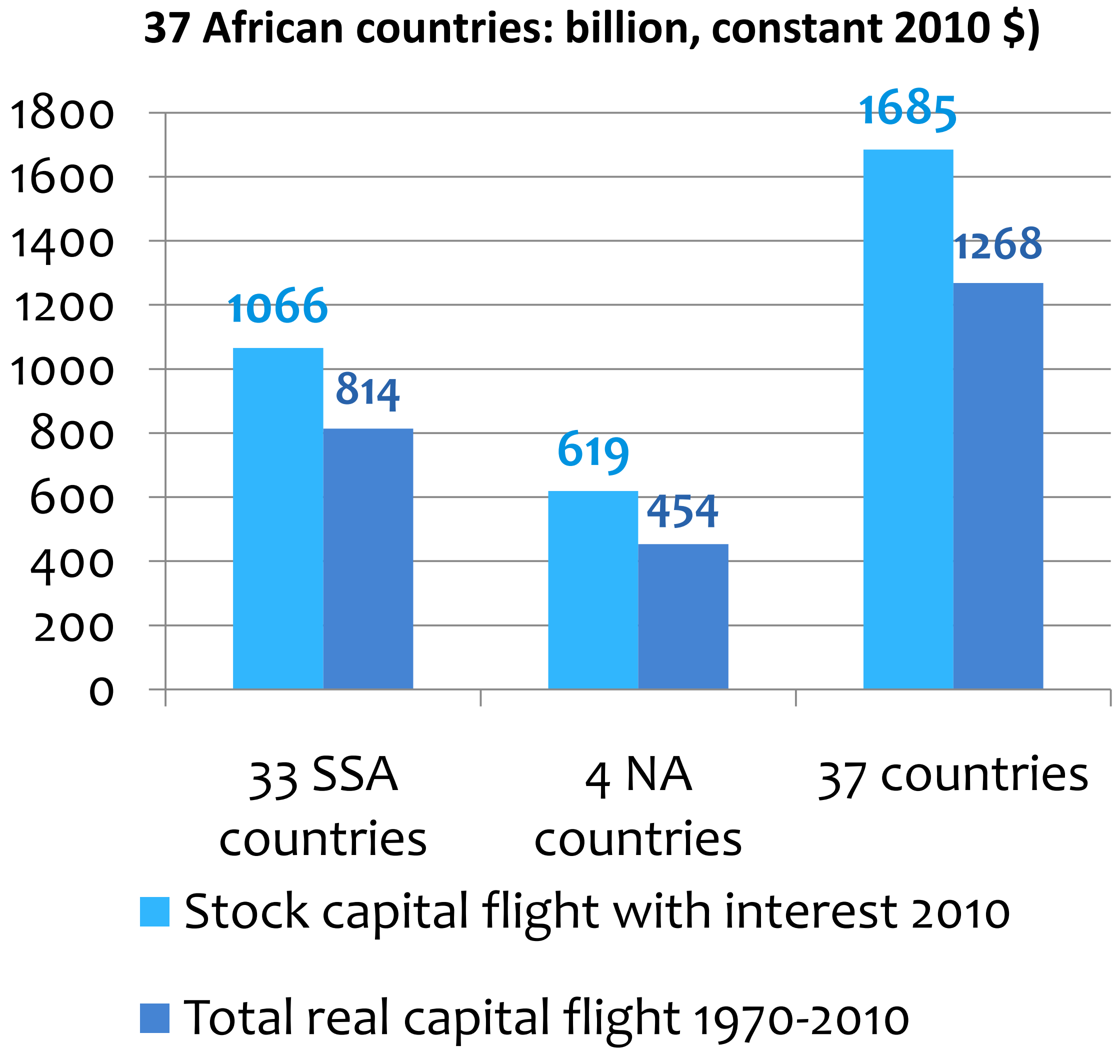
- He estimates that for period 2000 to 2010, they could have recorded an additional growth rate of up to 3 percent.

