Dissertation

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External debt and capital flight: Nigeria's experience (1970-1990)

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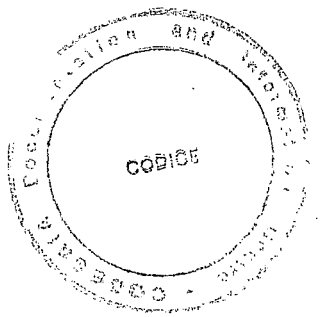
EXTERNAL DEBT AND CAPITAL FLIGHT: NIGERIA'S EXPERIENCE (1970-1990)



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DEDICATION

This work is dedicated to God the Father, God the Son and God the Holy Spirit, for in You I live, and move and have my being.

DECLARATION

I hereby declare that this is a product of my own research and that no part thereof has been submitted by anybody elsewhere for the award of any degree.

All materials consulted and references made are fully acknowledged by way of bibliography at the end of the thesis.

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I commend you all to God and to the word of His grace which is able to build you up, and to give you an inheritance among all them which are sanctified in Jesus' name.

Thank you.

Bamidele, R.O.
April, 1994

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ABSTRACT

The debt crisis has contributed to economic difficulties and political conflicts in Nigeria. Often lost in the policy debates and political struggles about the crisis has been this central fact that there is a coexistence of massive capital flows in both directions.

Capital flight which is the exit of residents' own capital from the domestic economy was measured as a residual from the balance of payments equation which equated the source of finance to their uses. The relationship between external debt and capital flight on the one hand and other factors determining them was elucidated by multiple regression models.

The regression results support the hypothesis that debt fueled capital flight and flight-fueled external debt or borrowing were important aspects of the Nigeria's experience in the study period. By inference, capital flight imposes growth cost, erodes the tax base, worsen income distribution and constitutes the single major factor keeping Nigeria in her present debt problems. Consequently, the solution to Nigeria's external indebtedness is located within the penacea to the capital flight syndrome.

CHAPTER ONE

INTRODUCTION

The first oil shock (1973/1974) was one that brought a boom and boost to the economy of Nigeria. The increase in revenue was accompanied by a change both in pattern and level of expenditures. This phenomenon was one in which the 'life' of the country was caught up in the present mess as the government of the day lacked foresight into the future. Thus, the oil sector was given prominence to the neglect of the other sectors, particularly agriculture, which prior to that time had been the mainstay of the country. Nigeria became a monoproduct economy highly susceptible to the vagaries in the world market. Given a short fall in the oil export receipts, Nigeria resorted to deficit financing. This was actually apparent since 1978. The Eurodollar market soon became a prominent a source of credit to finance our deficits through recycling.

Since 1982 the debt crisis has contributed to economic difficulties and political conflicts in Nigeria. Infact the issue of external indebtedness of the Less Developed Countries (LDCs) has dominated most debates about global finance since 1982. This phenomenon has become a thorn in the flesh that has remained intractable in this country. Nigeria's external debt which was at US $567 million in 1970

had reached an height of US $5091 million in 1978. However, its growth has reached a dramatic stage such that it stood at US $30,178 million in 1988.

The magnitude and severity of Nigeria's debt problem is more forcefully demonstrated by movement of certain debt ratios. At 13.3 per cent in 1980, the debt/export ratio rose to 404.2 per cent in 1986 and from 341.0 per cent in 1987 and to 241.5 per cent in 1991. The ratio of debt /GDP rose continuously from only 3.8 per cent in 1980 and from 62.3 per cent in 1986 to 350.1 per cent in 1991. Similarly, the burden as measured by the ratio of debt service/export of goods and services rose rapidly from 0.7 per cent in 1980 to 28.1 per cent in 1985 and to 25.8 per cent in 1991. This ratio would have exceeded 65 per cent since 1985 but for payment defaults and subsequent debt restructuring and refinancing (CBN,1992).

The factors which combined to bring the external debt to its current levels comprised borrowings from the multilateral and lateral institutions, the accumulation of trade arrears, default in the payment of loans, capitalization of unpaid interest, and depreciation of the US dollar against other major international currencies in which the loans were contracted. This plight is one that has occasioned a situation of servant-master relationship between Nigeria on the one hand and the creditor governments and institutions on the other.

Often lost in the policy debates and political struggles about the crisis has been one central fact. That is, Nigeria has enough assets outside her borders to off set large portions of her total external debt. Capital flight- the exit of residents' own capital from the country amounted to US $26.7 billion in the years 1970-1990 (Table 16, page 85). If compared to the increase in debt over the same period the results are startling; about 87 percent of the debt build-up was used to finance capital flight. The coexistence of debt and capital flight is, thus, considered unsound and abnormal.

The high level of capital flight presents several economic and political problems. First, growth is reduced, partly because investment has been diverted abroad but also because necessary imports are limited by the foreign exchange drain from both the flight itself and the fact that earnings on such flight assets are often not repatriated. Second, the combination of debt accumulation and capital flight creates a perverse distributional dynamic. The poor undergo austerity in order to pay international banks which in turn make interest payments to those Nigerians wealthy enough to have assets abroad. Finally, capital flight impedes a resolution of the overall debt problem (and by extension ,a recovery of world trade) since it is difficult to persuade developed nations to extend new credit or debt relief when such a high percentage of the new resources may

merely "slip out" of the country again as capital flight (Pastor, 1990).

The preponderant of the causes of capital flight are often attributed to economic factors. These are often traced to disincentive created mainly by distortion in domestic macro economic policy. These distortions manifest themselves in large public sector deficits, exchange rate misalignment, inflation and financial repression. As part of the economic causes also are incentives provided by foreign banks and government. These include attractive returns and the maintenance of secrecy on deposits. These are basically the obverse of the factors that triggered them off the domestic economy.

Part of the explanation for capital flight which is often ignored in most analysis on the topic is the political aspect. This is predicated on corruption and access to foreign funds by political leaders. It has been alleged that some political leaders through the perquisites of their offices siphon funds to foreign countries . Thus, access to political offices and the corruptibility of such office holders become important factors. As part of the corruption, it has been alleged that in the years when petrodollar surged into Mexico, Venezuela and Nigeria, the opportunity for graft multiplied in these years and a lot of money consequently was siphoned abroad (Ajayi,1992).

The conduits for capital flight are both many and

varied. These include cash or monetary instruments, bank transfers from a local affiliate of foreign owned bank to a designated recipient abroad, precious metals and collectibles including works of art, false invoicing of trade transactions, the black market and commissions and agents fees which are paid by foreign contractors into the foreign bank account of residents.

This study intends to construe capital flight as a stolen money by placing emphasis on the private capital outflow from Nigeria. The public capital outflows would take the form of repayments on external debt and donation made to foreign government. Discussions here have not centred on the public capital outflows since it is officially documented and assumed to be reflected in the country's official level of reserves. Having acknowledged the role of the investment climate at determining capital flight, we have also recognised public officials and a few influential persons as very important. The role of these people is predicated on corruption.

Econometric investigation of the linkages between external debt and capital flight supports what we have referred to as "debt-driven" capital flight and "flight-driven" external debt on the one hand and "debt fueled" capital flight and "flight-fueled" external debt on the other. These are situations in which external debt and capital flight both provide the motive and resource for each

other. The econometric investigation did not show much significant influence of the economic factors on capital flight determination. Given the relationship between external debt and capital flight, corruption becomes a point of reference and a plight to embattled Nigeria.

1.1 STATEMENT OF THE PROBLEM

One of the greatest problems confronting many LDCs including Nigeria today is the level of their external indebtedness. The external debt problem of these countries is becoming more acute for a number of reasons. First, the size of the debt relative to the size of the economy is enormous which discourages private investment in the country. Secondly, the debt servicing payments has gulped-up an increasing proportion of the annual export earnings thereby reducing resources needed to improve on the welfare of the citizens. The welfare of the people and the growth process of the economy is thus jeopardized. Thirdly, the debt burden of these countries threaten not only the execution but also the prospect and success of the adjustment programme being embarked upon. This is particularly important considering the various hardship the populace of these countries have been subjected to since the commencement of the adjustment programmes.

It is however worthy of note that there exists movement of capital in both directions in Nigeria and most other

LDCs. While the government is borrowing abroad to finance rising fiscal deficits some other people within the domestic economy are procuring external assets. This simultaneous coexistence of foreign borrowing and capital outflows is of importance both on practical and theoretical grounds. First, it is believed that capital should move from capital concentrated Developed Countries to capital scarce Developing Countries. Any contrary movement of capital is theoretically abnormal and unsound. However this is exactly what has been happening in Nigeria and many more Less Developed Countries for some decades now. Secondly, the exported capital reduces the growth rate of the country . This is because flight capital is not available for local investment. Thirdly and very importantly, flight capital reduces the capacity of the countries to service their debts.

It has been discovered that capital flight both provide the motive and the resource for foreign borrowing. At the same time,foreign borrowing both provide the motive and resource for capital flight. Thus,it becomes a thing of concern why the government and the populace of the country through the government should be shouldered with the burden of debt servicing when the borrowed funds are not invested within the domestic economy to benefit the people. While the income earned on such external assets are retained abroad the hard-earned foreign exchange is used to service

external debt.

As important and urgent as this plight might look, there still remains a research gap in the literature. It is the intent of this work to unfold these phenomena of external debt and capital flight in Nigeria.

1.2 OBJECTIVE OF THE STUDY

With the magnitude of research work that have been undertaken on external debt in Nigeria, this study is intended to concentrate more on capital flight than external debt. It is specially designed to examine among other things:-

i the magnitude of capital flight from Nigeria during 1970-1990.

ii the composition of capital inflows to Nigeria during 1970-1990.

iii the absorption of foreign borrowing in Nigeria during 1970-1990.

iv the linkages between external debt and capital flight in Nigeria during 1970-1990 via an econometric investigation.

v to profer policy recommendations based on the study.

1.3 RATIONALE FOR THE STUDY

Following from the problems enumerated in the statement of problems, it is clear that the problem of external indebtedness is acute in Nigeria. Various management techniques have been adopted to redress these problems but to no avail. Therefore, we say here that a lasting solution to these problems will come from a proper conceptualization of the major root cause or causes of the problem.

Capital flight is identified here as a major determinant of external debt in Nigeria. This being the situation, the solution to the external debt problems will lie in combating the capital flight syndrome. We do hope that this work will provide significant solutions to the problem of external debt in Nigeria and many less developed countries.

1.4 THE SCOPE AND LIMITATION OF THE STUDY

This study will cover the period between 1970 and 1990. This period is significant for a number of reasons. It has been asserted that political leaders using their offices siphon the wealth of this nation out for their selfish use. Since the study period witnessed succession of governments in Nigeria, we want to examine capital flight and external debt before and since the outbreak of the debt crisis.

Also, this period shall allow us to compare the level of capital flight associated with the various regimes of government.

One great problem of research work in LDCs is scarcity and unreliability of statistical data. Data unreliability is a major problem in this work. This is particularly true for figures on foreign borrowing because of its periodical review by the World Bank. Given the various definition of capital flight the method we have adopted may not be the best measure even if it suits the context within which we have used it.

Another great constraint on the path of this research work is finance. The researcher is capital poor which posed a serious limitation on his mobility , access to most current literature, photocopying of necessary materials and computer services that are most required for the excellent execution of the study.

1.5 ORGANISATION OF WORK

This study is divided into five Chapters. Chapter one is a brief introduction to the work. Literature review is treated in chapter two. Chapter three is centred on the methodology of this work. Chapter four gives the model tests and results with the analysis. And in chapter five, we have summarized, recommended and concluded.

CHAPTER TWO

LITERATURE REVIEW

This chapter seeks to unfold the cocoon round about the term "capital flight. In the course of doing this, the relationship between external debt and capital flight will be brought to light. Specifically we seek among other things the definition, measures, mechanisms and causes of capital flight in this chapter. This will provide for us the basis for the calculation of capital flight from Nigeria.

