How Much Capital Flight from Developing Countries?

In the author's view, public discussion too readily assumes that there has been a large and persistent capital flight from the developing countries. The article suggests that some widely publicized estimates of this flow may have tended to exaggerate its actual volume. The author believes that in the interest of the cause of development, greater caution should be shown in public discussion of this admittedly difficult problem.

Poul Høst-Madsen

"It was printed in the newspaper; and it's perfectly true—one little feather can easily become five hens."

Hans Christian Andersen

THE MAGNITUDE of the flow of private capital from the developing to the developed countries is one of the most difficult questions in the field of international payments. Nobody would question that this flow has in some periods and in some areas of the world been very large, or that it deserves serious consideration. But when the balance of payments statistician is asked to estimate the total amount of these capital flows, he is embarrassed. Not only is he unable to produce exact figures; he cannot even be precise about orders of magnitude. On the occasion of the recent United Nations Conference on Trade and Development, the Fund was asked to submit a paper on the "magnitude and trend of the net flow of short-term funds from developing to developed countries." While the paper that was prepared contained the relevant statistics, it did not provide simple and clear answers to the questions that had been asked. Much of it, indeed, was devoted to a discussion of the reasons why it is not to be expected that movements of private capital out of developing countries will be recorded in balance of payments statistics. Even the statistical tables included in the paper avoided a total that might be quoted as the Fund's estimate of capital flight from developing countries.

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Obscure Origin of Some Estimates

To one who has often been frustrated by the difficulties of estimating capital flight[1] it is a source of amazement how easy some find it to produce such estimates, and how readily they are given credence. However little foundation an estimate may have, after it has been repeated a number of times, and in particular if it has appeared in the press, it tends to be treated as authoritative. It is widely believed and influences public opinion considerably.

An instructive example of this process may be found in hearings conducted in May 1962 by the Sub-Committee on Inter-American Economic Relationships of the Joint Economic Committee of the U.S. Congress. In the course of these hearings, a clipping from *The Washington Post* of May 6, 1962 was inserted in the record, containing, in a correspondence from Mexico, the following statement about capital flight from Latin America:

> Many economists estimate that there is now a minimum of $6 billion in Latin American capital abroad. Daniel Oduber, who has been designated Minister of Economics in the new Costa Rican Government that will take over on May 8, feels that the figure is closer to $10 billion.

The Sub-Committee obtained some other estimates. One witness, who gave very high figures, was most definite in his statement:

> The absence of confidence by Latin America's business elite and ruling groups is widely demonstrated by their own export of capital which over the past decade has been in excess of $10 billion.
>
> In passing, may I say that this $10 billion represents the amount of flight capital in numbered bank accounts in Switzerland alone. My New York banker friends tell me that the amount of flight capital on deposit in New York or invested in American securities and bonds is probably equal to another $10 or $12 billion.

In the light of this and other evidence the Sub-Committee drew the following conclusion in its report:

> The testimony brought disturbing evidence of a reluctance on the part of some wealthy Latin American investors to risk private investment in their own countries. The reluctance is, indeed, reported to have taken the form of a substantial flight of local capital to Europe or the United States. Estimates presented to the Sub-Committee of the amount of this expatriated "flight" capital ranged from $5 to $15 billion. The $10 billion estimate ascribed to one Latin American Ministry of Economics is probably as good a figure to use as any.

Soon after this report had been issued, the estimate of $10 billion for capital flight from Latin America gained further currency by being reported by *The Economist*, in a correspondence from Washington in which it was stated that "wealthy Latin Americans are believed to have some $10 billion safely lodged in Swiss banks and elsewhere and another billion or so slips abroad each year." One member of the Congressional Sub-Committee, apparently drawing in part on its findings, stated in a public speech the following year that there had been "an estimated outflow of between $9 and $15 billion of Latin American capital," this time with the added twist that the outflow had taken place "over the past few years."