An estimation of the global impact of capital flight (excluding trade misinvoicing)

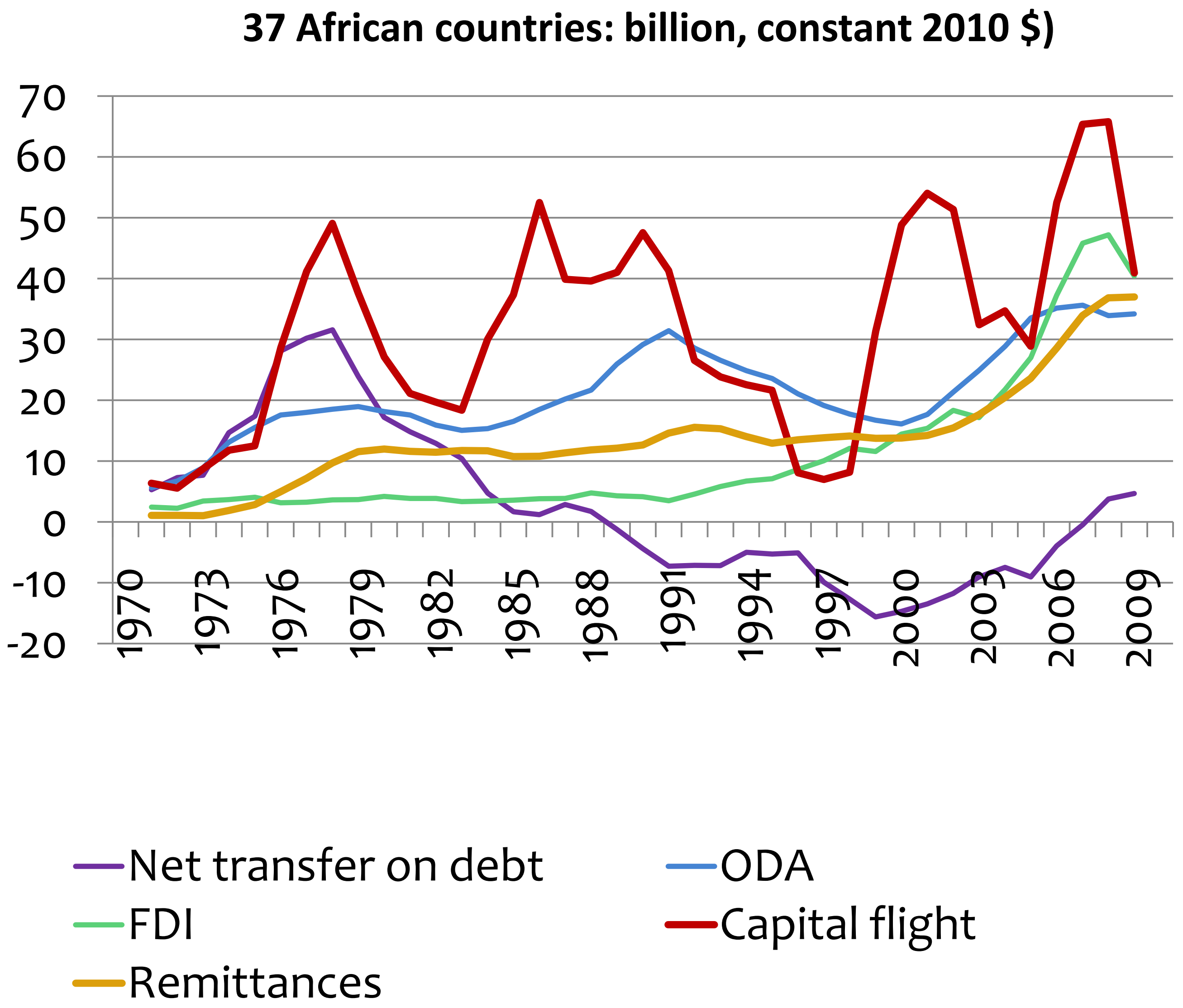
	Cumulative capital flight[a], 1970–2014[b]	Capital flight stock, 2014	Debt stock, 2014	Net external assets, 2014[c]	Cumulative capital flight to GDP ratio (%)
Central Europe	1436.8	1868	993	875	53
East Asia	2691.2	4317	3595	722	20
Latin America and Caribbean	1350.2	1944	1607	336	25
Middle East and North Africa	1869	2737	692	2045	52
Middle East only	1695.8	2459	572	1887	59
South Asia	174.9	284	580	-296	7
Sub-Saharan Africa	405	710	393	317	23
Africa	578	988	513	475	24