2.1 CONCEPTS OF CAPITAL FLIGHT

There are various definitions of capital flight. The use of the term "capital flight" arouses strong emotions in some quarters. Some analysts view capital flight as the cause of heavily indebted countries' inability to recover from their debt problem. To others, capital flight is regarded as a "pejorative description of natural economically rational response to portfolio choices that have confronted wealthy residents of some debtor countries in recent years" (Lessard and William ,1987 p.202) . The controversy surrounding the term is due partly to the lack of a precise and universally accepted definition for it in economic theory and partly because of the way the term is

used between developed and developing countries. It is usual among some economists to refer to capital outflows from developed countries as foreign investments while the same activity when undertaken by the redisents of developing countries is referred to as capital flight. At the same time, when residents of a developed country put a percentage of his equity abroad it is called strategic diversification and when the same is done by residents of a developing country it is called lack of confidence (Kaniz, 1984). One of the distinction that is often made, however, is that exchange rate control regimes exist in many developing countries .

One of the argument for this dichotomy is the belief that the investors from developed countries are responding to be better opportunities abroad and the investors from developing countries on the other hand are said to be escaping the high risks which they perceive at home (Cuddington 1986 and Ajayi, 1992). This interpretation makes it very obvious why a lot of economists are ill-at - ease with the definition of capital flight. In general, it is believed that the investors from all countries whether developed or developing will base their investment decisions on the relative returns and risk of such investment at home and abroad. Developing countries given their characteristic feature however will be hard hit.

There are possibly a number of reasons why capital

flows from developing countries should be labelled as "capital flight". Firstly, it is the general presumption in economics that capital should flow toward capital scarce countries. Any flow in opposite direction , that is, from developing to developed countries are not only unusual but abnormal. The second reason is a policy issue. What is important is the extent to which those assets held abroad could be utilized at home to reduce the level of external indebtedness and relieve the inherent liquidity problems brought about by debt service obligations (Pastor, 1990). This is further substantiated by the fact that such external assets never return into the country (Cuddington,1986). In distinguishing between capital flight and normal capital flows, two broad approaches are taken in the literature. The first is an identification of specific episodes (or countries) that are characterized by abnormally adverse economic conditions for investment and consider all estimates of the acquisition of external claims by the private sector as capital flight. The second approach distinguishes capital flight from other capital movements by considering capital flight to consist of the acquisition of external claim that are not reported to the domestic authorities (Chang and Cumby,1987 and Dooley, 1986). On the other hand, capital flight can be considered as those capital outflows which are in excess of "normal flows". One problem with this definition lies with what constitutes

"normal" capital flows in this context(Anthony and Hallet, 1990)

These various difficulties essentially lie at the heart of the varying definition and computation methodologies which have been employed to quantify the capital flight phenomenon (Bank of England Quarterly Bulletin, 1989, Anthony and Hallet,1990). Thus, the possibility of multiple definational terms is one of the quandaries in this area in a sense and yet perhaps one of the strong points. There exists more than one viable definition of capital flight and the appropriate choice will depend on the policy question most pertinent to the country for which capital flight in being estimated and the time period under consideration (Bank of England Quarterly Bulletin 1989; Chang and Cumby,1991). A distinction is often made between legal and illegal activities in order to distinguish between capital flight and the so called "normal" capital flows . Since illegal transactions are not recorded, it is therefore not only difficult, but almost impossible to measure it as a component of capital flight "capital flight is capital that flees" (Ingo Walter,1987; Kindlebeger,1987). Alternatively, capital flows in response to economic or political crisis are capital flight(Husted and Melvin, 1990). Normal capital flows on the other hand refer to flows that correspond to ordinary portfolio diversification of domestic residents (Dooley, 1986, Khan and UI Haque,1987).

According to Cuddington (1986) capital flight refers to short-term private capital outflows. It involves "hot money" that respond to political or financial crises, heavier taxes, a prospective tightening of capital or a major devaluation of of the domestic currency arising from a high misalignment of the currency. This definition suggest that capital flight is a response to differences in return and risk across countries. In the Morgan Guaranty Trust company (1986, P.13) an expansive definition is adopted. Capital flight is the reported and unreported acquisition of foreign assets by the non-bank private sector and elements of the public sector.

In order to clarify our thoughts on capital flows, Ajayi, (1992) presented table one below which he adopted from Lessard and Williamson (1987) showing a taxonomy of factors explaining international capital flows.

TABLE ONE

TAXONOMY OF FACTORS EXPLANING INTERNATIONAL CAPITAL FLOWS

	ONE-WAY FLOWS	TWO-WAY FLOWS
ECONOMIC RISK AND RETURNS	* National Resources Endowments * Terms of Trade * Technology changes * Demographic shifts * General economic managements	*Differences in Absolute riskiness of economies * Low correlation of risky outcome across country * Differences in investor risk preferences
FINANCIAL RISKS AND RETURNS RELATIVE TO ECONOMIC	* Taxes(deviations from World Levels) * Inflation * Default on government Obligations * Devaluation * Financial repression * Taxes on financial Intermediation * Political Instability, Political confiscation	* Differences in taxes and THEIR incidence between residents and non-residents. * Differences in nature and incidence of country risk * Asymmetric application of guarantees. * Different interest ceiling for residents and non-residents * Different access to foreign exchange denomination claims

Source: Ajayi (1992, P.13)

The upper left quadrant of the table identifies various factors based on differences in economic return across countries. In the upper right quadrant are those additional factors that deal with the two-way-flows "normal" portfolio diversification. Most of the theoretical and empirical studies of capital flight place emphasis on the lower left and right quadrants. The factors emphasised are those that create a "wedge" between economic and financial returns regardless of whether they operate across the board or symmetrically among resident or non-resident (Lessard and Williamson ,1987, p.217). From the table and the analysis therein normal capital outflows are the ones that take place in order to maximize economic return and opportunity between countries . Normal portfolio diversification take place on the basis of differentials in economic returns. Capital flight on the other hand as seen from this analysis is that "subset of capital outflows that are propelled by the source country policies (Lessard and Williamson, 1987, P.217). A distinction is drawn (at least to a large extent) between private and public capital outflows (Duwendag, 1988). According to him, the public capital outflow is separately recorded in the change of official reserve assets of the balance of payments statistics. A vital contribution was again made by Cuddington (1986). He was able to identify the outflow of talents in the form of brain drain from developing to developed countries as capital flight. Thus,

according to him, capital flight should not be limited to financial assets alone.

2.2 MEASURES AND ESTIMATES OF CAPITAL FLIGHT

Following from the problem of establishing what constitute capital flight, it is difficult to measure it. The difficulties involved not withstanding, a number of capital flight estimates have been made over the last several years. The preponderant of these studies cover a number of countries including mostly Argentina, Brazil, Chile, Korea, Mexico, Peru, the Philippines and Venezuela. Duwendag (1988) covered 25 Less Developed Countries in his study of capital flight from Less Developed Countries. Those various studies differ from one another in terms of the methodological approaches of measurement, country coverage, and time span. The most significant of these studies which have made impact on capital flight estimates include the studies by Dooley (1986, 1988), Dooley et al, (1986), World Bank (1985), Morgan Guaranty Trust Company (1987), Cline (1986), Cuddington (1986), Cumby and Levich (1987), Gulati (1987),Lessard and Williamson (1987), Khan and Ul Haque (1987),Duwendag(1988),Gajdeczka (1990), Khan (1989), Verna (1989), Verna -Schneider (1991), and Ajayi (1992). The World Bank (1985) study covered Argentina, Brazil, Mexico, Portugal, South Korea, Turkey, Uruguay, and Vernezuala.

Duwendag (1988) study covered Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela, India, Indonesia, Korea, Malaysia, Pakistan, the philippines, Thailand, Portugal, Turkey, Hungary, Romania, Yugoslavia, Algeria, Egypt, Israel, Morocco, Nigeria, and South Africa.

In Cuddington (1986) approach, capital flight is defined as short-term speculative outflows which according to him is the typical meaning of capital flight. Capital flight is defined as short-term external assets by the non - bank private sector plus the errors and omissions in the balance of payments. This approach is concentrated on what is popularly referred to as "hot money flows" method because of the fact that funds are expected to respond quickly to changes in expected returns or to changes in risk. Variations in economic conditions are likely to affect the magnitude of such flows. These in essence are funds "on the wings" that are expected to return very quickly to the country of origin when economic conditions are favourable - that is when appropriate macro economic stance is adopted.

Khan and Ul Haque (1987) calculated capital flight for eight highly -indebted developing countries for the period 1974 - 1982. They defined capital flight in two ways. First, it is defined simply as gross private short term capital flows plus net errors and omissions in the country's balance of payments accounts. This is the same as the Cuddington estimate. The second method tries to take account of normal

capital flows. Capital flight is defined as that part of the increase in external claims that yields recorded investment income. This is not dissimilar to Dooley (1986) approach. In the Morgan Guaranty Trust Company (1986, pp.13) study, capital flight is defined as "the reported and unreported acquisition of foreign assets by the non-bank private sector and some elements of the public sector". Capital flight is estimated indirectly as the counterpart of net direct investment in- flows plus increase in gross external debt less recorded outflows through current account balance deficits and less the building of foreign assets by the banking system and official monetary authorities (Morgan Guaranty Trust Company). Cline (1986) critiques the capital flight definition adopted by the Morgan Guaranty Trust Company study. He argues that income from tourism and border transaction should be subtracted since these earnings are beyond the control of the relevant foreign exchange authorities. He also argues that reinvested investment income should not be considered as capital flight since this is also beyond the control of the authorities. Duwendag (1988) calculated capital flight implicitly as a residual via an indirect calculation using a balance of payments equation. Capital flight is calculated here as equal to the sum of the change in foreign borrowing, net direct investment, and the Use of Fund Credits less the current account deficit, net errors and omissions in the balance of

payments, the counterpart items and the change in official reserve (Duwendag, 1988,p34). This is an extension of the Morgan Guaranty Trust Company estimate. In Diaz Alejandro (1984.p. 362-363), Sach, (1984, p397), the Bank for International Settlements (1984, p.101), the World Bank (1985), and Boyce (1992 p.342) capital flight is a residual. Capital flight is calculated as the increase in external debt outstanding minus the sum of current account deficit, the net direct investment outflow, and the increase in official reserves.

A thorough examination of the literature shows that there are a variety of ways of measuring capital flight. Ajayi (1992) classified the measuring techniques into six categories. In the first category is the "narrow" definition and measurement of capital flight. Capital flight is defined as the net short term capital outflows plus errors and omissions in the balance of payments. This is the Cuddington (1986) approach. Under this definition capital flight is equated to "hot money" flows. The second category is the "derived" measure of capital flight. Capital flight is that part of the increase in external claims that yields no recorded investment income. This is the approach adopted by Dooley (1986, 1988). The third category consists of a broad measure of capital flight. In this approach, capital flight is the measured acquisition of foreign assets by the non-bank private residents plus errors and omissions. Specially,

the broad measure equals capital inflows in the form of changes in external debt and net foreign investment minus the current account deficit and changes in the assets of the banking system. This measure of capital flight corresponds to that adopted by various authors including Morgan Guaranty Trust Company (1986),World Bank (1985), Erbe (1985). The fourth measure is the private claims measure which defined capital flight as the acquisition of external claims by the private sector including deposits banks and the non-bank sector plus recorded errors and omissions in the balance of payments. Conesa (1986) corresponds to this. The fifth method is published by the International Monetary Fund. Capital flight under this method is derivable from the "Cross Border Bank deposits of Non-banks by residence of depositor" published in the International Financial Statistics. This measure has been used in the literature by Khan (1986). The sixth popular method is that adopted by Pastor (1989, 1990). This method is labelled the "sources and uses" approach to capital flight. Capital flight is derived residually from the balance of payment plus the sum of the current account plus the changes in reserves. This method is similar to those used by Dooley et al (1983), Donbusch (1985), and Duwendag (1988).

