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The Flight of Capital from Developing Countries

by Susanne Erbe, Hamburg*

The export of capital, legally and illegally, is a major problem for many developing countries. The following study analyses the causes and nature of the flight of capital and estimates its scale in 34 countries.

Heavily indebted developing countries with recurrent debt service problems must face the fact that capital is turning its back on them. Not only are they having difficulty obtaining new loans, but their own citizens, including in some cases the political elite, are trying to salvage their money. The flight of capital is exacerbating their balance of payments problems and the private assets held abroad often equal the level of official external liabilities.

The African state of Zaire is a prime example of debt problems coupled with the flight of capital. For almost ten years the country has stumbled from one debt crisis to the next and the government has hardly ever been able to service its foreign debt, which stood at around US \$ 4.2 billion at the end of 1982. And yet, it is reported that the fabulous wealth of President Mobutu and his clan amounts to between US \$ 4 and 6 billion,¹ well invested in Swiss accounts and foreign real estate. These sums could solve the country's debt crisis with ease; the crisis might not have occurred in the first place if a large proportion of the funds borrowed abroad had not immediately flowed out of the country again.

Zaire is undoubtedly one of the most blatant examples of the flight of capital from those developing countries that desperately need foreign exchange to solve their debt problems. However, other developing countries are also affected by the flight of capital. Various estimates put the amount flowing out of Latin America at a minimum of US \$ 50 billion (1978-82)² or even as high as US \$ 120 billion³ or US \$ 130 billion (1975-83).⁴ This is a substantial order of magnitude, given the continent's gross indebtedness of some US \$ 350 billion in 1983.

The debt problem could be alleviated if flight capital could simply be set against foreign borrowing. However, outstanding foreign debts cannot be redeemed with

capital invested abroad by residents, for creditors and debtors are not identical. In general, the bulk of foreign loans were raised by the state or state enterprises, and even in economic circumstances that did not augur well for the efficient use of the funds obtained. The state or state enterprises often did not react to the adverse signals issuing from the market, but they were heeded by private individuals. Thus it was that a country could rank as a major debtor because the state had raised substantial loans while at the same time there were substantial foreign claims due to private investment abroad.

This distinction between the groups means that countries with substantial foreign assets can also find themselves in a debt crisis, for the state has no access to the wealth held abroad by its citizens. Nor can the banks involved offset their claims against deposits from a particular country, for the same reason.⁵

Against this background it is clear that the "flight of capital" should not be perceived solely as the export of foreign exchange in contravention of domestic regulations; perfectly legal exports of private capital can also raise serious problems for the country involved. Nevertheless, far-reaching controls on the movement of capital apply in many developing countries, such as a ban on the possession of foreign exchange, requirements to obtain authorisation for capital exports

¹ Cf. Peter Körner et al: Im Teufelskreis der Verschuldung. Der Internationale Währungsfonds und die Dritte Welt, Hamburg 1984, p. 137; cf. also Die Zeit, No. 7 of 8th February 1985.

² Cf. Bank for International Settlements, 54th Annual Report, 1984.

³ Cf.: Kapitalflucht, Sparschwein im Ausland, in: Wirtschaftswoche, 14th October 1983.

⁴ Cf. anon.: Lateinamerikas Kapitalflucht hat gigantische Ausmaße erreicht, in: VWD-Nachrichten of 10th July 1984; anon.: Lateinamerikas Bosse bringen ihre Gewinne in Sicherheit, in: Frankfurter Rundschau, 11th July 1984.

⁵ In addition, investors from developing countries have a strong preference for solid financial institutions, avoiding those that have a high exposure in developing countries. Cf. L. Glynn, P. Koenig: The Capital Flight Crisis, in: Institutional Investor, November 1984.

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and so forth, so that such legal exports of capital frequently play only a relatively minor role.

Forms of Capital Flight

For that reason, many methods of exporting capital illegally have emerged. One relatively easy way is to carry foreign exchange out of the country in a suitcase. In many instances, this hot money was earned illegally from bribery, black market dealings, and so on, so that it cannot be tracked statistically. In addition, foreign exchange earned from smuggling is invested directly abroad. This practice is also widespread in Zaire, for example. As a result, Zaire's neighbour, the People's Republic of the Congo, has become a diamond exporter of some importance without having any diamond deposits.⁶ Statistically, this form of capital flight does not have a direct impact on the balance of payments of the country of origin of the funds, but it does have an adverse effect on the current account through the loss of recorded export receipts.