Source: Ndikumana (2017) calculations using data from James Henry, Global Haven Industry

Volumes are staggering



Capital flight (incl. trade misinvoicing) and other flows



Source: Ndikumana (2017)

Estimation of Capital Flight on South African public finance position

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Average
SA Illicit financial flows as % GDP[1]	5.3	5.3	4.7	9.1	7.9	10.0	6.6	5.5	6.6	4.7	6.6
Deficit as % GDP[2]	-2.2	-1.4	-0.3	0.7	0.9	-0.7	-5.1	-4	-4.8	-5.3	-2.2
If we assume that effective tax rate of 30% on illicit flows - % GDP	1.6	1.6	1.4	2.7	2.4	3.0	2.0	1.7	2.0	1.4	2.0
Recalculated deficit with 30% tax on illicit flows % GDP	-0.6	0.2	1.1	3.4	3.3	2.3	-3.1	-2.4	-2.8	-3.9	-0.2

Source: Author's calculations using GFI and SARB data

Note 1: Estimations for Illicit financial flows were calculated by Global Financial Integrity

Note 2: Deficit as a percentage of GDP was sourced from the SARB QB time series

http://www.gfintegrity.org/report/illicit-financial-flows-from-developing-countries-2004-2013/. Downloaded 1 Oct. 2016

Economic explanations of capital flight

- Wealthy private and corrupt political elites want to hide and avoid scrutiny of their wealth
- Boyce and Ndikumana (2012) use the term “secrecy premium” because perpetrators of capital flight are willing to accept much lower returns to hold their wealth abroad
- Large amounts of illicit flows of former leaders uncovered in safe haven country banks
- Large levels of capital flight for tax avoidance
- Capital flight supported by financial and trade deregulation without adequate monitoring and other institutional oversight
- The preponderance of extractive industries and the increase in commodity prices seems to be an important factor

Pull factors: financial haven industry

- Moving and concealing private wealth around the world is easier
- Bank secrecy in an era with increased financial deregulation and integration and the growth of offshore finance
- Offshore financial centers are not just found on tropical islands
- Some of the most secretive jurisdiction are in developed countries such as US, UK, Germany and Switzerland
- Gray et al (2014) point out that most of the stolen funds recovered so far under the Stolen Assets Recovery Initiative (a partnership of the World Bank and the United Nations Office on Drugs and Crime) were from major developed countries