The various approaches listed is as comprehensive as it can be when due cognizance is taken of the different names that are often used for the same thing (for example,

implicit capital flows, Dooley et al 1986).

2.3 THE MECHANISMS OF CAPITAL FLIGHT

The conduits for capital flight are not only many but varied. They come in various forms and it is almost impossible to develop an exhaustible inventory of channels. A very apt description of some of the conduits and the various forms they take is described by Glynn and Koenig (1984,p.109).

> "It comes in false-bottom suitcases or in electronic fund transfers from private banking services that cater to "high-net worth individuals". It may take the form of frugerrands stashed inside hollowed out sculptures or more via false invoices approved by corrupt customs officers. Its destination range from banks in Zurich, Miami or the Cayman islands to co-opt apartments in New York or Condos in San Diego".

The interesting story of the narration of an actual happening in the philippines some years ago is not only illuminating but gives a proper insight to the issue of various forms or conduits that capital flight can take. The general applicability of this event has very high probability rate for developing countries at least (Ajayi, 1992, p.19).

"In Manila not too long ago, a police dog sniffing for explosives in the cargo hold of a plane about to leave for

Hong Kong grew interested in a crate containing two frozen chickens and a duck. The Philippines customs officers decided that the chickens were above suspicion but noticed a large gash in the duck. Inside the foul was $29,000 in very cool U.S. Cash" (Glynn and Koenig, 1984, p.112). Police dogs have not been known as a popular mechanism for the detection of suspicious materials from the various airports in Nigeria. The possibility is high, however, that some amazing discoveries could be uncovered by these sets of dogs if used for tracing illegal transactions.

Ajayi (1992, p.20) noted a number of channels through which capital flight can take place in Nigeria. First, transfers can take place through cash or monetary instruments. These are usually in the form of either foreign or domestic currency, travellers checks or other checks. In the early 1970s, stories abound about Nigerian currency being carried out of the country and being exchanged in big cities like London or New York."These were exchanged legally abroad for other currencies at current market rates. Inspite of the present economic predicament, there are still some African countries where the Naira is exchanged for other currencies in the cause of trade" (Ajayi, 1992,p.20).

Secondly, capital flight can take place through bank transfers from a local affiliate of a foreign owned bank to a designated recipient abroad. This amount of money can be exchanged at the market rate where no constraints or

restrictions are in place. Transfers can still be possible in the face of exchange controls but possibly at a less favourable rate. In the history of banking institutions development in Nigeria local affiliates of foreign banks existed. Given this institutional set up, transfers of the type mentioned took place and are indeed still taking place even though the exact statistics on the magnitudes are lacking. It is reasonable to assume, however, that such transfers may not be available for incomes that are known to be illegally generated.

Another channel of transfer is through precious metals and collectibles including works of art. This is a substitute for currency movement. Local currency is converted into gold, silver or other precious metals, precious stones, jewelry and similar assets that can not only be moved abroad but that will also be able to retain their value. The sale value of these are usually high in foreign currency. Usually, governments tend to restrict or prohibit imports and exports of any such items. Such international transfers therefore usually involve smuggling. Although it is known that there are large risks involved in such activities, some people who have taken risks in this regard have been successful while some others have been caught in the act.

The fourth mechanism of transfer is through false declaration involving trade transactions. In this case,

false invoices are issued. Substantial amount of money can arise from the systematic banking of imports and exports. The expectation in case of capital flight is that exporters will systematically engage in under-invoicing while importers over invoice and in the process derive foreign exchange gain that is outside the control of the foreign exchange authority. The procedure for doing this is that the foreign supplier issues an invoice that is greater than the agreed price of the product. The importer on receipt of the necessary foreign exchange remits it to the foreign supplier who then keeps the difference between the actual price and the invoice in a bank abroad for the importer. On the export side, the invoice issued is for an amount in foreign currency that is less than the agreed price. The foreign buyer places the difference between the invoice price and the agreed price in a foreign bank account of the exporter and remit the invoice amount. It is this amount of money that is surrendered to the Central Bank for local currency at the prevailing official exchange rate. If collusion exists between exporters and importers, trade faking is an effective means of acquiring excess foreign exchange (Ajayi, 1992). However, recent research by Gulati (1987) seems to indicate that under-invoicing of imports to avoid tariffs may be more common than over-invoicing to engage in capital flight.

Capital flight through false trade invoicing is

generally applicable to the local affiliates of multinational companies, and owners of business engaged in international trade. It is known in some cases that false invoicing can be multiplied through a practice called "round tripping". The process is one in which foreign currency assets are accumulated abroad at the official exchange rate via trade misinvoicing (that is, over or under invoicing). According to Ajayi (1992) "some of the assets are repatriated in the form of cash or other monetary instruments which are converted to local currency at premium at the local parallel market for foreign exchange. Whatever gain is made in local currency can then form the basis for further false-invoiced transactions". This in effect is "arbitraging the official and parallel-market exchange rates" (Walter, 1987,p.113).

A fifth method of transferring money abroad is through the black market itself. This, until recently, has been a thriving source of transferring funds abroad. The amount of money so transferred is so difficult to estimate. Another vehicle through which capital can be transferred overseas is through commissions and agents' fees which are paid by foreign contractors into the foreign bank accounts of residents. Commissions and agents fees are in some cases polite words for the myriads of kick backs on foreign contracts! Recent years have witnessed the existence of bureau de change. This is an important mechanism through

which a lot of capital can be transferred abroad. The number of such institutions and the transactions undertaken by them have been rising in recent times" (Ajayi, 1992 p.22).

There are some other vital channels of capital outflows that have been neglected in the literature. These include the massive outflow of resource persons from this country especially in the last one decade. Those who felt humiliated and under paid in their professions, whether due to the fallen value of the domestic currency or negligence on the part of the government, left for where their services would be better appreciated. This phenomenon is normally referred to as "brain drain".

Another important conduit of capital flight is the repayments on the external debt. It can be said that the foreign borrowings which look very attractive when they come in are the seeds which eventually grow to become problems to the national economy. This is particularly so when the net transfers are negative (that is, the sum of amortization and interest payment is greater than the inflows). The Nigerian total debt service has grown over the years. We have a superfluity of this particularly since the outbreak of the debt crisis in 1982. The total debt service which was $55.6 million in 1970 grew to over $4 billion in 1985. However, most analysis do not talk about these repayments (principal and interest payments). This may be because it is officially recorded and as such not regarded as capital flight.

2.4 ALTERNATIVE MEASURES OF CAPITAL FLIGHT

The area of capital flight is still fallow in Nigeria. However ajayi (1992) worked on the alternative measures of capital flight by adopting different methodologies for estimating capital flight in the literature. He divided its estimation into two parts. The first part replicates for Nigeria the different methodologies for estimating capital flight that have been used for Argentina, Brazil, Mexico, Philippines, and Venezuela. He covered the period 1972 - 1989. In the second part, he employed various techniques as have been defined to estimate capital flight.

Using Cumby and Levich(1987), and adopted by Verna(1989) and Vena - Schneider (1991), he calculated from the balance flight estimates for Nigeria using the various methods listed below.

TABLE TWO

NOTATIONS

A. Current Account Balance

B. Net Foreign Direct Investment (FDI)

C. Private short-term capital outflows

D. Port folio Investment

E. Banking system Foreign Assets

F. Changes in Reserves

G. Errors and Omissions

H. Changes in Debt

I. IMF Credit

J. Travel Credit

K. Reinvested FDI Income

L. Other Invested Income

M. Counterpart Items

CAPITAL FLIGHT ESTIMATES

World Bank	=	(H+B+A+F)
Erbe	=	(H+B+A+F)
Morgan	=	(H+B+A+E+F)
Cline	=	(H+B+A+E) - (J+K+L)
Duwendag	=	(H+B+A+F+G+I+M)

Source: Ajayi (1992, p.24)

The result of his calculation is shown in Table 3.

TABLE THREE

CAPITAL FLIGHT FROM NIGERIA: DIFFERENT ESTIMATION METHODS (1972 - 1989) (US $ MILLIONS)

Year	Erbe/W/B	Morgan	Cline	Duwendag
1972	106.44	477.28	453.37	127.70
1973	636.10	1,265.38	1,228.03	551.75
1974	325.00	5,995.00	5,824.27	450.88
1975	119.80	5,988.60	5,474.48	148.04
1976	124.80	5,524.44	5,044.21	187.40
1977	2,490.00	7,021.86	6,554.79	2,111.95
1978	508.40	2,695.20	2,309.48	235.23
1979	- 86.30	5,659.54	5,370.07	601.59
1980	2,713.30	12,974.11	12,234.36	2,590.79
1981	2,132.30	6,145.22	5,267.31	1,345.14
1982	-3,805.80	-2,230.87	-2,569.33	-3,812.09
1983	2,016.10	3,098.82	2,893.61	1,991.64
1984	- 169.80	1,594.72	1,494.72	182.81
1985	3,569.40	5,385.40	5,272.14	2,994.37
1986	5,502.90	6,841.80	6,592.39	5,138.37
1987	5,874.60	7,522.20	7,398.83	5,462.11
1988	1,043.80	2,479.12	2,385.12	902.80
1989	-299.70	2,212.46	2,102.46	-369.70
Cumulative				
1972-79	4,224.20	34,627.30	31,258.70	4,414. 5
1979-83	2,969.60	25,646.82	23,196.02	2,717.07
1972-89	22,801.30	80,650.28	75,330.31	20,840.99
1983-87	16,793.20	24,442.94	23,651.69	15,769.51

Notes:(1) Some of the items in some cases could not be operationalized fully because some of the statistics do not exist. This is true of IMF credit and reinvested FDI income.

(2) The following statistics were taken from the balance of payments statistics year book: Travel, other investment Income, Counterpart items. These were normally recorded in Millions of SDR and were converted to Millions of dollars using the conversion rate under U.S. country data of the IMF line 8c

Source: Ajayi (1992, p.29)

Capital flight using the Morgan Guaranty Trust Company approach was about US $ 477 million in 1972. This rose to US $ 12, 974 million in 1980. It rose and fell systematically there after reaching only US $ 2,212 million in 1989. Capital flight was by this method, 13 percent of GNP in 1980, but was about only 8 percent of GNP in 1989. The percentage share of capital flight in GNP using the Cline approach are not too different: 12 percent of GNP in 1980, and 7.6 percent of GNP in 1989. Capital flight as a proportion of external debt was 145 percent in 1980, and 37 percent in 1989 using the Morgan Guaranty Trust Company method. In all cases, these figures are significant and cannot be ignored. It is clear that the different results obtained derived from the different approaches that go into the calculation of capital flight. It is clear that the approaches yield substantial amount of capital flight over the period covered (Ajayi, 1992, p25-26).

The differences in the magnitude of the results using different definition of capital flight are not surprising. Ajayi (1992) further classified the similarities and differences according to different periods. The amplitude of capital flight for the period 1972 - 1979 and 1979 - 1983 were not too different in the four measures. The period 1972-1979, which include the oil shock years showed more

capital flight than the following period. The year 1980, which is the second year of the political regime of the civilian administration is noteworthy for the criticisms and allegations it had received including corruption which made possible the transfer of huge amount of money abroad. In all cases, the amount of capital flight rose dramatically from what it was in the previous year.