An equally widespread practice is the acquisition of foreign exchange through the provision of "false" information in trade documents. For example, the exporter in the developing country agrees with his trading partner to show a lower price for the exports in the documents. The difference between the recorded price and the actual proceeds can be invested abroad by the exporter. The foreign trading partner has an incentive to go along with the transaction if the price he actually pays is less than the market price or if underinvoicing allows him to save on import duty.

The overinvoicing of imports, which is an equally common practice, has the same effect as the underinvoicing of exports. The parties to the deal record a high fictitious price in the documents for the foreign trade authorities. The importer can invest the difference between the fictitious and real proceeds abroad. In this way, foreign trade credits or foreign exchange allocated to an importer by the monetary authorities can be immediately diverted abroad. Such transactions are particularly simple for firms with a branch in the country in which they wish to invest, for the deal can then be carried out internally. Florida, with its proximity to Latin America, offers numerous examples of this; the state is swarming with import-export firms and there are countless bank branches competing for the flood of money stemming from such transactions.

These transactions are included in the statistics, but the recorded data do not accurately reflect the true flows

of goods and capital. Overinvoicing and underinvoicing inflate the recorded current account deficit of the country from which the capital originates.

The practices outlined above usually have the result that the balance of payments of neither the country of origin of the capital nor the country in which it is invested shows the full extent of the economy's foreign currency receipts or capital outflows. All that can be calculated with reasonable accuracy is the scale of private investment abroad that was reported or authorised, and hence left the country legally. In addition, it is possible to put a figure on capital exports resulting from the legal acquisition of foreign exchange, even if a reported transaction (exports of goods are recorded by the harbour authorities) is not matched by a corresponding financial entry (the monetary authorities are not informed, and there is no increase in the foreign exchange reserves). Cases such as these give rise to a gap in the balance of payments that is filled by the item "errors and omissions".

Hence, as far as the statistics on capital outflows are concerned, it is very important whether the foreign exchange has been earned illegally. For the individual investor, the form of investment is of just as much interest as the complicated methods by which the funds are acquired. The most sought after refuge currency is the dollar, although the Swiss franc and Japanese yen also play quite a significant role. The USA offers a safe haven for flight capital, particularly from Latin America. The funds do not necessarily enter the USA direct; they are often channelled via tax havens such as the Bahamas, the Cayman Islands, Panama or the Netherlands Antilles.

Causes of Capital Flight

What induces individuals and firms in developing countries to invest their capital abroad? There are basically three motives for capital flight. These can be characterised as the exchange rate motive, yield or tax considerations and capital flight on the grounds of risk and security.

(a) An overvalued currency and consequent rumours of devaluation can trigger the flight into a foreign currency. This foreign exchange need not necessarily be invested abroad. In many cases, however, domestic bank deposits may not be denominated in a foreign currency, so that investment abroad suggests itself.

Moreover, if the domestic currency is overvalued there are many reasons for hoarding foreign currency or investing abroad even if devaluation is not considered

⁶ Cf. bfai-Marktinformation, Volksrepublik Kongo, Wirtschaftsdaten und Wirtschaftsdokumentation, Cologne 1983, p. 16.

imminent. When the exchange rate is too high the demand for foreign currency far exceeds supply. The foreign exchange market is therefore strictly regulated. To give the monetary authorities complete control over foreign exchange receipts, the regulations already begin to apply at the point where foreign currency can be earned. Hence, foreign exchange received in payment for exports must often be converted immediately at the official exchange rate. Similarly, foreign exchange is allocated by an official body, usually only for specified import purposes. In such cases, the export of capital is also subject to authorisation or completely prohibited. As no individual or firm willingly surrenders import decisions to a state agency, exchange market controls such as these are circumvented.

Exporters and importers also have an incentive to engage in illegal foreign exchange transactions if different exchange rates apply to commercial and capital market transactions. The monetary authorities often support imports by setting a lower rate for foreign currency, thereby discriminating against capital exports. In such cases the importer can overinvoice for imported goods, eliminating the distinction between commercial and capital transactions and obtaining the foreign exchange at a better rate.