Trade misinvoicing

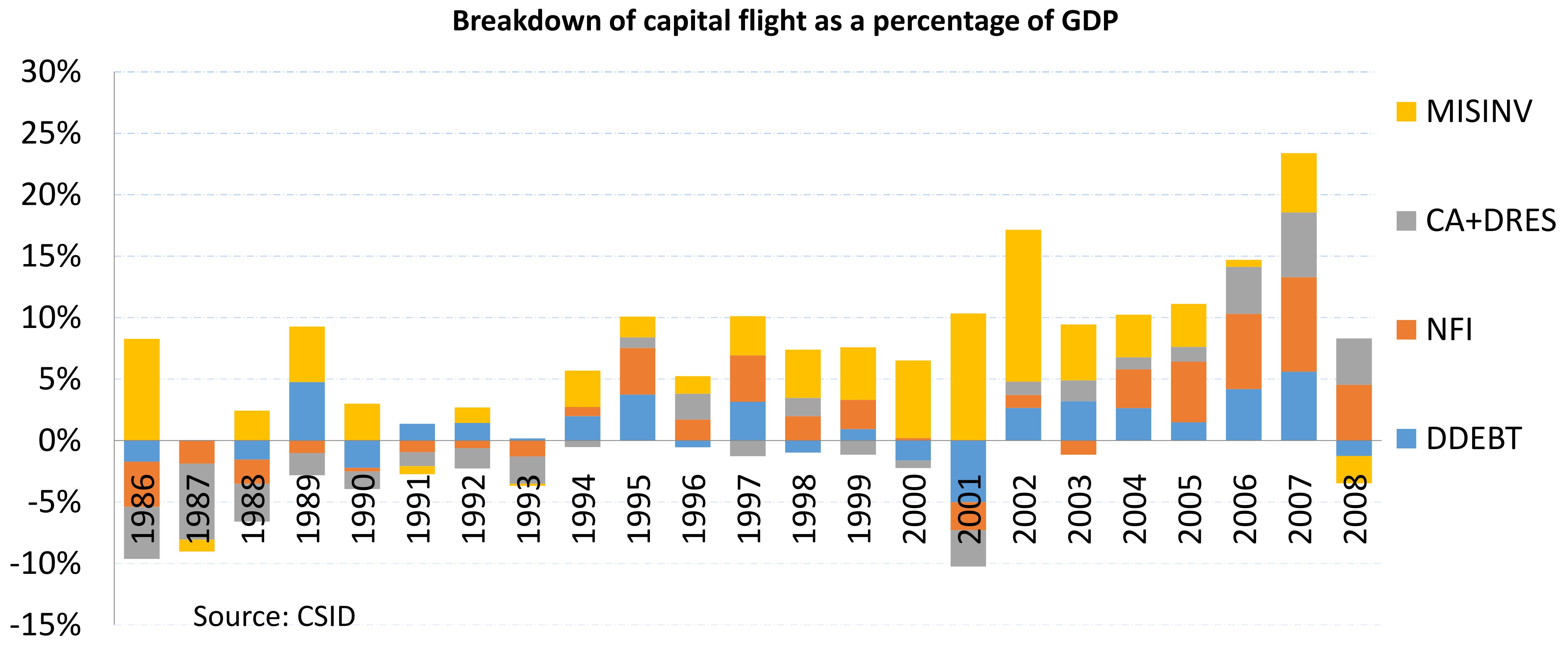
- It occurs through underinvoicing of exports and overinvoicing of imports
- Trade misinvoicing is an important component of capital flight and is growing in many countries
- Export of primary commodities and trade misinvoicing are important components of capital flight