From the cumulative totals, several results emerge. For the entire period, 1972-1989, the Morgan Guaranty Trust Company methodology gave a total capital flight of about US $80.7 billion as opposed to Cline's of US $75.3 billion. In the Erbe and World Bank methodology, capital flight was US $ 22.8 billion while it was US $20.8 billion using the Duwendag method. Over the period of the civilian regime, 1979-1983 (with overlaps), the maximum capital flight of US$ 25.6 billion was recorded using the Morgan Guaranty Trust Company methodology and about U.S $15.8 billion by Duwendag methodology (Ajayi, 1992,p.27).

On the next stage, six different approaches were used in calculating capital flight from Nigeria. These are variously labelled as estimated capital flight, the total private capital outflows, the residual method, the hot method (two versions), and the derived method. The "mirror stock statistics", though not given prominence is also presented. The starting point is the calculation of the total stock of external claims. From this is derived the

"estimated" capital flight. In the process of estimating the stock of total external claims, Ajayi (1992) followed a modified version of

the Dooley (1986,1988) approach.

TABLE FOUR

ALTERNATIVE MEASURES OF EXTERNAL CLAIMS FROM NIGERIA (1972 - 1989) (US $ MILLION)

Year	(1) Recorded claims on Non-Resident other than Direct Investment	(2) Errors and Omission	(3) Total External Claims BOP Col. 1+2	(4) Unrecorded stock of external claims	(5) Total Stock of External Claims
1972	126.0	6.5	132.5	972.0	1,104.5
1973	-432.8	-48.3	-480.1	1,207.4	727.3
1974	-10,111.4	72.2	-10,039.2	1,674.2	8,365.0
1975	-352.5	-41.0	- 393.5	1,184.0	790.5
1976	838.6	45.3	883.9	1,190.6	2,074.5
1977	1.537.6	-58.3	1,479.3	3,195.8	4,675.1
1978	4.587.2	-131.5	4,455.7	3,510.3	7,966.0
1979	-6.486.2	731.2	5755.0	5,386.5	-368.5
1980	-8.464.3	-687.5	-9,151.8	8,235.0	-916.8
1981	9.776.5	-103.6	9,672.9	7,887.6	17,560.5
1982	3,765.2	9.9	3775.1	7,459.0	11,234.1
1983	473.3	102.6	575.9	13,865.7	14,441.6
1984	-248.0	256.9	8.9	17,766.4	17,775.3
1985	-4,400.0	-146.2	-4,576.2	20,286.5	15,710.3
1986	- 700.5	-218.8	-919.2	25,161.6	24,242.3
1987	-1,995.7	- 68.1	- 2,063.8	31,873.9	29,810.1
1988	- 1,407.0	-215.0	1,622.0	31,383.9	29.761.0
1989	678.0	-1,252.0	-1,930.0	31,182.0	27,252.0

Source: AJAYI (1992, P.29).

Table Four gives the total stock of external claims for the record 1972-1989. In 1978 the total stock of Nigeria's external claims was about US $8.0 billion. This rate steadily rose to US $17 billion in 1981 - more than twice the 1978 figure. By 1987, it stood at US 29.8 billion but dropped slightly to US $ 27.3 billion in 1989. From the stock of external claims, two versions of capital flight are calculated (Ajayi, 1992,p27). This is reported in Table Five.

TABLE FIVE
ESTIMATED CAPITAL FLIGHT FROM NIGERIA (1972-1989) (US $ MILLION)

Year	(1) Estimated capital flight* (a)	(2) Estimated capital flight*(b)
1972		
1973	377.3	-377.4
1974	9,104.1	-9,108.7
1975	9,108.0	9,092.1
1976	1,272.9	1,278.2
1977	2,616.8	2,621.1
1978	-3,314.8	3,317.5
1979	-8,323.2	-8,318.8
1980	-574.4	-579.5
1981	18,483.9	18,486.2

1982	-6,301.3	-6,298.1
1983	3,213.6	3,216.4
1984	3,339.3	3,340.1
1985	-2,070.5	-2,071.2
1986	8,530.8	8,530.6
1987	5,572.1	5,572.1
1988	-47.4	-46.7
1989	-2,513.5	-2,513.9
Cumulative		
1973-80	-2,066.5	-2,075.6
1979-83	15,396.2	15,404.6
1983-87	18,585.3	18,587.9
1973-89	39,470.2	39,469.0

Notes: * Capital flight calculated using two steps.

(1) Estimate the total stock of external claims.

(2) Subtract from it the capitalized value of non-direct investment income receipts in that year BODY lines 15,17,19. These are capitalized by (a) using U.S. Treasury bill rate IFS line 60c and (b) using the UBOR rate on U.S. deposits from the international interest rates section of the IFS. As it turns out both results are about the same.

Source: Ajayi, (1992, p.30).

The capital flight estimates in columns 1 and 2 of Table Five are calculated as follows from the stock of external claims after subtracting the capitalized non-direct investment income from the balance of payments statistics using LIBOR rate and the U.S treasury bill rate as explained in the footnote to the table. From the table, it can be seen

that regardless of whatever rate is used to capitalize the non-direct investment income, the resulting capital flight estimates are virtually the same. In 1983-1987, for example, the amount of capital flight under the two methods was US $18.6,billion. For the entire period from 1972 - 1989, the amount of capital flight was estimated at US $39.5 billion. The variations in the ratio of total stock of external claims to the level of external debt is shown in Table Six.

TABLE SIX

NIGERIA EXTERNAL DEBT AND STOCK OF EXTERNAL CLAIMS

(1972-1989) (US $ MILLION)

Year	STOEXTCL	EXTDEBY	REX TCDEB
1972	1,104.5	732.0	150.9
1973	727.3	1,205.0	60.4
1974	8,365.0	1,274.0	-656.6
1975	790.5	1,143.0	69.2
1976	2,074.5	906.0	229.0
1977	4,675.1	3,146.0	148.6
1978	7,966.0	5,091.0	156.5
1979	-368.5	6,235.0	-5.9
1980	-916.8	8,934.0	-10.3
1981	17,560.5	12,018.0	146.1
1982	11,234.1	12,954.0	86.7
1983	14,441.6	18,539.0	77.9
1984	17,774.3	18,537.0	95.9
1985	15,710.3	19,551.0	80.4
1986	24,242.3	24,043.0	100.8
1987,	29,810.1	31,193.0	95.6
1988	29,761.0	31,947.0	93.1
1989	27,252.0	32,832.0	83.0

Notes: (1) STOEXTCL = Total stock of External claims
(2) EXTDEBT = External Debt
(3) REXTCDEB = Ratio of stock of External claims to level of external debt in percentages.

Source: Ajayi (1992)

The result of the second method of calculating capital flight, that is, the total private outflows method is shown in Table Seven.

TABLE SEVEN

ESTIMATED CAPITAL FLIGHT FROM NIGERIA: TOTAL PRIVATE OUTFLOWS 1972 - 1989* (US $ MILLION)

Year	Amount
1972	246.15
1973	-271.86
1974	175.86
1975	-509.78
1976	-724.38
1977	-418.60
1978	3,059.40
1979	2,140.09
1980	593.42
1981	1,693.60
1982	5,316.18
1983	3,581.21
1984	-2,100.61
1985	-3,665.01
1986	-1,334.40
1987	-5,408.89
1988	-4,941.00
1989	1,381.00
Cumulative amounts	
1972-1979	3,245.2
1979-1983	13,324.5
1983-1987	- 8,927.7
1972-1989	1,639.7

Note: Total private outflows is other short term capital, net errors and omissions, other long-term capital, long term and short term capital of resident official sector, other short term capital of deposit of money banks. Short term and long term capital of resident official sector and short term capital money banks are from relevant lines of the IMF: BOP Year Book Several Years. Other statistics are got from IFS year book 1990.

Source: Ajayi: (1992, P.32)

Over the period 1983-1987, the cumulative flows were US $8.9

billion. The values for 1979-1983 and 1980-1989 were US $13.3 billion and US $6.3 billion respectively.

The next measure recognises that capital flight is "speculative capital". It is "hot money" on the wings. It is one that is supposed to respond to various forms of domestic macro economic policy distortions. Taking this approach of course, means that capital flight refers especially to "capital export by the private non-bank sector, although in some cases banks and official entities may also engage in it" (Cuddington, 1986,p.2). Also since capital flight is essentially concealed, they show up in the "errors and omissions" of the balance of payments entry. Thus, capital flight is the sum of short term private capital outflows plus errors and omissions in the balance of payments entry.Two versions of the "hot money" approach are adopted. The first approach strictly follows the Cuddington approach, the result of which is shown in Table Eight.

TABLE EIGHT

NIGERIA:CAPITAL FLIGHT 1970 - 1989 (THE HOT METHOD) VERSION I (US $ MILLION)

Year	Amount
1970	134.0
1971	205.0
1972	119.0
1973	-177.0
1974	48.0
1975	-42.0
1976	5.0
1977	-231.0
1978	43.0
1979	211.0
1980	-673,0
1981	106.0
1982	149.0
1983	-63.0
1984	-642.0
1985	-2,014.0
1986	-249.0
1987	-953.0
1988	-1,315.0
1989	- 1,895.0
Cumulative sum	
1972-1979	-24.0
1979-1983	-270.0
1983-1987	-3,921.0
1972-1989	-7573.0

Notes: Data used are short term capital of other sector and errors and omissions.

Source: Ajayi (1992, p.33)

There is however, no justification for leaving out other parts of capital that can strictly speaking be considered as "speculative" money. These other capital flows are added to the Cuddington measure to generate the second version of our "hot money" method (the hot method version II) Ajayi, 1992,p31). The result of the calculations is shown in Table Nine.

TABLE NINE

NIGERIA: CAPITAL FLIGHT: (THE HOT METHOD) VERSION II 1972 - 1989 (US $ million)

Year	Amount
1972	119.00
1973	-238.52
1974	24.74
1975	-86.50
1976	17.78
1977	-357.88
1978	196.65
1979	220.22
1980	-664.07
1981	146.75
1982	3,145.51
1983	1,045.51
1984	-535.14
1985	173.91
1986	1,195.99
1987	-1,788.46
1988	1,889.00
1989	1,371.00
Cumulative	
1972-1979	104.10
1979-1983	13, 894.31
1983-1987	-92.20
1972-1989	5,876.38

Notes: Items included are other short term capital of other sectors, net errors and omissions, other short term capital of resident official sector, plus other short term capital of deposit money banks.

Source: Ajayi: (1992, p.34).

In Table Ten we present capital flight estimates using the residual method as adopted by Boyce (1990)

TABLE TEN
NIGERIA: CAPITAL FLIGHT: THE RESIDUAL METHOD

1972-1989 (US $ MILLIONS)

Year	Total Residual method
1972	773.10
1973	652.56
1974	-9,609.07
1975	247.81
1976	865.46
1977	4,656.87
1978	8,241.62
1979	-3,241.62
1980	-7,839.49
1981	16,127.00
1982	10,931.89
1983	10,908.60
1984	-406.61
1985	-1,249.31
1986	4,916.41
1987	6,400.25
1988	1,774.00
1989	14,004.00
SUM 1972-1979	5,828.35
SUM 1979-1983	26,255.61
SUM 1972-1989	57,522.70

Notes: Increase in external debt minus current account, minus net direct investment, minus increase in official reserves (ala Boyce, 1990).
Source: Ajayi (1992, p.36)

The next approach that is used to calculate capital flight is referred to as the "sources and uses" approach mentioned earlier. It starts by focussing attention on the balance of payments. The balance of payments (BOP) can be defined as

BOP = CA + KA = NIOR ------ (1)

KA = NFNR + NFR ----- (2)

If we substitute equation (2) into (1) taking cognizance of the fact that net flow from non residents (NFNR) include changes in external indebtedness (CHDEBT) and Foreign Direct Investment (FDI) flows, capital flight (CF) is negative net flows from residents . Thus,

CF = (CHDEBT + FDI) - (CA + CHRES) -------(3)

The estimate of capital flight using this methodology is shown in Table Eleven.