Estimates Unsupported

In rationalizing the figure of $10 billion for Latin American flight of capital, the Sub-Com-

[1] The problem of capital flight that is considered in this article is confined to outward movements of local (rather than foreign) capital from the developing countries. But not all such outward movements represent capital flight: for instance, some accumulation of foreign assets as working balances, or in the form of trade credits extended, is part of the normal flow of capital. Even long-term investment abroad by a developing country may sometimes be so regarded, say in a country whose foreign exchange earnings from oil production are very large but in which local opportunities for investment are very limited.

mittee's report argued that "while short-term liabilities to Latin Americans, reported by banks in the United States, have held fairly constant, around $2.5 billion for the past five years, this admittedly is only a fraction of liquid Latin American assets in this country alone." In fact, this figure of $2.5 billion covers not only the holdings of private Latin American individuals and businesses, but also Latin American official reserves and bank holdings in U.S. dollars, which can certainly not be regarded as flight capital. Deducting these, the remaining private holdings had averaged about $1 billion over the five years preceding the issue of the report, but with a rising trend. Even this much lower figure is not made up exclusively of flight capital. It must include some quite normal working balances of Latin American businesses, for example, those that are branches or subsidiaries of U.S. corporations.

The figure of $10 billion given by one witness for the amount of Latin American funds held in numbered accounts in Switzerland is an interesting example of the manner in which rumors can arise and thrive in the absence of authoritative published information. In fact, the figure of $10 billion was considerably larger than the total amount held, when the statement was made, by *all* foreigners in Swiss banks in the form of securities as well as bank liabilities. It was several times larger than the total liabilities of the Swiss banks to all foreigners, of which it is understood that numbered accounts represent only a negligible proportion. Also, Latin American holdings are understood to represent only a small proportion of total foreign holdings with Swiss banks and of total foreign investments in Switzerland, which at the end of 1960 were estimated at about $4 billion.[2]

Indirect Estimates: Are the Data Adequate?

Sometimes the notion of a massive flow of capital from the developing countries has been supported by sophisticated calculations, based almost entirely on the statistics of the developed countries. Calculations of this sort derive their rationale from the fact that one cannot expect capital flight to be reported in the statistics of the developing countries themselves. They rest on the further assumption, which is more doubtful, that the balance of payments statistics of the developed countries have a fairly high degree of accuracy and are mutually consistent, so that by combining them one can make a sound estimate of their collective balances of payments with the developing countries. Some organizations have used such methods to prepare estimates suggesting a very large gross outflow of capital from the developing countries.

Yet even if all the complex conceptual problems involved in such calculations are properly handled, the results are questionable because the underlying statistics are not sufficiently reliable to justify the refined methods applied. For example, the unidentified residual of international transactions that are not recorded bulks very large in the statistics of many developed countries, including in recent years Italy, Switzerland, the United Kingdom, and the United States. Moreover, as is known to everyone who has had an opportunity to work with different countries' estimates of the same

[2] The information about foreign assets in Switzerland is based in part on "Die Schweiz als internationaler Kapitalmarkt" by Dr. Max Ikle in *Festschrift für Fritz Marbach zum 70 Geburtstag* (Bern, 1962) and in part on discussions between Fund and Swiss officials.

transactions, the data of the developed countries are far from being consistent with one another. One cannot, therefore, expect to obtain a reliable estimate of the collective balances of payments of the developed countries by combining their data. A special problem arising in such calculations is the absence of balance of payments data for the Soviet area. Any indirect estimate of the developing countries' collective balances of payments will, in practice, include the transactions of the Soviet area along with those of the developing countries themselves.

For all these reasons, such estimates of the outflow of capital from the developing countries are subject to grave doubts, however sophisticated the methods, and whatever the degree of scholarly caution used. One element in some of these calculations, which may give them a degree of plausibility, is the large outflow of capital which in recent years has taken place from Algeria. This is discussed below. However, apart from this element, which can better be elucidated by more direct methods, the calculations do not provide any safe basis for concluding that the flight of capital from developing countries has been very large.

More Direct Methods

If one rejects both the unsubstantiated estimates and the more sophisticated but still unsatisfactory indirect methods of estimating capital flight from developing countries, what is left?