Trade misinvoicing

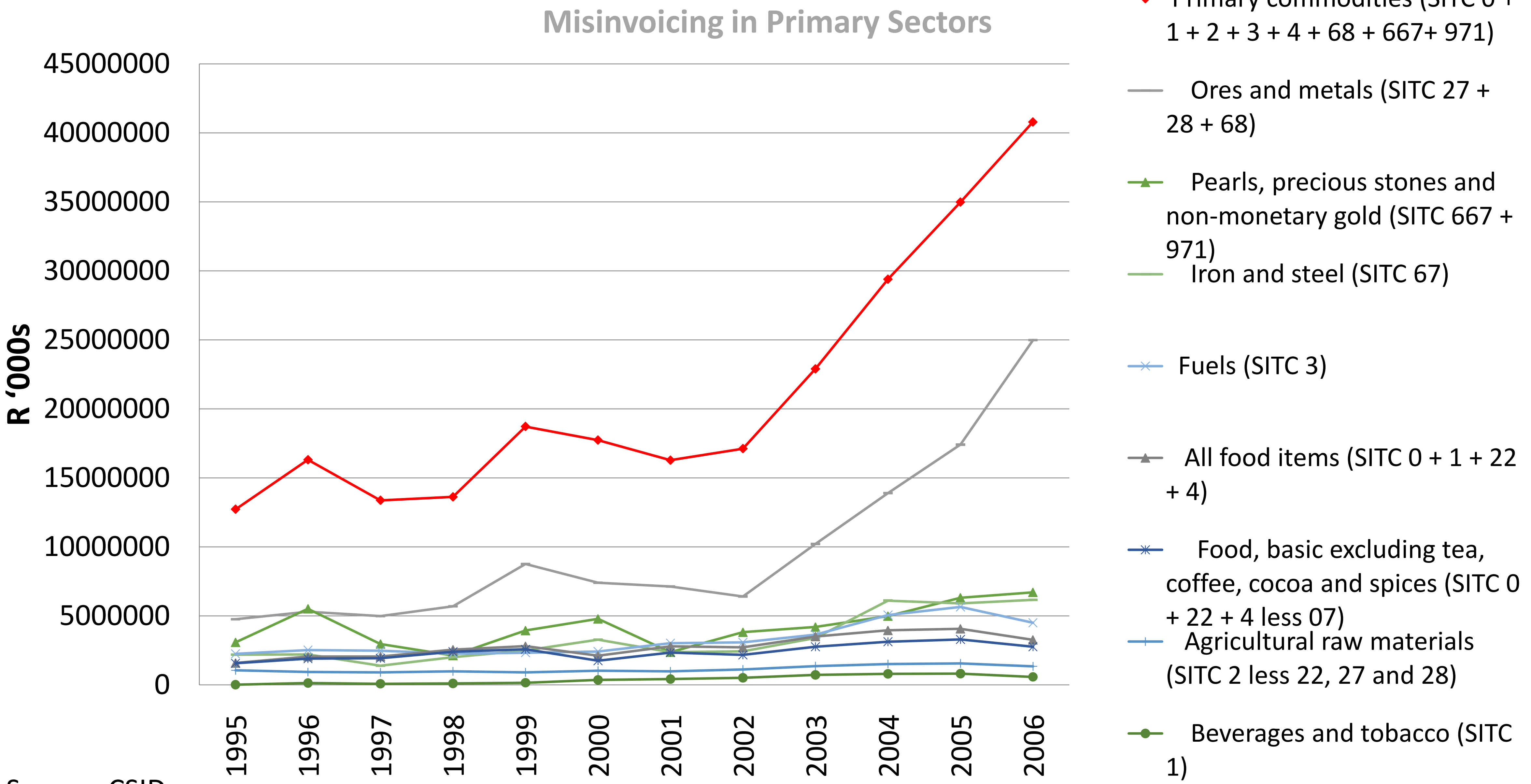
- The dominant role of multinational corporations (MNCs) in the global value chains facilitates trade misivoicing
- MNCs dominate extractive industries, and generally global trade flows
- MNCs can use their complex ownership structures and presence in many countries to manipulate quanitities and prices and to obscure the destination and source of trade
- MNCs use misinvoicing to evade taxes and and other levies on international trade

Capital flight estimates for South Africa

- *ΔDEBT*: change in stock of external debt
- *NFI*: net foreign investment
- *CA*: current account deficit
- *ΔRES*: change in the net stock of foreign reserves
- *MISINV*: net trade misinvoicing