TABLE ELEVEN:

NIGERIA CAPITAL FLIGHT: THE DERIVED METHOD*
(1971 - 1989) (US $ MILLIONS)

Year	Amount
1971	936.2
1972	665.7
1973	1,056.7
1974	327.4
1975	453.9
1976	79.6
1977	2,868.2
1978	3,805.3
1979	3,008.0
1980	1,181.0
1981	5,246.0
1982	6,425.3
1983	9,842.4
1984	565.6
1985	-585.1
1986	3,814
1987	9,631,1
1988	1,669.1
1989	4,186.6
Cumulative	
1972-1978	12,264.1
1979-1983	25,702.0
1983-1987	23,268.9
1972-1989	54,241.0

Notes:* (CHDEBT + FDI) - (CA + CHRES) as in text.

Source: Ajayi: (1992, p.38)

The last approach used is what was referred to earlier as the "mirror stock statistics" method. The estimates of capital flight using this method is shown in Table Twelve.

TABLE TWELVE:

NIGERIA:CAPITAL FLIGHT: THE MIRROR STATISTICS METHOD (1981-1990) US $ BILLIONS

YEAR	CBDNRD	FLOWS OF CBDNRD
1981	0.30	0
1982	1.38	1.08
1983	1.38	0.0
1984	1.17	-0.21
1985	1.50	0.33
1986	1.68	0.18
1987	2.30	0.62
1988	1.96	-0.34
1989	2.66	0.07
1990	3.53	0.87

Notes: (1) CBDNRD = Cross Border Bank Deposit of non banks by Residence of Depositor

(2) Figures are available only from 1981.

Source: Ajayi (1992, p.40).

This method draws on international banking statistics to evaluate the amount of assets held by he residents of developing countries abroad. This method has been used by Khan and Haque (1987) and the Bank of England (1987). It is particularly useful in determining the minimum level of

assets held abroad. For this method, the recorded statistics by the IMF are called the Cross Border Bank Deposit of non Bank by Residence of Depositors. This amount represent stocks per year. When capital flight is defined as the increase over the previous years, we find that the amount is relatively very small. In all cases, the amount represents the lowest of all the estimates.

There are a number of reasons why the estimates so derived can not be an adequate measure of capital flight. First, some deposits are held outside the major financial centres.Indeed, the nationality of depositor(s) in some foreign banks are never revealed. The most cited example is that of the Swiss Bank accounts where secret codes are utilized to hide not only the identity of the depositor(s) but also in some cases the nationality. Second, substantial amount of money which are not revealed are held in other financial assets: equities, bonds, treasury bills, etc, and physical assets. As a result of the above reasons, the figures represent an underestimation of capital flight. In a large sense, however, foreign deposits give some indications of the amount of money which could have been held domestically" (Ajayi,1992, p.39). Such deposits are better seen within the context of other macroeconomic variables such as external debt and gross national product.

The summary of all the estimates of capital flight using the different methodologies is presented in Table

Thirteen.

TABLE THIRTEEN

NIGERIA: SUMMARY OF CAPITAL FLIGHT MEASURES 1992 - 1989 (US $ MILLIONS)

Year	Estimated Cap. Flight (1)	Total out flow (2)	Residual method (3)	Hot method I (4)	Hot method II (5)	Derived method* (6)
1972		246.15	773.10	119.00	119.00	665.70
1973	-377.30	371.86	652.56	-177.00	-238.52	1,056.00
1974	9,104.10	-175.86	-9,609.07	48.00	24.74	327.40
1975	9,108.00	-509.78	247.81	-42.00	-86.50	453.90
1976	1,272.90	-724.37	865.46	5.00	17.78	79.60
1977	2,616.80	-418.60	4,656.87	-231.00	-357.37	2,868.20
1978	3,314.80	3,059.40	8,241.62	43.00	196.65	8,805.30
1979	-8,323.20	2,140.09	-3,872.38	211.00	220.22	3,008.00
1980	-574.40	593.42	-7839.49	-673.00	-664.07	1,181.00
1981	18,483.90	1,693.60	16,127.00	106.00	146.75	5,246.00
1982	-6,301.30	5,316.18	10,931.89	149.00	3,154.51	6,425.30
1983	3,213.60	3,581.21	10,908.60	-63.00	1,045.90	9,842,40
1984	3,339.30	- 406.61	-406.61	-642.00	-535.14	565.60
1985	-2,070.50	-3,665.01	-1,249.31	-2,014.00	173.91	-585.10
1986	8,530.80	4,916.41	4,916.41	-249.00	1,195.99	3,814.90
1987	5,572.20	-5,408.89	6,400.25	953.00	-1788.46	9,631.10
1988	-47.40	1.774.00	1,774.00	-1,315.00	1,889.00	1,669.10
1989	-2,513.50	1,381.00	14,004.00	-1,895.00	524.00	4,186.60
Cumulative						
1973-80	-2,066.50	-3,838.50	-5,883.52	-697.00	-768.07	1,344.10

1979-83	6,498.60	13,324.50	26,255.62	-270.00	3,903.31	25,702.70
1983-87	18.585.40	-8,927.70	20,569.34	-3,921.00	92.20	23,268.90
1972-89	26,140.60	-1,639.33	57,522.71	-7573.00	5,038.39	54.241.00
1980-89	27,632,70	-4,884.50	55,566.74	-7549.00	5,142.39	41,976.90
1972-79	-1,492.10	3,245.17	1,955.97	-24.00	-104.00	12,264.10
1979-84	9,837.90	11,223.89	25,849.01	-912.00	3,368.17	26,268,30
1985-89	9,471.60		25,845.35	-6,426.00	1,994.44	18,716.60

Notes:* As shown in text

Source: Ajayi (1992, P.41)

2.5 CAUSES OF CAPITAL FLIGHT

The various causes of capital flight can be grouped under relative risks, exchange rates misalignment, financial sector constraints and/or repression, fiscal deficits, and external incentives (Khan, 1989) and disbursement of new loans to Less Developed Countries (Cuddington, 1987; Pastor, 1990; and Boyce, 1992). These are no doubt economic causes of capital flight. Ngeno (1993) talks about "investment climate". There are, however, other non economic causes which though important are often ignored (Ajayi, 1992 and Boyce, 1992). These include the corruption of political leaders and extra ordinary access to government funds.

In decision making process, the wealth holder looks at the various risks confronting him. There are certain inherent characteristics of developing countries which make risks attached to investment in developing countries larger than those of developed countries. Khan and Haque (1985) showed that any increase in risk in a rational expectations setting would tend to increase the outflow of private capital from the domestic economy into foreign countries where investments are less risky. This expropriation risk could include a variety of distortions such as differences in taxes and political instability resulting in possible reduction in private property. Eaton (1987) builds on the Khan - Haque model by relating the risk of expropriation of capital owned domestically which is defined especially in

this case as higher taxation to public and publicly - guaranteed foreign debt. The tax obligation arising from increase in external debt can lead to capital flight (Ajayi, 1992; Boyce, 1992). The flight of one investor leads to a rise in the potential tax obligations of the remaining investors in the domestic economy. This also may create the incentive for other investors to move abroad.

It is generally agreed that one of the principal determinants of capital flight is exchange rate misalignment. The importance of this variable has amply been demonstrated in several empirical analysis including the studies by Dornbusch (1985), Cuddington (1986), Lessard and Williamson (1987), Pastor (1989, 1990), and Boyce (1992). The real exchange rate plays a significant role in the direction and magnitude of capital flight from highly-indebted developing countries (Ajayi, 1992). Under normal circumstances, if a currency appreciation is expected, domestic wealth holders would shift out of domestic assets into foreign assets. In general, it is difficult to measure precisely exchange rate expectations. It is safe, however, to assume that if a currency is overvalued, economic agents would expect the currency to be devalued in the future (Ajayi, 1992 and Boyce, 1992). Holding firm to this expectation would cause residents to avoid the potential capital loss by converting into foreign claims.

Financial sector constraints can lead to capital

flight. It is well known that narrowness of the capital and money markets is a feature of developing countries. Financial markets in these countries provide only a limited variety of financial instruments in which wealth can be held. There is also in many developing countries the lack of full or credible deposit insurance on assets held in the domestic banking sector. Ajayi (1992) points out that "this deficiency is, however, being increasingly remedied by many developing countries".

Additionally, there are extensive controls on interest rates and other aspects of financial market behaviour in developing countries. Government policies in the financial sector have resulted in normal interest rates that are far below the rates on comparable foreign financial instruments. In most cases, the real rates of return on domestic financial assets are negative. Given the various forms of financial repression, it is expected that investors in these countries will seek for alternative countries where their assets will yield not only positive but higher returns. "Holding assets in foreign financial instruments provide the sought-after alternative" (Ajayi, 1992, P.52).

It has been shown by Dornbusch (1985) that capital flight is typically accompanied by fiscal deficits. When a rising fiscal deficit is financed through the printing of money, it leads to inflationary pressures. In order to avoid the erosion of their monetary balances by inflation, moving

out of domestic assets is one way by which wealth owners avoid inflation tax. When fiscal deficit is financed through bond sales, domestic residents may expect that at some future date their tax liabilities may increase in order to pay for the national debt. This would encourage domestic investors to move away their assets to foreign countries in order to avoid potential tax liabilities. Ize and Oritz (1986) formalized the link between deficit financing and capital flight. In the Ize-Oritz model, capital flight is related to the over all financial solvency of government. Insolvency and default risk created by fiscal deficit appear explicitly as the determinants of capital flight.

A number of external factors influence the flight of capital. These external influences in general are in the form of opportunities available outside the country. These include the attractiveness of foreign interest rates, the wide array of financial instruments in which wealth can be held, economic and political stability, favourable tax climate etc. These sets of incentives are amply described by Walter (1987, P.120). "Flight implies havens, and havens take the form of national status that provide an attractive range of real and financial assets to foreign based investors; political and economic stability, a favourable tax climate for non-residents and various other attributes that generally are the obverse of conditions triggering capital flight in the first place." On some types of

deposits, withholding taxes are not taken from non-residents deposits. In certain countries secret accounts are allowed. While the secrecy of accounts is attractive to some wealth owners for the purpose of maintaining the privacy of their accounts, it also inadvertently favours illegal transactions and tax evasion, both of which benefit from the secrecy (Ajayi, 1992, P.53).

As a result of the principle of national sovereignty, it is difficult for a country's government to have inside information on the foreign bank assets holdings of its individual citizens abroad. One safeguard is the domestic bank secrecy law which bars both the national and foreign authorities alike. The other is the blocking statute which effectively prevents the disclosure; copying, inspection or removal of documents located in the host country in compliance with order from or by foreign authorities (Hadj, 1979; Newcombe and Kohler, 1983).

Some economists and policy analysts argue that capital inflows in the form of disbursements to developing countries are a major cause of capital flight. In the case of public sector borrowing, the availability of foreign exchange can increase the potential for graft and corruption (Ajayi, 1992 and Boyce, 1992). It is, therefore, logical on theoretical grounds to assert that for many developing countries, (Nigeria perhaps inclusive), abuse of official power through the misuse of such funds can lead to capital flight. Highly-

placed public officials using the paraphernalia of their office can siphon much of the money under their care to foreign countries solely for the private use of themselves and their immediate family. This particularly is the focus of this work. It is important to note that such capital siphoned out of the country by public officials and other private individuals are usually not declared. They are out of the knowledge of the domestic government. They are "hidden" capital exports.

Given their nature and the circumstances that warranted their outflow, they are usually not hot money and therefore will not flow back into the country even if the macroeconomic policies are reviewed. They are the monies that flee to the safe havens abroad. The public officials are usually afraid of their wealth being confiscated by their national government into the national account when they are out of their office. As a result of the above, we suggest the use of the model by Dooley et al (1983) and Dornbusch (1985) which was adopted by Duwendag (1988) for estimating capital flight in this particular study. This method measures capital flight as a residual from the balance of payments statistics. Capital flight is referred to as private capital outflows here.