Some information about capital flight can in fact be derived from balance of payments statistics by more direct methods. It is true, of course, that capital flight will usually escape actual recording in the statistics, at least in the countries in which the movements originate. Yet capital flight will often be *reflected* in the statistics because the recorded data leave unexplained an outflow, or as the case may be an inflow, of funds. The balance of payments is a double entry system of accounts constructed in such a way that, if all transactions were correctly recorded, they should give rise to equal entries for debits (covering payments or outflows) and credits (covering receipts or inflows). In practice, there is usually an excess of one or the other. This imbalance is offset in the balance of payments by a formal balancing entry which is called "errors and omissions." A large debit entry for "errors and omissions" (an excess of unrecorded outflows over inflows) will often suggest that there has been an unrecorded outflow of capital. Conversely, a large credit entry for "errors and omissions" may suggest an unrecorded inflow of capital. *Changes* in "errors and omissions" from period to period may be even more indicative of unrecorded capital movements than the absolute size of these entries; this is because "errors and omissions" may include a sizable but fairly constant element applicable to current transactions.

In recent years, the best known instance of a flow of capital from a developing country is the outflow that accompanied the large-scale emigration of Europeans from Algeria during the years before and after that country became independent. This movement of capital was for the most part directed toward France, and is reflected as a large credit entry for "errors and omissions" in French statistics of economic transactions with the overseas franc area. This entry amounted to $0.9 billion in 1960, $1.6 billion in 1961, and more than $2 billion in

1962. Since the record of known transactions between France and the overseas French franc area is neither complete nor fully accurate, it should not, of course, be inferred that "errors and omissions" reflect only a flow of capital into France. For instance, it has been officially estimated that the movement of private capital from Algeria into France reached an equivalent of $1 billion in 1962, i.e., about half of the credit entry for "errors and omissions."

The Latin American Example

Is the alleged large flight of capital from Latin America in any way comparable with the case of Algeria? It is much more difficult to establish any clear statistical evidence. It is true that for the Latin American area, as distinct from any other developing areas in the world, outside the French franc area, there have been both some persistent reported substantial outflows of domestic short-term capital and a tendency for "errors and omissions" to show rather large debit entries. For the period 1952-63, all the developing countries that reported balance of payments data to the Fund, except Latin America and the French franc area, had a total cumulative net debit on account of reported outflows of domestic short-term capital, plus "errors and omissions," of only a few hundred million dollars. In the same period, Latin American statistics show reported outflows of domestic short-term capital aggregating $0.8 billion (a figure largely derived from U.S. sources), while net "errors and omissions" added a debit total of $3.3 billion.

The sum of these two latter figures cannot be regarded as an accurate measure of the outflow of local capital from Latin America. It is often argued that the unrecorded outflow of local capital would tend to be larger than suggested by the entries for "errors and omissions," because it often takes forms that make it unlikely that it will be reflected in the "errors and omissions." (For instance, if the authorities are given figures for imports which are deliberately overvalued, or for exports that are deliberately minimized, part of a capital flight could be disguised as a trade deficit or the reduction of a trade surplus.) If this reasoning is correct, the sum of the two figures mentioned above might be regarded as a minimum estimate of the outflow of local capital from Latin America.

But there are also reasons why "errors and omissions" may *overstate* the unrecorded outflow of local capital. "Errors and omissions" may refer to any item in the balance of payments, and in the Latin American instance cited about half of the cumulative debit entry for "errors and omissions" refers to two countries whose balances of payments in all periods, including those when no flight of capital could be suspected, have tended to show rather large debit entries for "errors and omissions." This suggests some systematic statistical error in the balance of payments accounts, most likely to be found in the record of current transactions. In one other instance, large debit entries for "errors and omissions" seem likely to arise primarily from unrecorded repayments of foreign trade credits rather than from an outflow of local capital. A close inspection of the balance of payments accounts, country by country, thus suggests that large debit entries for "errors and omissions" are not by any means always to be associated with a flight of capital—even though such a relationship sometimes seems obvious where the entries coincide with political or economic events likely to stimulate a capital flight. For all these reasons we cannot hope to measure the total outflow of local capital from Latin America on the basis of Latin American statistics. All we can say is that these statistics give some direct evidence (largely on the basis of U.S. sources), and from time to time some indirect indications, of considerable outflows of local capital.