The acquisition of foreign exchange can also be an important motive in the case of smuggling, although here capital flight is often only a secondary phenomenon if the smugglers' main aim is to evade high export duties or obtain a higher price for their goods abroad if prices are fixed at a low level at home and/or if a marketing board has a monopoly.

(b) The yield motive comes to the fore if capital will earn a lower return at home than abroad. If savers are faced with negative real interest rates on their deposits whereas positive real interest rates can be earned abroad, they come down in favour of a foreign account. Tax considerations also induce investors to invest their money in tax havens such as the Netherlands Antilles rather than at home, where their income is taxed heavily.

Low or highly uncertain yields at home also make it easier for potential investors to opt for an account abroad; high taxes, price controls, import restrictions and political instability can reduce profit margins and increase the risk. If inflation rates are high, price controls on certain goods to combat the rise in prices can have a particularly detrimental effect on investment at home. In such cases frequent price adjustments are necessary. If the authorities fail to make such adjustments, firms incur large losses due to price distortions. The mere expectation of possible price distortions due to high

inflation or price controls can make realistic planning difficult. In comparison, foreign investment is often considered to be less risky.

(c) Finally, capital exports are also induced by the simple desire to safeguard assets. Here it is usually not so much yield considerations as the security motive or portfolio considerations that come into play. Residents seek to invest part of their wealth abroad mainly for political reasons, especially the fear of expropriation.

Methods of Estimation

There are therefore enough reasons for transferring capital out of the country. In many cases, this is done in the illegal ways described above. Typically, the bulk of these illegal capital exports are not recorded statistically. Capital flows nevertheless leave traces that can provide a basis for estimating the scale of the phenomenon. For example, banks attempt to calculate the volume of flight capital from the deposits they receive from developing countries. However, individual banks can only provide information on part of the total amount, so that their estimates are necessarily subject to such wide margins of error that they serve only as a rough guide.

Easier to follow are estimates of private capital exports not used to repay debt, made on the basis of the balance of payments. This method has the advantage that it does not rely on rough estimates; its disadvantage is that it cannot reflect the full extent of capital flight owing to over and underinvoicing and smuggling. In other words, this method relates consciously to capital exports that are generally not effected by illegal means. As this capital cannot be used to repay foreign debt and hence constitutes a serious problem for heavily indebted countries, this article will concentrate on this form of capital exports.

Estimating the flight of capital on the basis of balance of payments statistics is a method that is frequently used, not least by the Bank for International Settlements.⁷ It consists in comparing officially recorded changes in gross foreign indebtedness with the net figures for all credit related positions in the balance of payments. The difference between the two aggregates allows conclusions to be drawn as to the scale of capital flight. The calculation is based on the assumption that a current account deficit and the accumulation of foreign exchange reserves give rise to a certain financing requirement, which would have to be reflected in the change in gross foreign indebtedness (the redemption

⁷ Cf. BIS, op. cit.

DEBT PROBLEMS

Table 1
Estimates of the Flight of Capital from Selected Countries, 1976-1982
(in millions of US dollars and percentages)