2.6 LINKAGES BETWEEN EXTERNAL DEBT AND CAPITAL FLIGHT

Given the characteristic features of the LDCs in which there is a vicious circle of poverty, there exists a savings gap. And to the extent that this gap cannot be domestically bridged, there is a recourse to foreign borrowing to urgument the national savings. On this logic, it is believed that foreign borrowing is normal, natural and desirable if and only if the loan will be put into a productive investment in the home country.

Capital flight occurs when individuals decide to reallocate their wealth from domestic to foreign assets. Three basic forms of domestic assets are available: holdings of money or currency, saving in the domestic financial system, or investments in real productive activity. Capital flight occurs when these domestic alternatives appear increasingly unattractive. That is, under normal circumstances in which "capital is capital" money would move across borders in response to international differences in rates of return and risk. Favourable conditions in any given country would attract foreign and domestic investment alike; unfavourable conditions would repel foreign investment and trigger resident capital outflows. The result would be a negative correlation between debt-creating inflows and resident outflows. And following from this, capital flight would be lowest in those years in which foreign borrowing was greatest, and vice-versa.

When in real-world settings the opposite occurs, such that capital flight is larger in years of greater lending - how is this to be explained? These we shall group into five categories:

2.6a INDIRECT LINKAGES

As in Boyce (1992), the explanation favoured by bankers, at least in their public statements, is that external borrowing and capital flight bear no direct causal relation to each other. Rather both are results of a common set of exogenous factors notably poor economic management by the debtor government. The Morgan Guaranty Trust Company (1986, p.15) declares, for example that the simultaneous occurrence of debt accumulation and capital flight in Third World Countries "was no coincidence", since "the policies and track records that engendered capital flight also generated demand for foreign credit". In other words there may be no direct relationship between external debt and capital flight but rather their joint occurrence has been informed by some other exogenous variables both within and without the country.

This line of reasoning seems plausible as an explanation for a positive cross sectional correlation between external borrowing and cumulative capital flight,

especially when they are both measured over an appropriately long interval. Comparatively, over a decade or two irresponsibly governed country A may witness more public sector demand for external credit, and more private sector propensity for capital flight, than a prudently governed county B. This is far less convincing, however, as an explanation for a positive time -series correlation between annual foreign borrowing and capital outflows in a given country since the time frame for the relevant "policies and track records" is clearly longer than a single year (Boyce, 1992).

Moreover, while the above reasoning may help to explain the demand for external borrowing there is yet another question untouched: Why were foreign creditors willing to supply large sums of money to governments whose own residents were voting no confidence by shifting their capital abroad? As Pastor (1990,p.7) remarks, "If the 'investment climate' in a country is negative enough to push out local capital, why would savvy international bankers extend their own capital in the form of loans"? Either the creditor were not so savvy,or they faced risks and returns systematically different from those perceived by residents. While the former may be far from true the latter do not carry all the argument for the situation on the supply side.

2.6b DIRECT CAUSUAL LINKAGES

The latter possibility relates to the explanation which posit direct causual linkages between debt and capital flight. Direct linkages can be classified into four groups on the basis of:

i) whether the direction of causality runs from debt to capital flight or vice versa and

ii) whether one simply provided the motive for the other or whether it also provided the means.

Explanation in which the causality runs from debt to capital flight can be divided into those in which external borrowing motivate residents to shift their own capital abroad. For example, external borrowing may generate expectations of exchange rate devaluation or fiscal crisis. Residents consider the phenomenon a situation of economic ill health. A second division is one in which the borrowed funds are themselves transferred abroad. Borrowed from Boyce (1992), the two cases are termed "debt-driven" and "debt-fueled" capital flight respectively. Similarly explanation in which the causality runs from capital flight to debt can be divided into "flight-driven" external borrowing" in which the export of capital generates an economy-wide demand for replacement funds, and "flight-fueled external borrowing", in which resident who exported capital then "borrow" their own money back. Table Fourteen summarizes these linkages.

TABLE FOURTEEN

LINKAGES BETWEEN EXTERNAL BORROWING AND CAPITAL FLIGHT

Indirect:	Exogenous variables	External borrowing Capital flight	
Direct		Causal Mechanisms:	
		motive only	Motive of capital
Direction of linkage	Debt to capital Flight (B——> KF)	Debt-driven capital flight	Debt fueled capital flight
	capital flight to debt (KF——> B)	Flight-driven External borrowing	Flight-fueled external borrowing

Source: Boyce (1992, p. 337)

Apparent in the foregoing is that, in each variant, capital flows in both directions as if through a revolving door. Pursuing this analogy, we can think of debt-driven capital flight as a case in which Mr. Dollar arrives through the revolving door, and Mr. Naira upon seeing him anticipates trouble and decides to leave. In debt-fueled capital flight, by contrast, Mr. Dollar enters, attends to a few formalities discussed below and then slips out again. In flight-driven external borrowing, Mr. Naira leaves and Mr. Dollar is invited to take his place. And in flight-fueled external borrowing, Mr Naira steps out and then comes back dressed as Mr. Dollar. Let us consider each scenario more

closely.

2.6bi DEBT DRIVEN CAPITAL FLIGHT

"Debt-driven" capital flight refers to capital which flees a country in response to the economic circumstances attributable to the external debt itself.

Consider the impact of external borrowing, upon the exchange rate. In the short run, the capital inflow increases the supply of foreign exchange which, other things being equal, exerts an upward pressure on the domestic currency. If, however, this debt is incurred for purposes which are unlikely to generate adequate foreign exchange for repayment, then in the long run an opposite pressure will result. When the net transfer (i.e new borrowing minus amortization and interest payment on past loans) turns negative, following from above, increased demand for foreign currency (compared to the no borrowing counter factual) will depress the value of the local currency. The rational response for any asset holder who can follow the trend of events and discern the time and the season will like to dollarize when the local currency is artificially inflated in the expectation of its eventual decline. Conesa (1987, p.55) remarks "The excessive supply of credit to a country without an adequate and efficiently implemented growth strategy only overvalues national currency and acts as a provider of counterpart funds for local citizens who then

deposit their money abroad". Since the era of the oil boom, quite a number of elephant projects have been desired and some embarked upon. Some of these projects never got started while some that got started and completed could not break even. The corollary of this today is the government programme of privatization and commercialization under the auspices of the Structural Adjustment Programme. We can still recall the unproductive programmes of the government in the Second Republic when food importation was taking a high percentage of total imports. As a rational consequence, the naira dollarization further increases demand for foreign exchange such that the pressure for devaluation gets an additional boost.

In the same vein, external borrowing temporarily eases the pressure upon government to tax residents either overtly or through the inflation tax. Further down the road, however, domestic assets holders may expect exceptionally onerous taxes on the wake of an eventual debt crisis. Dooley (1987) described "taxes" here to mean a broad range of regulations which may reduce the value of domestic financial assets. The desire to avoid this situation provides a further motivational link between debt inflows and capital flight. As in Boyce (1992) external funds may also preempt favourable investment opportunities, or drive down domestic interest rates, "Crowding out" domestic capital and pushing it overseas. It is worthy of note, however. that debt-driven

capital flight need not be hasty, particularly if the major informant or impetus comes from anticipation of future consequences of the debt accumulation. That is, the timing of debt-driven capital flight would not be expected to generate a terribly strong positive year-to-year correlation between external borrowing and capital flight. Debt-driven capital flight gives warnings such as negative net transfer which appears in the form of diminishing official reserves,increasing reliance upon short term finance and so on. In Nigeria, the net transfer was negative between 1974 and 1977 and since 1984 its trend has been going down. Those who lack perfect foresight may wait excessively too long to export their capital only after the crisis has broken out.

Boyce (1992,p.338) identified an additional economic impact which he called the "extra economic" impacts of external borrowing. When external borrowing increases the leverage of an avariciuos tyrant and his greedy cronies who control the borrower government,capital flight is encouraged. Further, if they employ this leverage to wrest control of asset and markets from their rivals in the national economy, using a combination of legal, quasi-legal and illegal methods, the resulting increase in expropriation risks may well propel further capital flight. These hypothetical circumstances, not dissimilar to those faced by "Nigerian capitalists" under the Babangida regime, might strengthen the phenomenon of debt-driven capital flight. The

relevant time frame would extend beyond a year. A strong year-to-year correlation may imply that other tighter linkages were at work.

2.6 bii DEBT-FUELED CAPITAL FLIGHT

In this division, the inflow of external resources provides both the resources and a possible motive for capital flight. The capital inflow motivates as well as provides the means for capital flight. The same individual borrows external resources and then transfers part or all of his or her assets abroad. Debt directly fuels capital flight. As in Pastor (1990,p.7) the fuel is fungible in some cases. He remarks; "an investor could draw a publicly guaranteed external loan cheaply and ship his or her own resources abroad to acquire foreign assets". In some other cases, money never entered into the country.It is borrowed and immediately deposited in a foreign bank, possibly the same one making the loan, so that "the entire cycle is completed with a few book keeping entries in New York" or other financial centres (Henry, 1986, p.20).

By way of analysis, it is necessary to differentiate between debt-driven and debt-fueled capital flight. To do this, let us contrast between two scenarios. In the first, the government borrows dollars (or any other hard currency) and then sells them to its own residents. Some of the buyers then legally or illegally transfer these dollars abroad. We

will see here that external borrowing merely furnishes foreign exchange; it does not generate real economic activities abroad since residents would have purchased the dollars with resources already acquired in other way. In the second scenario, the government again borrows dollars as in the foregoing but now lends these funds to private borrowers through a national development bank. The borrowers then transfer part or all of this capital abroad. In the latter case, unlike the former, external borrowing provides the resources locally but still fuels capital flight.

According to Boyce (1992,p.338), debt-fueled capital flight typically involves a process of "layering" between the external creditor and the private resident in whose name external assets are required. On the creditor's book, the debt is owed by the government or by a corporate entity, typically with a government guarantee of repayment in case of default. The external assets, by contrast, are in the names of individuals: government officials who siphoned part of the proceeds of the loan, or private residents, probably close to the government, who borrowed in the name of a firm. The holder of the external asset thus is not identical to the holder of the external liability. Yet the same individual is engaged in both transactions. This legal discrepancy is by no means coincidental. Public guarantees, according to him (Boyce), posed a "moral hazard" for both creditors and borrowers. Insured against the risk of

default, neither party had an incentive to minimize it. Below is a part of the answer for the question whether the creditors were not so savvy or there existed differences in risk and return between the two regions that creditors still lend in the face of massive capital outflows. Creditors might have been more reluctant to finance capital flight if repayment were the sole responsibility of the individual private capitalist. With the debt in the name of the government, or secured by government guarantee, the creditors could draw comfort from their faith that "countries do not go bankrupt".

For the flight capitalist, meanwhile, the evasion of responsibility for eventual repayment of the external loan was often a key element in the transaction's rationale. It is not likely that the capitalist could turn a profit by borrowing money from a bank and then depositing there or in another bank, for banks derive their own profit from the opposite spread between interest rates. It is conceivable that some borrowers were astute enough to identify lucrative overseas investment opportunities which permitted retention of a profit spread after repayment, but it is doubtful that all flight capitalists possess such acumen. In many cases, the principal motive for debt - fueled capital flight was the opportunity to exploit the legal dichotomy between the holder of the liability and the holder of the asset.Whenever there are

opportunities for the acquisition of private assets by means of public debts, "rational" profit maximizers can be expected to seize them. Debt inflow is an opportunity to the flight capitalist which naturally will be exploited instantly.