Statistics of Receiving Countries

If it is difficult to find clear statistical evidence of capital flight in the countries from which the capital flight takes place, is it any easier to find it in the recipient countries? It seems reasonable that a large part, at any rate, of the flows of local capital from developing to developed countries could be estimated from the balance of payments statistics of the latter. But once again, the matter is not so simple; the statistics of those countries that might be recipients of flight capital are not in general sufficiently detailed to identify movements of local capital from developing countries.

This difficulty does not apply to the United States. U.S. statistics identify two types of recorded capital movements by individual countries likely to be important as instruments of capital flight—the acquisition by residents of these countries of bank balances and other short-term assets in the United States, and also of U.S. corporate securities. The combined movement of private capital from Latin America into the United States recorded in these two categories for the 12 years 1952-63 was $1.2 billion; that from other developing areas was negligible.

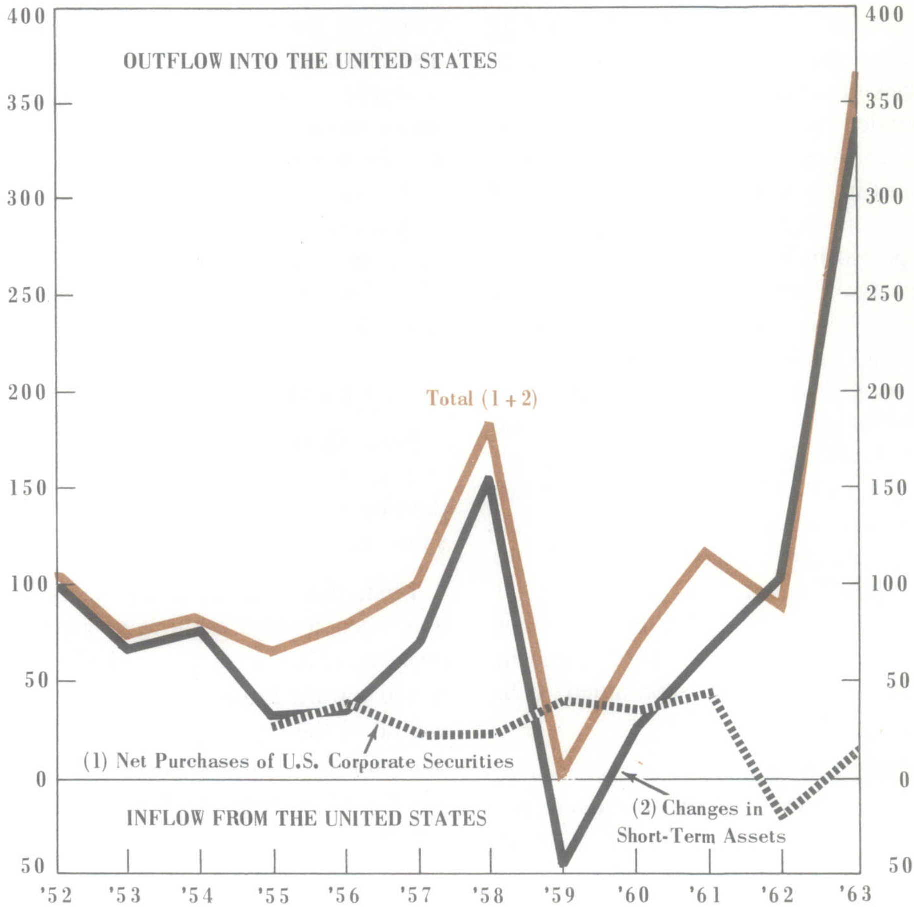
Flows of Latin American capital into the United States as recorded in U.S. statistics in both these categories are shown in the chart on page 31. The entry for flows of short-term capital in 1963 is significant in that it shows that large movements of short-term capital from developing countries *can* be reflected in the reported statistics; in other words, that such movements are not (as often assumed) necessarily concealed. The recorded movements of short-term capital in most years, other than 1963, and of security transactions in all years, are relatively moderate. But the cumulative net outflow recorded from Latin America of $1.2 billion must be regarded as substantial.

A Flight to Europe?

