THE MAGNITUDE AND DETERMINANTS OF CAPITAL FLIGHT:
THE CASE FOR SIX SUB-SAHARAN AFRICAN COUNTRIES**

BY

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1 INTRODUCTION

In recent discussions concerning the debt crisis, capital flight is an important issue. Many developing countries (LDCs) lack the financial resources needed for appropriate economic adjustments. Capital flight aggravates this shortage of resources, which indirectly leads to a decline in domestic investments. Capital flight also reduces the potential tax receipts of the government. Moreover, capital flight is generally seen as an indicator of a lack of private confidence which allows commercial banks to rationalize their unwillingness to resume new lending. Some authors show that LDCs' borrowing is substantially diverted into private assets abroad, i.e. in capital flight (Cuddington 1987, Pastor 1990).

Most studies treat capital flight as an exclusively Latin American problem. Therefore, nearly all capital flight estimates refer to countries from this region. It is surprising that there are very few capital flight studies for African countries.1 One wonders, however, whether capital flight is indeed not an important issue for the African region. This paper estimates capital flight for six African countries and shows that the emphasis on Latin American capital flight is not correct. It appears that the burden of capital flight is also important for many African countries. Moreover, this paper tries to find some determinants for the African countries' capital flight. The increase of government and government-guaranteed foreign debt and the overvaluation of the real exchange rate appear to be the most important explanatory factors of capital flight for the African countries in this study. After discussing the different methods which are used to estimate capital flight in section 2, section 3 presents capital flight estimates for six African countries. Section 4 summarizes the

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1 Deppler and Williamson (1987) give some estimates of capital flight for the African region as a whole. They do not present estimates for individual countries. Brown (1990) estimates capital flight for Sudan. Erbe (1985) gives estimates for ten African countries. Of these ten countries, only Nigeria appears in our study. Moreover, these authors do not try to find determinants of the African capital flight.
literature on the different determinants of capital flight, while section 5 presents an econometric investigation of the determinants of African capital flight. Section 6 contains some conclusions.

2 METHODS TO ESTIMATE CAPITAL FLIGHT

Two concepts of capital flight can be distinguished. The first concept emphasizes the difference between normal capital outflows and capital flight. Normal capital outflows are defined as the legal capital outflows, whereas all capital flows based on the desire to place assets beyond the control of domestic authorities are labeled capital flight. The problem with this concept is that the distinction between normal capital outflows and capital flight cannot be determined empirically. Besides, the impact of normal capital outflows and capital flight on the domestic economy does not really differ. A country confronted with a lack of financial resources suffers from capital outflows, irrespective of the form of the capital outflow.

Yet, Dooley (1986) tries to estimate the magnitude of capital flight on the basis of the above-mentioned concept. He sees capital flight as the difference between total capital outflows and capital outflows on which interest payments are received and registered in the balance of payments statistics, i.e. legal capital outflows. Total capital outflows ($TK$) are calculated as:

$$TK = \Delta D_g + FDI - CA - \Delta RES_n$$

where $\Delta D_g$ is the increase in gross debt; $FDI$ is net direct investments inflows; $CA$ is the current account deficit; and $\Delta RES_n$ is the net increase in reserves.\(^2\)

Next, the registered interest receipts are considered. With the help of a realistic interest rate the amount of assets corresponding with these registered interest receipts is calculated. Finally, capital flight is determined as the difference between the local capital outflows and the legal capital outflows calculated via the interest receipts registered.\(^3\) Next to the above-mentioned problems with respect to this concept of capital flight, an additional problem is how to determine the realistic interest rate.

The second concept of capital flight does not distinguish between true capital flight and normal capital outflows. It measures capital flight as the increase of all or a subset of the foreign assets held by residents of the country. Cuddington (1986), Dooley et al. (1986) and Ketkar and Ketkar (1989) measure capital flight as the sum of the yearly short-term capital outflows plus the balance of payments entry 'net errors and omissions.' This method exclusively concen-

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2 In fact he also adds, among other things, the difference between World Bank and IMF debt statistics.