CAPITAL FLIGHT, PUBLIC FINANCE AND DEVELOPMENT
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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 domestic 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 “Simulations 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)

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

Source: Ndikumana (2017) calculations using data from James Henry, Global Haven Industry
Volumes are staggering
37 African countries: billion, constant 2010 $

Stock capital flight with interest 2010
Total real capital flight 1970-2010

Capital flight (incl. trade misinvoicing) and other flows
37 African countries: billion, constant 2010 $

Source: Ndikumana (2017)
## Estimation of Capital Flight on South African public finance position

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

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  
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 misinvoicing

• MNCs dominate extractive industries, and generally global trade flows

• MNCs can use their complex ownership structures and presence in many countries to manipulate quantities and prices and to obscure the destination and source of trade

• MNCs use misinvoicing to evade taxes and other levies on international trade
Capital flight estimates for South Africa

• $\Delta DEBT$: change in stock of external debt
• $NFI$: net foreign investment
• $CA$: current account deficit
• $\Delta RES$: change in the net stock of foreign reserves
• $MISINV$: net trade misinvoicing

Breakdown of capital flight as a percentage of GDP

Source: CSID
Misinvoicing in Primary Sectors

Primary commodities (SITC 0 + 1 + 2 + 3 + 4 + 68 + 667 + 971)

Ores and metals (SITC 27 + 28 + 68)

Pearls, precious stones and non-monetary gold (SITC 667 + 971)

Iron and steel (SITC 67)

Fuels (SITC 3)

All food items (SITC 0 + 1 + 22 + 4)

Food, basic excluding tea, coffee, cocoa and spices (SITC 0 + 22 + 4 less 07)

Agricultural raw materials (SITC 2 less 22, 27 and 28)

Beverages and tobacco (SITC 1)

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

Source: UNCTAD, 2016
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
References


• James Henry, Global Haven Industry http://globalhavenindustry.com


• UNCTAD. (2016). Trade Mis invoicing in Primary Commodities in Developing Countries: The cases of Chile, Côte d’Ivoire, Nigeria, South Africa and Zambia (Vol. December). Geneva: UNCTAD.