Continent/ country	Increase in external indebtedness based on OECD data — in millions of US dollars —	Increase in short-term indebtedness statistics — in millions of US dollars —	Net capital inflow based on balance of payments statistics (3)	Unrecorded capital exports taking into consideration			
				Medium & long-term indebtedness		Total indebtedness	
				US\$m ^a	% ^b	US\$m ^c	% ^d
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Latin America							
Argentina	22,787	6,070	5,636.9	17,150.1	(75.3)	23,220.1	(80.5)
Bolivia	1,850	—	1,158.3	691.7	(37.4)	—	—
Brazil	49,857	11,219	53,271.0	-3,414.0	(0.0)	7,805.0	(12.8)
Colombia	4,560	2,068	6,376.6	-1,816.6	(0.0)	251.4	(3.8)
Costa Rica	2,237	—	1,392.0	845.0	(37.8)	—	—
Ecuador	3,404	—	4,085.2	— 681.2	(0.0)	—	—
El Salvador	678	—	432.2	245.8	(36.3)	—	—
Guatemala	1,135	—	884.8	250.2	(22.0)	—	—
Honduras	1,049	—	1,296.4	— 247.4	(0.0)	—	—
Jamaica	1,102	—	804.3	297.7	(27.0)	—	—
Paraguay	1,023	—	1,912.6	— 889.6	(0.0)	—	—
Peru	5,132	765	4,991.7	140.3	(2.7)	905.3	(15.4)
Mexico	43,824	22,087	30,336.2	13,487.8	(30.8)	35,574.8	(54.0)
Venezuela	14,281	2,557	5,827.4	8,453.6	(59.2)	11,010.6	(65.4)
Africa & Middle East							
Cameroon	1,789	—	1,422.5	366.5	(20.5)	—	—
Egypt	11,535	—	7,591.4	3,943.6	(34.2)	—	—
Jordan	1,860	—	1,240.4	619.6	(33.3)	—	—
Kenya	1,834	—	2,706.9	— 872.9	(0.0)	—	—
Lesotho	139	—	177.3	— 38.3	(0.0)	—	—
Liberia	466	—	463.1	+ 2.9	(0.6)	—	—
Morocco	7,825	—	9,821.3	-1,996.3	(0.0)	—	—
Nigeria	6,490	—	3,747.4	2,742.6	(42.3)	—	—
Syria	1,968	—	78.9	1,889.1	(96.0)	—	—
Tunisia	2,676	—	2,293.3	382.7	(14.3)	—	—
Yemen	1,158	—	1,657.8	— 499.6	(0.0)	—	—
Zambia	1,470	—	1,041.5	428.5	(29.1)	—	—
Zimbabwe ^e	1,024	—	1,743.5	— 719.5	(0.0)	—	—
Asia							
India ^f	6,403	—	4,271.3	2,131.7	(33.3)	—	—
Indonesia	11,669	—	6,504.6	5,164.4	(44.3)	—	—
Korea	16,223	—	22,259.8	-6,036.8	(0.0)	—	—
Papua-New Guinea	523	—	894.6	371.6	(0.0)	—	—
Philippines	9,221	—	12,294.0	-3,073.0	(0.0)	—	—
Thailand	6,308	—	9,371.0	-3,063.0	(0.0)	—	—
Turkey	11,373	—	11,721.3	— 348.3	(0.0)	—	—

^a (1) - (3). ^b $\frac{(1) - (3)}{(1)} \times 100$. ^c (1) + (2) - (3). ^d $\frac{(1) + (2) - (3)}{(1) + (2)} \times 100$. ^e 1977-82. ^f 1976-81.

Sources: OECD, External Debt of Developing Countries, 1983 Survey; IMF, Balance of Payments Statistics, Vol. 35, Yearbook Part 1, 1984; IDB, External Debt and Economic Development in Latin America, Background and Prospects, Washington, D.C., January 1984.

of previous loans has already been balanced out here). If the change in gross foreign indebtedness exceeds the current account deficit and the increase in foreign exchange reserves, it can be assumed that external resources were tapped for other reasons, namely for the private export of capital.

This is essentially the method that has been used in the following examination. The change in medium and

long-term gross external indebtedness is drawn from OECD statistics.⁸ Estimates of short-term borrowing, where available, have been added for certain countries. The comparable aggregate from the balance of payments consists of the following items:

⁸ Cf. OECD: External Debt of Developing Countries, 1983 Survey, Paris 1984.

- ☐ official and private long and short-term loans;
- ☐ portfolio investment, which mainly comprises long-term public bonds;
- ☐ other loans from the item "exceptional financing" to the extent that they do not relate to payment arrears;⁹
- ☐ changes in liabilities towards foreign monetary authorities;
- ☐ errors and omissions as a catch-all for capital movements not recorded in the statistics.

These items correspond to the sum of the current account balance, the balance on foreign exchange account and net direct investment.

An example: balance of payments statistics for the period from 1976 to 1982 show that country X raised medium and long-term loans totalling US\$ 6 billion. According to OECD data, external indebtedness grew by US\$ 10 billion over the same period. Hence US\$ 4 billion flowed abroad in the form of long-term private exports of capital. In addition, short-term credits showed a net capital outflow of US\$ 2 billion and the item "errors and omissions" was negative to the tune of US\$ 4 billion. Private exports of capital therefore totalled US\$ 10 billion.