How are these recorded movements to be reconciled with the indirect indications in the statistics for Latin America that outflows of local capital from that area may have been considerable in a number of recent years other than 1963? Three explanations, which are not mutually exclusive, are possible: outflows of local capital may not have been nearly as large as suggested by the Latin American data; they may have resulted in inflows into the United States either unidentified or not identified as Latin American; or much of these outflows may have been directed to other countries. The latter explanation has some plausibility. It will be noticed from the chart that there was a persistent, although rather moderate, build-up of private short-term dollar assets until 1958, but after that a slowdown in this movement in the years 1959 and 1960, followed by an acceleration during 1961-63. Judging from Latin American data, it does not seem likely that the outflow of local capital from Latin America was particularly small in 1959-60. There are, for instance, indications that there was a very large outflow of capital from Venezuela in 1960

LATIN AMERICA: Private Capital Flow

In millions of U.S. dollars



This chart shows the only dependable statistical information on outflows of Latin American capital. It covers changes in (1) U.S. short-term liabilities to the private, non-bank public in Latin America, and (2) net purchases of U.S. corporate securities by Latin Americans. The first series is available from 1952 onward, but the second series only from 1955. The drop in the total rate of outflow in the years immediately after 1958 may reflect a change in the direction of outflows of Latin American capital, away from the United States.

associated with a prolonged exchange crisis. It seems likely, therefore, that there was a flight of capital from Latin American countries during 1959-60 directed mainly to countries other than the United States—perhaps as a result of the weakness of the U.S. dollar during these years, coinciding with the new strength of the currencies of a number of European countries, as signaled by their decision to introduce nonresident convertibility by the end of 1958. While, at least in the years 1959-60, substantial amounts of Latin American flight capital may have been placed in Europe, it is by no means evident that the European countries have in other periods been large-scale recipients of Latin American capital. Prima facie, there is no reason to believe that residents of Latin America should generally have had a strong preference for placing flight capital in Europe rather than the United States—at least not before 1958, when the large deficits of the U.S. balance of payments emerged. It is, on the other hand, apparent that flows of local capital from Latin America to the United States cannot have been much inhibited in 1962, and in particular in 1963, by the continued U.S. deficits.

Although the U.S. data cannot, of course, be expected to tell the full story on movements of local capital out of Latin America or other developing areas, it is unfortunately not possible to establish any evidence of the role which the European countries have played as recipients of capital flight in various periods. Rumor, of course, gives Switzerland a leading part, but the published statistics for that country do not give much of a clue as to the degree to which it may have acted as a recipient of flight capital from the developing countries. It is this very absence of information that has, as earlier suggested, tended to stimulate exaggerated notions of the amount of flight capital placed in that country. Some arguments for a very large role for Switzerland are being drawn from the very large credit entries for "errors and omissions" in the Swiss balance of payments after 1959. These entries make the Swiss balance of payments something of an enigma in the analysis of world payments, but it is by no means certain that they reflect only inflows of capital, and even less certain that, to the extent that they do so, such inflows were mainly from developing countries. In recent years, movements of capital among the developed countries themselves have been very large.

Some General Conclusions

How should one evaluate all this uncertain statistical evidence about capital flight from developing countries? A few general conclusions may perhaps be drawn.

First, there has in recent years unquestionably been a large outflow of capital from the overseas franc area, in particular Algeria, directed toward France. This was not a flight of capital in the ordinary sense of the term but a once-and-for-all movement associated with emigration of a large portion of the European settlers.

Second, there is no statistical evidence of systematic movements of local capital from developing countries other than the overseas franc area and Latin America.

Third, there is some incontrovertible evidence in U.S. statistics of an appreciable outflow of local capital from Latin America and some indirect indications in Latin American statistics of further large outflows. But to derive precise figures from such evidence as exists would be an excessively hazardous task.

Many of those who have quoted very high figures for capital flight from less developed countries have undoubtedly been greatly concerned about the threat to development posed by the problem of capital flight, and have endeavored to find ways of dealing with it. While acting with the best intentions, they may, nevertheless, have provided the opponents of development aid with a powerful argument: does not the large flight of capital from developing countries show that it is hopeless to aid these countries, and that the taxpayers' money is being wasted? Since the relationship between the developed and developing countries is one of the greatest problems of the twentieth century, and the question of capital flight is one of the most delicate problems within that greater problem, students dealing with admittedly enigmatic and incomplete data should avoid alarmist statements that have no firm basis in known facts.