Debt-fueled capital flight generate a rather strong year-to-year correlation between net debt inflows and capital flight. Unlike debt-driven capital flight, the causal relation is not mediated by changing perceptions of the economic and political environment. Nor are the lags between the borrowing and flight likely to extend over a period of several years.Rather the loan is obtained for the intended purpose of capital flight, and the borrower may well be anxious to consummate the circuit expeditiously, while the window of opportunity is open. Mr. Dollar round trip through the revolving door is likely to be quick.

2.6.iii FLIGHT-DRIVEN EXTERNAL BORROWING

We now turn to causal linkages running in the opposite direction, from capital flight to external borrowing. Here too we can distinguish between the case in which the link is solely motivational (here termed "flight-driven" external borrowing) and that in which flight capital directly provides the resources which re-enters the country ("flight-fueled" external borrowing).

The demand side of flight-driven external borrowing is straight forward. The drain of domestic resources through capital flight generates demand for replacement funds on the part of the government and the private sectors. Why are external creditors willing to meet this demand, when local residents are not? The answer is likely to be found in different risks and returns facing resident and non resident capital, rather than in different perception of the same risks and returns. An inflation tax, for example, will erode the returns to holders of fixed interest domestic-currency liabilities, whereas non-residents who hold claims denominated in foreign currency are unaffected. The problem would have been alleviated if residents were permitted to hold dollar-denominated assets domestically. Foreign creditors may also enjoy "comparative advantage" in risk mitigation thanks to the "direct or indirect sanctions" they can bring to bear upon the borrower (c.f Lessard, 1986,p.16). If so, they may believe that "domestic assets held by residents are effectively subordinated to sovereign external obligations in the case of a fiscal crisis" (c.f Lessard, 1987).

Such differences can be expected to lead to offshore financial intermediation, by which foreign creditors provide fresh loans as domestic capital is exported, in effect transforming resident capital into non-resident capital. This process in turn can intensify debt-driven capital

flight, since "the substitution of foreign funds backed by international leverage for resident savings may increase the likelihood of crises and the relative exposure of (the remaining)resident holdings of domestic asset" (Lessard, 1987, p.98). A vicious circle is set in motion in which debt and capital flight feed upon each other.

2.6.biv FLIGHT - FUELED EXTERNAL BORROWING

In flight-fueled external borrowing, Mr Naira flees and then reenters the country in the guise of Mr. Dollar. The flight capitalist seeks to arbitrage the yield and risk differentials between resident and external capital, by engaging in a series of transaction sometimes known as "round-tripping" or "back-to-back loans". Resident capital is dollarized and deposited in an overseas bank, and the depositor then takes a "loan" from the same bank. (for which the deposit may serve as collateral).

As in the case of offshore financial intermediation, government guarantees provide a crucial part of the rationale for back-to-back loans. Khan and Haque (1985, p.625) remarks:

> To the extent that the investor believe that foreign debt implicitly carried a government guarantee, he was assured that, if the domestic firm or enterprise went bankrupt or was expropriated, the foreign lenders claim will be assumed by the government. Savings

> held abroad would obviously not be at risk, so that the investors was protected if he relied as much as possible on foreign borrowing. Given this scenario, the domestic investor was behaving in a completely rational fashion. In many cases, of course, the government guarantee have been explicit.

Another motivation for flight-fueled external borrowing is the concealment of the source of funds from present or prospective government authorities.

Which of the two causal linkages from capital flight to external borrowing is more likely to generate a strong positive correlation between their year-to-year variations? It seems reasonable to hypothesize that flight-fueled external borrowing generates the link, since the causal relation is again not mediated by other economic variables, and accordingly the interval between the flight and borrowing may be shorter.

The linkages between external debt and capital flight sketched above are not mutually exclusive. On the contrary, they may be mutually reinforcing. Capital flight may be both driven and fueled by external borrowing and vice versa. Econometric analysis can test for the presence of direct as opposed to indirect linkages, since a positive year-to-year correlation between external borrowing and capital flight would indicate the former. Econometric analysis may also shed light on the relative importance of the different hypothetical direct linkages by examining timing and causality.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 THEORETICAL FRAMEWORK

The accumulation of external debt by the Less Developed Countries since in the 1970s was accompanied in many instances by substantial amount of capital out flows. Morgan Guaranty Trust Company (1986) estimated, for example, that 18 Third World Countries experienced US$198 billion in capital flight during 1976-1985. At the same time, the total external indebtedness of these countries was US $451 billion.

The coexistence of these massive capital flows in opposite directions is of interest on both practical and theoretical grounds. The US Treasury secretary James Baker stated at the 1985 World Bank/International Monetary Fund annual meeting in Seoul, "it is unrealistic to call upon the support of voluntary lending from aborad, whether public or private, when domestic funds are moving in opposite directions". If a country's own citizens have no confidence in its economic system, how can others?" (Gulati, 1988, P.165). Similar sentiments have been expressed by commercial bankers, who describe themselves as "understandably reluctant to provide fresh funds unless the debtors put a stop to the capital flight (De. Vries, 1986, p.6). Likewise Cunningham (1988, P.76) remarks: "The debt crisis represents

an unwillingness of former creditors to reinvest in an economy (i.e, roll over the debt). Capital flight represents precisely the same decision, though made by domestic residents rather than international lenders. Thus, when one sees foreign capital unwilling to invest in an economy, one might also expect to see domestic capital make the same decision. Capital flight and debt crisis go hand in hand, but making the relationship out to be anything more than axiomatic is extremely misleading."

In the indebted Third World countries such as Nigeria where the public is reluctant to accept cut in living standards to free resources for debt service one finds a different perspective on the implications of capital flight. If external borrowing financed the accumulation of external assets by private citizens or government officials, the question normally arises as to why the government, and through it the populace at large, should be shouldered with the burden of continued debt service. Among others, the late Carlos Diaz-Alejandro (1984, P.379) drew attention to this view: "This situation reduces the political legitimacy of efforts to service the external debt; indeed it has generated a crisis of legitimacy for the role of the private sector in Latin American development."

Underpinning these two views are equally different understanding of the causes of capital flight. In the Baker - Banker view, Third World governments themselves bear most

of the blame for capital flight. This is particularly blamed on the inappropriate macro-economic policies of these governments - notably exchange rate over valuation, financial repression, and inflationary fiscal and monetary policies which are believed to have driven national investors to more favourable climates. The Third World debt critics, by contrast, place the main onus upon the irresponsible policies of the official and private creditors. They noted that external loans provided vital financial support to the very regimes, many of unpopular dictatorships, whose policies are now deplored after the fact by the bankers. Moreover, the Third World debt critics suspect that the international private banking departments of large commercial banks actively encouraged and facilitated capital flight (Boyce, 1992).

In the Baker-Banker view, capital flight is a reason for creditors not to lend since it leads to diminished debt serving capacity. In the critic's view it was lending itself which provided the motive and the means for capital flight. By the first logic we might expect a negative correlation between net debt disbursement and capital flight. That is, across countries and overtime more capital flight leads to less lending. By the second logic however we would expect a positive correlation, that is, more lending leads to more capital flight.

3.2 A MODEL OF CAPITAL FLIGHT FROM NIGERIA.

Following our discussion in the previous chapter, we shall adopt a method by Dooley et al (1983) Dornbush (1985) which was modified and used by Duwendag (1988) to measure capital flight from Nigeria. This method is adopted here because it offers the best way of measuring private capital outflows from the country in the context in which it is concieved in this work.

The basic equation for the following calculation of the volume of private capital outflows is the balance of payments identity(1)

(1) $CA = KA + EO + CP + R$

The variables of equation (1) are interpreted as balances. Accordingly the balance on current account (CA) is always equal in absolute terms, to the sum of the balance on capital account (KA), the net error and omissions of the balance of payments (EO), the counterpart items to reserve assets (CP) and the change in official international reserve (R).

Equation (1) is then specified in such a way as to express the typical balance of payments pattern for LDCs. Equation (2) reflect a balance of payments constellation which can be regarded as typical in the longer term for major LDC borrowers.

(2) $KAS = CAD + EOD + CPD + \Delta R$

in which:

KAS;Capital account surplus

CAD:Current account deficit

EOD: Net errors and omission ('deficit' ie negative balance)

CPD : Counterpart items ('deficits' ie negative balance)

+ΔR: Increase in official reserve assets (decrease,).

A few explanatory statements should be made on the nature of this framework and the balances selected. The monetary authority is assumed to be set out to build up the official reserve assets in order to maintain international credit worthiness. As opposed to the IFS and the BOPs the items "use of IMF Credit' is not taken into account here by ΔR, but dealt with separately in the following as a special source of finance ΔR, therefore is the sum of the total change in holding of monetary gold, special drawing rights (SDRs), foreign exchange assets, other reserve claims and of the change in the reserve position in the IMF.

The various counterpart to the monetization/cancellation of SDRs, and the valuation change generally reveal a negative balance (CPD) in the long term. The same applies to the net errors and omissions (EOD). Deficits on current account and surplus on capital account can be taken for granted.

In order to calculate the volume of private capital

outflows, reference is made to the capital account. In the IFS and the BOPS all forms of net capital import (KAS) are broken down into the following compoment (equation (3)). As already mentioned, the 'Use of Fund Credit' variable (UFC) is also included here as an additional source of finance since it was previously extracted from the BOP figures on reserve asset (ΔR)

(3) KAS = DIR + PI + KL + KS + EF + LR + UFC in which:

DIR: net direct investments

PI: net portfolio investments (almost exlusively in the form of net sales of public securities and bonds abroad).

KL other long-term capital inflows net (principal repayments and private gross capital outflows subtracted).

KS: Other short-term capital inflows, net (see KL)

EF: 'exceptional financing', net (payment arrears e.g due to interest payment arears or payment arrears for imports)

LR: 'Liabilities constituting foreign authorities' reserves', net (Change in certain kind of external debt which constitute reserve assest when viewed from the creditor or side).

UFC: Use of Fund Credit, net.

In equation (3), PI, KL, KS, EF and LR represent the various forms of foreign borrowing statistically recorded in the IFS and BOPs. These are net variables in that all principal repayments and private capital outflows have already been subtracted. In order to be able to compare the

actual volume of foreign borrowing with the figures recorded in the IFS and BOPs the gross quantities are again required. To this end the following breakdown was effected into quantities which have not been netted out: including the variables:-

B^t: total foreign borrowing

REP: principal repayments on external debt

KO: private gross capital outflows (increase in private gross external assets)

and

B: (gross) foreign borrowing (increase in gross external debt).

the following applies when referring to the foreign debt - creating capital inflows specified in equation (3):

(4) $B^t - REP - KO = PI + KL + KS + EF + LR$

in which:

(5) $B = B^t - REP$

B is identical with the term 'increase in gross external debt', that is, only the principal repayments have been subtracted, but not the private gross capital outflows. We shall simply refer to B in the following as 'foreign borrowing'. Taking into account equations (4) and (5), equation (3) then becomes (3a) $KAS = DIR + B - KO + UFC$

Equations (2) and (3a) form the framework for the methodological approach to estimating capital outflows presented in the next chapter. The following should be noted

in this approach, - the 'Use of Fund Credit' variable (UFC) is explicitly incorporated as a further possible source of finance for capital outflows; a distinction is drawn between private and public capital outflows by separately recording the latter in the change in official reserve assets (ΔR); the (as a rule) negative balances of net errors and omissions and of counterpart items (EOD, CPD) are also stated separately. As the order of magnitude of these two components is substantial, their inclusion in the 'residual' KO (as, for example, in the case of Dooley et al and Dornbusch) would lead to a corresponding distortion.