This method has been used for twelve of the countries with the heaviest debts in absolute terms¹⁰ and for a further 22 middle-income countries¹¹ for the period from 1976 to 1982.

Scale of Capital Flight

The calculations show that the largest flight of capital in absolute terms was recorded by Argentina (US\$ 17.2 billion, or US\$ 23.2 billion including short-term credits), Mexico (US\$ 13.5 and 35.6 billion), Venezuela (US\$ 8.5 and 11.0 billion) and Indonesia (US\$ 5.2 billion) (see Table 1). These countries and three others with a substantial flight of capital (Egypt, Nigeria and India) also belonged to the group of major debtors. Among the other heavily indebted countries, there is evidence of capital flight on a small scale from Brazil only if short-

term borrowing is taken into account; the same applies to Peru. Using this method, Korea, the Philippines and Turkey do not appear to have suffered a flight of capital.

The fact that countries with heavy borrowing also exhibit a high level of capital flight could lead one to conclude either that a country relatively well endowed with foreign exchange as a result of borrowing also has a potential for outflows of foreign exchange, or that substantial capital outflows were the cause of heavy borrowing in the first place. Indeed, the flight of capital from seven of the twelve heavily indebted countries was also high in relation to recorded gross borrowing. However, a few countries that were less heavily in debt in absolute terms also displayed a high level of capital flight in relation to borrowing. In the following countries, capital flight accounted for more than one-fifth of loans: Bolivia, Cameroon, Costa Rica, El Salvador, Guatemala, Jamaica, Jordan, Syria and Zambia. Nevertheless, these are only 9 of the 22 countries with middle per capita incomes.

In the balance of payments, the items that reveal capital flight are relatively easy to recognise: as a rule, countries with a substantial level of capital flight had negative "errors and omissions" and/or "short-term credits" (see Table 2).

For some countries, the difference between gross short-term credits recorded by external independent agencies (for example, the Inter-American Development Bank (IDB) makes such estimates for South America) and the net figure for the balance of payments item "short-term credits" can be quantified precisely; in the case of Argentina, the balance of payments shows net short-term credit operations of US \$ -12.2 billion (cumulative for the period from 1976 to 1982), while IDB statistics¹² show a gross increase of US \$ 6.1 billion over the same period. This means that private individuals accumulated assets of US \$ 18.3 billion abroad in this way, compared with recorded capital imports of US \$ 6.1 billion. According to balance of payments statistics, Venezuela exported a net amount of US \$ 10 billion in short-term capital, but the IDB recorded a gross increase of US \$ 2.6 billion in short-term capital imports.

Whereas the IDB statistics and the balance of payments for these countries even show capital flows in opposite directions, in some countries the short-term capital inflows according to IDB statistics are still larger than the net inflows calculated from the balance of payments; this is true of Mexico (US \$ 22.1 billion according to IDB statistics as against US \$ 9.8 billion on a balance of payments basis) and Brazil (US \$ 11.2

⁹ Payment arrears are not to be equated with borrowing and are not covered by the OECD reporting system.

¹⁰ Argentina, Brazil, Mexico, Peru, Venezuela, India, Indonesia, Korea, the Philippines, Turkey, Egypt and Nigeria.

¹¹ Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Paraguay, Jordan, Cameroon, Kenya, Lesotho, Liberia, Morocco, Syria, Tunisia, Yemen Arab Republic, Zambia, Zimbabwe, Papua-New Guinea and Thailand.

¹² Cf. Inter-American Development Bank: External Debt and Economic Development in Latin America, Background and Prospects, Washington, D.C., January 1984, Table 1.