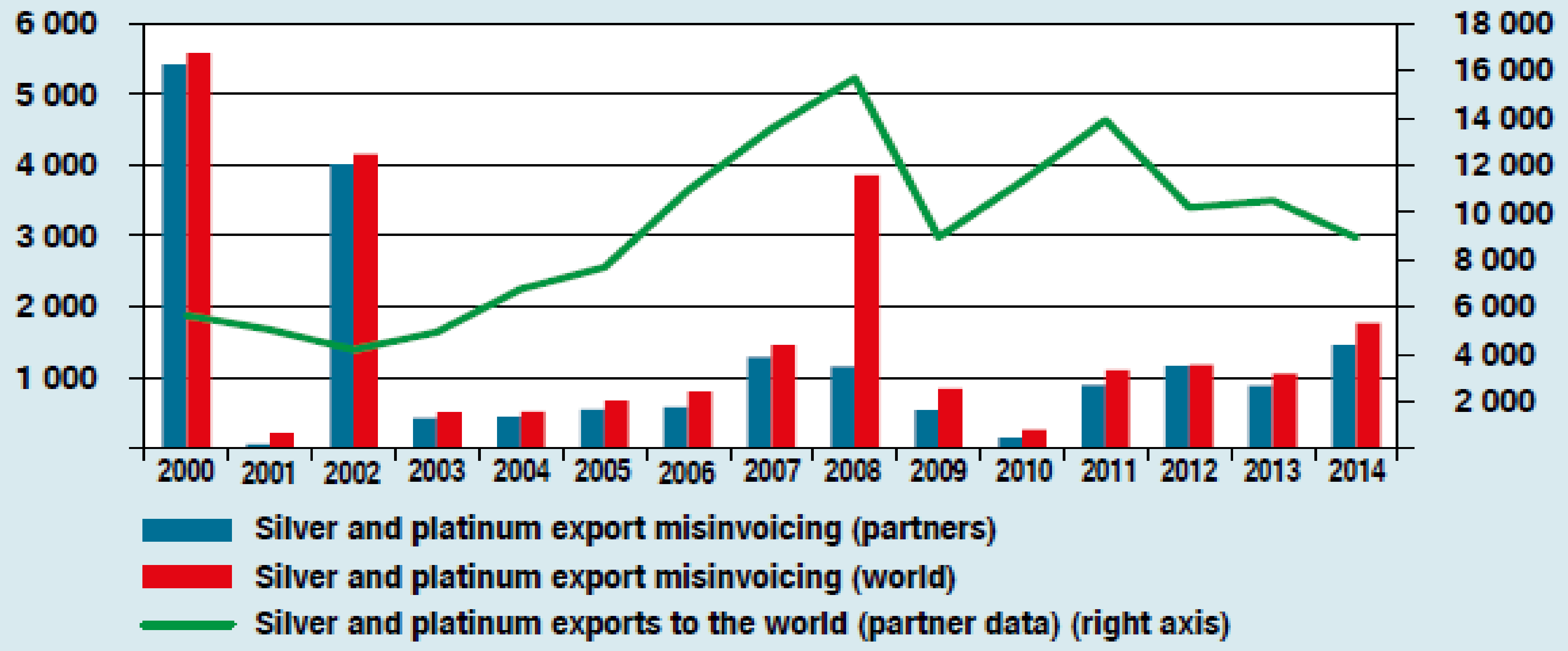
Sectoral misinvoicing



Source: CSID

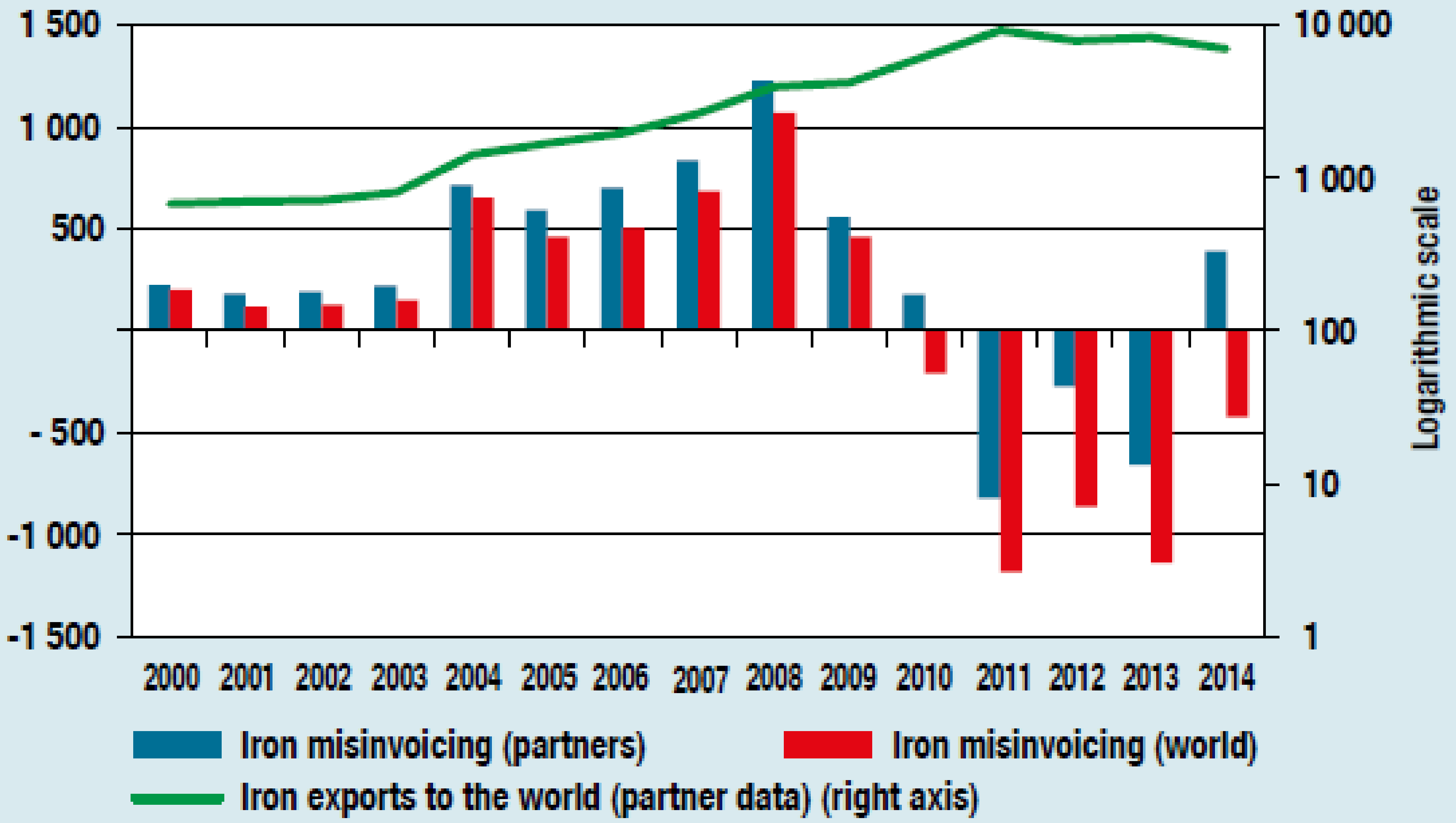
Trade misinvoicing from South Africa
(Draws on empirical work in UNCTAD, 2016)

Figure 7. South Africa: Silver and platinum exports and export misinvoicing (Millions of constant 2014 dollars), 2000–2014