DEBT PROBLEMS

Table 2
Financing of Current Account Deficits, 1976-1982
(Averages as a percentage of current account deficit)

Country	Direct investment	Long-term credits ^a	Short-term credits	Errors & omissions	Change in foreign exchange reserves	Other items ^b	Current account balance
Capital flight > 20 % of indebtedness							
Syria	—	236.4	445.9	-657.5	155.3	-80.1	100.0
Argentina	30.8	250.8	-176.9	- 8.7	-33.7	37.7	100.0
Venezuela	- 6.4	392.0	-262.2	22.5	-101.4	55.5	100.0
Indonesia	36.2	321.9	- 35.5	-141.5	- 88.2	7.1	100.0
Nigeria	12.7	38.1	2.2	- 9.2	25.8	30.4	100.0
Costa Rica	13.8	63.0	- 13.1	3.2	- 10.1	43.2	100.0
Bolivia	11.7	165.7	- 16.2	- 64.2	1.9	1.1	100.0
El Salvador	7.6	177.6	0.9	-104.2	17.2	0.9	100.0
Egypt	35.4	89.5	- 17.6	2.7	- 6.3	- 3.7	100.0
Jordan	117.5	337.9	228.9	-110.4	-533.4	59.5	100.0
India ^c	—	—	—	—	—	—	negative ^d
Mexico	22.7	101.7	25.2	- 54.0	1.0	5.2	100.0
Zambia	8.1	42.2	- 2.2	- 1.8	25.2	28.2	100.0
Jamaica	- 8.0	59.0	- 4.5	1.5	45.3	6.7	100.0
Guatemala	39.3	68.3	- 7.7	- 8.6	8.8	- 0.1	100.0
Cameroon	26.9	77.0	0.6	0.6	- 4.9	- 0.2	100.0
Capital flight < 20 % of indebtedness							
Tunisia	37.1	79.4	- 13.0	4.2	- 8.6	0.9	100.0
Peru	10.7	95.1	- 0.2	7.8	- 19.0	8.2	100.0
Brazil	19.4	65.8	9.9	0.4	2.4	2.1	100.0
Ecuador	6.6	87.8	11.0	- 8.3	- 2.7	- 5.6	100.0
Honduras	5.0	83.4	11.9	- 4.6	4.0	0.3	100.0
Colombia	23.7	126.5	21.5	34.7	-139.7	33.3	100.0
Paraguay	13.7	62.6	68.6	- 2.8	- 48.3	6.2	100.0
Yemen	7.7	67.7	- 7.0	43.5	- 16.2	4.3	100.0
Kenya	12.0	65.8	16.0	- 1.4	6.6	1.0	100.0
Lesotho	9.9	100.1	8.2	23.7	- 39.4	- 2.5	100.0
Liberia	11.0	68.1	2.3	- 9.4	25.0	3.0	100.0
Morocco	3.6	86.1	0.4	0.8	9.4	- 0.3	100.0
Zimbabwe ^e	0.1	40.2	33.2	30.9	- 7.3	2.9	100.0
Korea	1.1	83.1	55.5	- 16.0	- 27.4	3.7	100.0
Papua-New Guinea	31.7	67.3	1.5	10.7	- 14.3	3.1	100.0
Philippines	7.5	63.4	51.7	- 13.7	- 24.8	15.9	100.0
Thailand	9.2	71.6	25.5	- 7.2	- 1.6	2.5	100.0
Turkey	4.5	88.3	2.4	- 4.1	2.4	6.5	100.0

^a Long-term credits, portfolio investment, exceptional financing (excluding defaulted loans), liabilities towards foreign monetary authorities.

^b Counterpart items, defaulted loans.

^c 1976-81.

^d Current account surplus.

^e 1977-82.

Source: Calculated from IMF, Balance of Payments Statistics, Vol. 35, Yearbook 1984, Part. 1.

billion as against US \$ 6.9 billion). The difference between the figures suggests that private exports of capital have taken place. Unfortunately, data on short-term borrowing are only available for a few countries.

The methods employed in this examination are such that estimates of the flight of capital based on balance of payments data constitute the lower limit of private exports of capital, for, as a rule, only capital flows recorded by the monetary authorities can be measured. Nevertheless, the order of magnitude of the

phenomenon calculated in this way is comparable with estimates based on other methods. These confirm that the major debtors Mexico, Venezuela, Argentina, Nigeria, Indonesia and Egypt are among the countries with the highest flight of capital.¹³

However, it also transpires that other countries which appeared to be above suspicion when viewed on a

¹³ Cf. anon.: Lateinamerikas Kapitalflucht etc., op. cit.; and anon.: An Exodus of Capital is Sapping the LDC Economies, in: Business Week, 3rd October 1983.