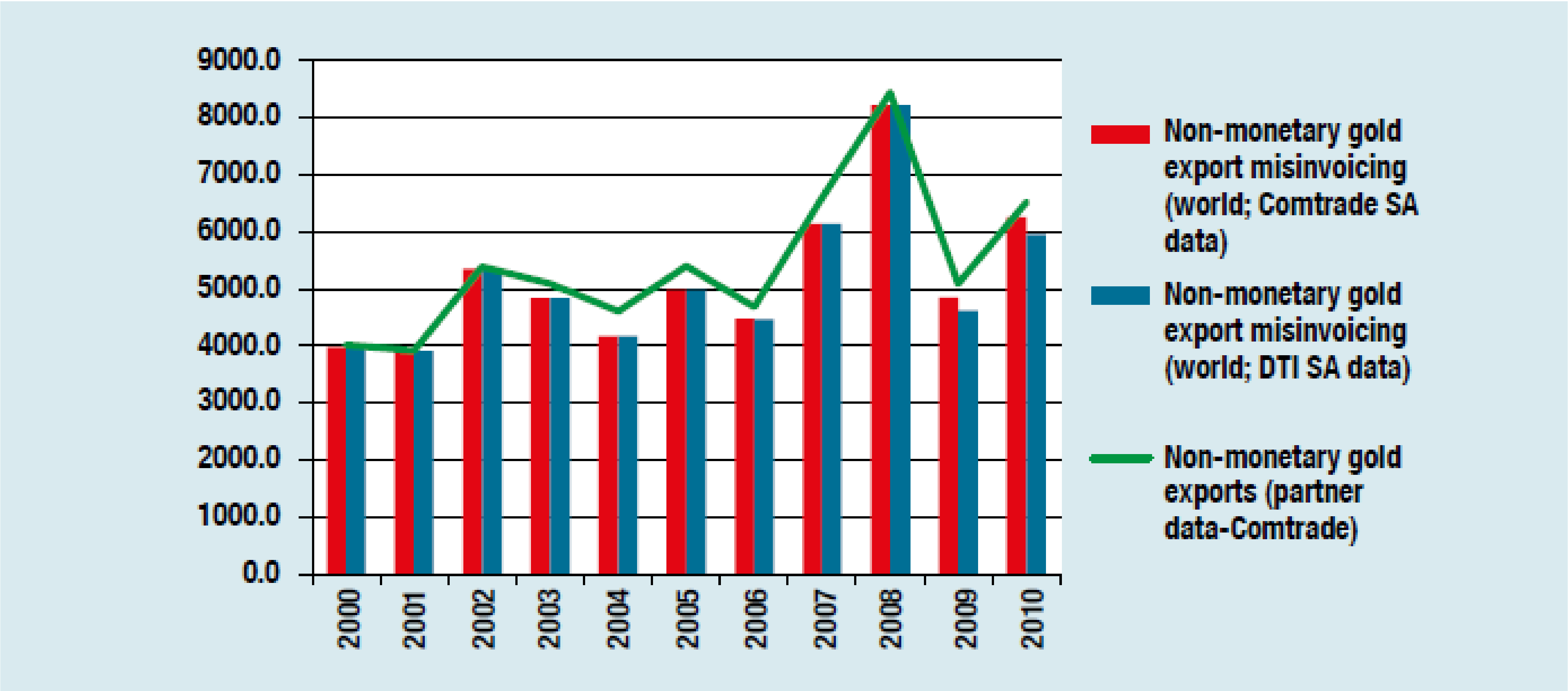
Source: UNCTAD, 2016

Figure 8: South Africa: Iron ore exports and export misinvoicing (Millions of constant 2014 dollars), 2000–2014



Source: UNCTAD, 2016

Figure 9. South Africa: Non-monetary gold exports and export misinvoicing (Millions of constant 2014 dollars), 2000–2010



Source: UNCTAD, 2016

Misinvoicing, other examples from Africa

- Nigeria:
  - UNCTAD (2016) shows that COMTRADE data between 1996 and 2014 has Nigeria reporting exports of oil worth 44 billion US dollars of oil to the Netherlands.
  - The Netherlands' data shows only 28 billion US dollars of oil imports from Nigeria
- Zambia:
  - UNCTAD (2016) says that Zambia's national data show that Switzerland is the top buyer of its copper (51 percent of total)
  - Swiss trade data show no copper imports from Zambia
- Switzerland and Holland are important hosts to MNCs in the extractives industry

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