Table 3
Capital Flight, Price Distortions and
Exchange Controls, 1976-1982

Country	Capital flight as a percentage of borrowing ^a	Holding of bank accounts abroad permitted ^b	Real percentage interest rate ^c	Average percentage rate of change in real effective exchange rate ^d
Capital flight > 20 % of indebtedness				
Syria	96.0	×	- 3.2	- 1.8
Argentina	75.3	×	- 6.6	- 5.4
Venezuela	59.2	×	-14.4	n. a.
Indonesia	44.3	×	- 0.5	3.4
Nigeria	42.3	-	-10.3	- 5.9
Costa Rica	37.8	×	- 4.1	10.2
Bolivia	37.4	-	- 8.3	- 4.0
El Salvador	36.3	-	- 3.7	- 4.2
Egypt	34.2	×	- 6.4	7.5
Jordan	33.3	-	- 4.0	- 1.2
India	33.3	-	1.1	2.8
Mexico	30.8	×	- 0.8	1.4
Zambia	29.1	-	- 4.7	0.2
Jamaica	27.0	-	- 3.2	2.3
Guatemala	22.0	×	- 1.3	- 0.7
Cameroon	20.5	-	- 5.3	1.5
Capital flight < 20 % of indebtedness				
Tunisia	14.3	-	- 2.4	4.3
Peru	2.7	-	-17.8	3.7
Brazil	-	-	-14.7	- 5.4
Ecuador	-	×	- 6.1	- 2.0
Honduras	-	×	2.3	- 1.0
Colombia	-	-	1.0	- 3.3
Paraguay	-	×	-	- 5.6
Yemen	-	n. a.	n. a.	- 4.2
Kenya	-	-	- 3.3	- 0.2
Lesotho	-	n. a.	-	- 1.1
Liberia	-	×	- 1.8	- 0.1
Morocco	-	-	- 3.5	2.4
Zimbabwe	-	-	- 5.2	1.9
Korea	-	-	- 4.3	- 1.0
Papua-New Guinea	-	n. a.	-	0.0
Philippines	-	-	- 3.5	- 1.2
Thailand	-	-	3.1	0.2
Turkey	-	-	-20.5	5.5

^a Medium and long-term borrowing only.

^b × = yes, - = no.

^c The real interest rate r is obtained by deflating the nominal interest rate i (here the discount rate) by the inflation rate p (here the GDP deflator); $r = \frac{i-p}{1+p}$

^d Real effective exchange rate index = $\frac{\text{international consumer price index}}{\text{consumer price index (developing country)}}$ x nominal exchange rate index;

the international consumer price index is an index of the consumer price indexes of trading partners (USA, Federal Republic of Germany, Japan, United Kingdom, France) weighted according to their import shares; the nominal exchange rate index is an index of the exchange rate indexes of the currency of the country in question in relation to the US dollar, Deutsche Mark, yen, pound sterling and French franc, weighted according to import shares. - Positive variations indicate trend towards undervaluation, negative variations trend towards overvaluation. Rates of change were calculated by the least squares method. Sources: Table 2; Philipp P. Cowitt (ed.): World Currency Yearbook 1984, Vol. 23, Brooklyn, New York 1985; Klaus Stanzel: Preisverzerrung und Effizienz, internal HWWA study.

balance of payments basis must have a quite substantial volume of private investment abroad. In 1984 Peru's assets abroad were put at "between \$ 5 and 10 billion" by banking circles, and Brazil was said to have foreign assets of between US \$ 14 and 19 billion.¹⁴ The flight of capital from the Philippines is put at about US \$ 3 billion between 1980 and 1982¹⁵ or as high as US \$ 8.9 billion between 1978 and 1983.¹⁶ Discrepancies between calculations of external assets on a balance of payments basis and estimates from other sources mostly arise in the case of countries where strict controls on capital transactions induce unrecorded capital flows (profits from smuggling, over and underinvoicing), as in Brazil, the Philippines and Peru.

Price Distortions in Capital Flight Countries

It is highly probable that many more countries were affected by the flight of capital in the seventies than the statistics show. There were motives enough for outflows of private capital from these countries; in almost all of the countries examined here (except India, Honduras, Colombia and Thailand) the real interest rate for domestic credit was negative from 1976 to 1982,¹⁷ so that financial investment at home was not worthwhile.

The World Bank has identified overvaluation of the currency as one of the most important and common causes of the flight of capital.¹⁸ In point of fact, the currencies of most of the countries under examination showed a tendency towards overvaluation (see Table 3). Even those countries that devalued their currencies in real terms between 1976 and 1982 generally showed an overvaluation in earlier years. This was corrected, mainly in the context of conditional IMF programmes. Examples of this are the real devaluation of 130 % by Argentina in 1982, 82 % by Egypt in 1979, 32.7 % by Turkey between 1980 and 1982, 30.2 % by Peru in 1978 and 21 % by Brazil in 1980.

These are circumstances that apparently encourage particularly high outflows of capital. However, even after devaluation of the currency, the resources were not generally repatriated. One can only speculate as to the reasons for this. First, return flows may only occur after a time-lag. Secondly, the continuing prospects of better yields abroad and growing political uncertainty at home

¹⁴ Cf. anon.: Lateinamerikas Kapitalflucht etc., op. cit.

¹⁵ Cf. anon.: An Exodus of Capital etc., op. cit.

¹⁶ Cf. L. Glynn, P. Koenig, op. cit.

¹⁷ Over the same period the real interest rate in the USA (calculated on the basis of the discount rate and the GNP deflator) was 1.9 %. Calculated from IMF: International Financial Statistics Yearbook 1984.

¹⁸ World Bank: World Development Report 1985, pp. 63 ff.

in the wake of the austerity measures associated with the IMF programmes may have induced capital exporters to leave their money abroad.

However much the methods of estimating the flight of capital may differ, Argentina, Venezuela and Mexico are regularly identified as the countries with the highest level of capital flight in absolute terms. In relation to external indebtedness, however, capital outflows from smaller countries are also significant. As a rule, mistaken economic policies led sooner or later to capital flight. Controls on capital transactions could only stem the flow, not prevent it; they lead to illegal capital exports that are very difficult to record statistically.

Nevertheless, the flight of capital is not the inevitable fate of the countries in question. In general, it is a symptom of economic mistakes and not the cause of economic problems. Moreover, in the economic conditions that prevailed (negative real interest rates, an overvalued currency, and so forth) the export of capital can prove a more efficient alternative to investment at home, as in these circumstances the domestic use of the resources is bound to lead to the waste of capital. In theory at least, the export of capital leaves open the possibility that the capital will return home when the economic climate improves and can then be invested efficiently.

INDUSTRIAL POLICY

Industry-specific Strategies in a Protectionist World

by Robert Ballance, Vienna*

The period from 1950 to 1974 was one of exceptional economic progress, particularly in manufacturing. This article examines how some of these developments have altered the objectives and methods of formulating industrial policy in western countries. Following a brief discussion of sector-wide policies and strategies, evidence from two industries – steel and advanced electronics – is used to illustrate the growing range of strategic choices and the interaction between public policy-makers and private industry. Finally, some generalizations with regard to industry-specific strategies are presented.

Since 1950, policy-makers in various capitals have witnessed a relative decline in the international role of their country's manufacturing sector. A marked deterioration occurred in the case of the US, although similar trends emerged in the UK and elsewhere. For instance, during 1963-78, the combined share of world manufacturing value added in eight western countries declined from 46 to 33 per cent.¹ Opposite trends were observed in other countries, notably Japan and West Germany.

The redistribution of industrial capabilities led to several modifications in the international framework

which, heretofore, had guided policy-makers in the fields of industry, trade, finance and investment. First, experience suggests that the operation of such a system usually requires a powerful leader or regulator. The internationalization of economic relations is thought to proceed most rapidly when one nation has a near monopoly of power.² But as the range of industrial capabilities between western countries narrowed, more

¹ Cf. R. Ballance and S. Sinclair: *Collapse and Survival: Industry Strategies in a Changing World*, London 1983.

² The UK performed this function prior to the 1930s (cf. C. P. Kindleberger: *The World in Depression, 1929-39*, Berkeley 1973). A similar role was played by the US until the mid 1970s when a vacuum in international leadership emerged (cf. OECD: *Interfutures, Facing the Future: Mastering the Probable and Managing the Unpredictable*, Paris 1979).

* UNIDO. The views expressed in this paper are those of the author and are not necessarily those of the organization with which he is affiliated.