Taking into account these modifications, equating equations (2) and (3a) results in the financing equation (6) of the balance of payments:

(6) $DIR + B - KO + UFC = CAD + EOD + CPD + \Delta R$

or

$$\underbrace{DIR + UFC + B}_{\text{Sources of finance}} = \underbrace{CAD + EOD + CPD + \Delta R + KO}_{\text{Uses of finance}}$$

KO is calculated implicitly that is, as a residual via an indirect calculation from equation (6). This produces the actual estimating equation (7) for the determination of private capital outflows:

(7) $KO = (DIR + UFC + B) - (CAD + EOD + CPD + \Delta R)$.

Since KO is a residual, all the inaccuracies of the other data series are automatically subsumed in the estimate for private capital outflows. UFC seems probably the most

reliable variable in this context. The variable B is likely to have a sound basis, although the repeated upward revisions of the internal IMF debt statistic suggest that it still tends to underestimate the true extent of foreign borrowing.

3.3 MODELS OF THE RELATIONSHIP BETWEEN EXTERNAL DEBT AND CAPITAL FLIGHT

A complete model of the relationship between capital flight and external borrowing must incorporate other variables. Other possible determinants of capital flight include:

(i) The level of the country's official foreign exchange reserves: Higher reserves as an indicator of a lower likelihood of a balance of payments crisis are expected to lead to less capital flight.

ii) The rate of growth of gross domestic product: Higher growth and the associated opportunities for investment could be expected to result in less capital flight.

iii) The government budget surplus or deficit as a signal of the likelihood of a fiscal crisis: a higher surplus (or lower deficit) would be expected to result in less capital flight.

iv) The degree of appreciation or depreciation of the exchange rate: The higher the degree of appreciation or depreciation of the exchange rate in the domestic

economy the higher the extent of capital flight.

v) Changes in inflation: This is expected to have a positive effect on capital flight.

Each of these variables could also affect the level of external borrowing. Higher foreign exchange reserves and budget surpluses could be expected to lead to lower demand for external capital and to greater supply. Also, higher changes in inflation and the degree of appreciation or depreciation of the exchange rate signifying the existence of a certain imbalances in the domestic economy would likely be expected to lead to a higher demand for external capital and to a lower supply. In each of the above, the net effects, if any, would hence depend upon the relative importance of supply and demand in determining the amount of external debt or external borrowing. The net effect of gross domestic product growth rate is also uncertain - higher growth would presumably boost private investment demand (and perhaps supply), but public sector demand for external credit could be counter-cyclical. In addition, the Structural Adjustment Programme (SAP) of June 1986 had a drastic effect on the performance of the economy in the subsequent years.

A general model incorporating these variables would be a multiple regression model. A multiple regression model can be defined as $Y = f(X_1, X_2, X_3 \ldots\ldots, X_n)$ ------ (8)

Y = dependent variable

X_{1m} independent variables

In a multiple regression equation given as

$Y = f\ [B_1X_1]$,

Where;

B_{1m} are the respective X_{1m} coefficient, if capital flight is a function of external debt and the other variables can be fitted into our regression model, then a regression model of the form

KF = f (B, RES, GDPGR, BS, MER, CINF, SAP) ..... (10)

can be formulated.

Also if external debt is a function of capital flight and the other variables can be fitted into our regression model, then a regression model of the form

B = (KF, RES, GDPGR, BS, MER, CINF, SAP) ---- (11)

can be formulated.

where:

KF: annual capital flight;

B: external borrowing;

RES: the level of the country's official foreign exchange reserves;

GDPGR: the percentage growth rate of gross domestic product;

BS: The government Budget surplus or deficit as a percentage of gross domestic product;

MER: the degree of appreciation or depreciation of the exchange rate measured by the percentage change in

the exchange rate between Naira and Dollar;

CINF: change in inflation defined as the difference between the log of this year's inflation rate and the log of last year's inflation rate;

and SAP: a dummy variable to capture the impact of the Structural Adjustment Programme taking the value zero before 1986 and one thereafter.

The predicted effects of these variables are summarized below.

TABLE FIFTEEN:

THE PREDICTED EFFECTS OF INDEPENDENT VARIABLES ON DEBT-CAPITAL FLIGHT REGRESSIONS

Independent Variable	Dependent Variable		
	KF	B	
		Demand	Supply
KF		+	+
B	+		
RES	−	−	+
GDPGR	−	?	+
BS	−	−	+
MER	+	+	−
CINF	+	+	−
SAP	+	+	+

A fairly general initial specification of this model

is:

$$B = a_0 + a_1 KF + a_2 RES + a_3 GDPGR + a_4 BS + a_5 MER + a_6 CINF + a_7 SAP + V_t \quad \text{----------} \quad (12)$$

$$KF = a\ o + a\ 1\ B + a\ 2\ RES + a\ 3\ GDPGR + a\ 4\ BS + a\ 5\ MER + a\ 6\ CINF + a\ 7\ SAP + V\ t \quad \text{---------} \quad (13)$$

3.4

SOURCES OF DATA

The data for the variables used in this research work are time series data and are secondary in nature. The sources of data include the Central Bank of Nigeria Statistical Bulletin (several issues), The International Monetary Fund: International Financial Statistics (several issues), World Bank: world Debt Tables (several issues), and African Economic Research Consortium journals.

CHAPTER FOUR

DATA ANALYSIS AND REGRESSION RESULTS

SOURCES AND USES OF FINANCE IN NIGERIA

The actual estimating equation for the determination of private capital outflows is given by KO =

(DIR + UFC + B) - (CAD + EOD + CPD + DR)

The results of the estimation equation are presented below

TABLE SIXTEEN
SOURCES AND USES OF FINANCE IN NIGERIA
(1970 - 1990) IN US$M.

Year	B*	AB	DIR	UFC	CAD	EOD	CPD	DR	KO
1970	531	-	205	0	-368	101	18	-19	-135
1971	651	120	286	0	-406	83	46	-207	- 78
1972	693.8	42.8	305	0	-342	5	17	46	738
1973	1205.8	511.2	373	0	- 8	-47	4	-206	672.2
1974	1140.5	-64.5	257	0	4897	71	146	-5044	262.5
1975	938.5	-202	418	0	42	-41	-206	17	28
1976	570.1	-368.4	339	0	-357	-46	-28	406	37.6
1977	3084.1	2514	442	0	-1018	-49	-121	948	2716
1978	5035.6	1951.5	213	0	-3785	169	-224	2343	667.5
1979	6158.5	1122.9	304	0	1372	616	464	-3663	215.9
1980	8754.3	2595.8	-734	0	5104	-706	343	-4687	1915.8
1981	11648.23	2893.93	543	0	-6222	-96	-1611	6340	1847.93
1982	12177.7	529.47	430	0	-7241	2	-183	2282	-4180.53
1983	17404.7	5227	345	0	-4337	90	-185	623	1763
1984	16444.2	-960.5	200	0	114	271	-9	-472	-856.5
1985	16576.6	132.4	489	0	2623	-138	-445	- 56	2605.4
1986	21930.8	5334.2	199	0	371	-191	- 40	580	6273.2
1987	29732	7801.2	616	0	362	-745	56	104	7986.2
1988	30235.6	503	839	0	-555	-521	- 58	514	722
1989	30380.5	145.5	2082	0	-143	-1252	na	-1114	-281.5
1990	31,171	790.5	588	0	5126	82	na	-2099	4487.5
Total	31,171	8	8739	0	-4771	-2250	-2016	-3644	26698

B*: this external borrowing that has been taken as a proxy for external debt.

Sources: (1) Calculated from IFS Year Book, International Monetary Fund, 1989, 1991.

(2) World Bank, World Debt Tables, Several Years.

TABLE SEVENTEEN:

NIGERIA: EXTERNAL BORROWING AND CAPITAL FLIGHT (IN US$ M)

Years	B*	KO
1970 - 1972	162.8	-139.2
1970 - 1975	407.5	778.5
1976 - 1979	5558.4	3637
1979 - 1984	10285.7	705.6
1970 - 1984	15913.2	4905.2
1985 - 1990	14726.8	21792.8

B*: this external borrowing that has been taken as a proxy for external debt.

Source:(1) Calculated from IFS Year Book, International Monetary Fund, 1989, 1991.

(2) World Bank, Wold Debt Tables, Several years.

The reference figure is the increase in gross external debt (B) during the last twenty one years which amounted to approximately $31 billion. According to the results, approximately $27 billion (=87%) of this figure flew out of the country again in the form of private capital out flows (KO). It is evident given this high percentage of external debt taken away in flight that Nigeria is a hard-core capital flight country.

It will be important if we can look at the periodical growth in these two variables. In the period between 1970 - 1972, foreign borrowing (B) was $162M and the corresponding private capital outflows (KO) stood at $-139.2M. This period

marked the upsurge of oil exploration in Nigeria. The country had depended on the agricultural sector both for her revenue and foreign exchange prior to this time. The economy of Nigeria can be said to be blossoming at this period. The investment climate was attractive both to local and foreign investors. As such, we can not think of economic factors having to trigger off capital from Nigeria. No wonder the private capital outflows was negative. This implies that there was a repatriation of external private capital assets to the tune of $139.2M into the country in those years.

The experience between 1970 and 1972 could not be sustained. As a matter of fact, we can link the experience to the episode of the first oil shock at 1973/1974. Given the increase in oil revenue brought about by the increase in the price of oil, the government can be said to have been beclouded. The government embarked upon a wasteful spending and inappropriate macroeconomic policies. To this end, the private capital outflows (KO) had out-strengthened the external borrowing as early as 1975. Corruption of public officials might not have been a serious problem at this time but it could be seen that the economy lacked a good sense of direction. Import-substitution industry was embarked upon even though the necessary ground for it can be said not to have been prepared. Example of this is the Ajaokuta steel rolling company. The nation, deceived by the upsurge in oil revenue, neglected the agricultural sector which was

initially her main source of income. The problem the nation is facing today cannot be divorced from this unwise act, since the food, employment and to a large extent the revenue base of the economy was eroded. Since then the economy has lacked the self-equilibrating capability to sustain herself.

While it may be untrue to attribute the present predicament of the country to the Babangida's administration, we can make bold to say that the total manifestation of the plight became very evident in his regime. For example, total foreign borrowing between 1970 and 1984 stood at about $15.9 billion and the equivalent private capital outflows were approximately $4.9 billion (= about 31% of external borrowing). However, there has been a dramatic change since 1985 that IBB took over the mantle. External borrowing between 1985 and 1990 totalled about $14.7 billion with the corresponding private capital outflows of about $21.8 billion (= about 149% of foreign borrowing). It is shocking to note the rapid growth in external borrowing in this period. Nevertheless, it is glaring from this result why the people of this country have been subjected to so much hardship. The nation as a whole was made to suffer for debts that were used by a handful of people in the nation.

The dramatic upsurge in the private capital outflows in the study period, though may not be free from economic factors triggering off capital flight, cannot yet be

disengaged from the political condition in the country. According to Ajayi (1992, P.4), this is predicated on corruption (a problem that is hardly limited to LDCs) and access to foreign funds by political leaders. It has been alleged that some political leaders through the perquisites of their offices siphon funds to foreign countries. Many of such leaders are said to be operating a secret code account system. Thus, access to political offices and the corruptibility of such office holders become important factors. Infact, many people had talked about corruption as being legalised under the Babangida's administration.And it was in the wake of this that Decree 419 was put in place.

4.2 COMPOSITION OF CAPITAL INFLOWS AND THE ABSORPTION OF FOREIGN BORROWING IN NIGERIA

The sources of finance to Nigeria going via our measure of private capital outflows are:

- the foreign borrowing (B)
- the net direct foreign investment (DIR), and
- the Use of Fund Credits (UFC).

Over the twenty-one years under review, IMF credit was zero. This reveals that Nigeria is open only to the other two sources of finance. Of these two, foreign borrowing accounted for about 78% of the total capital inflows into Nigeria during this study period. That is the Nigerian

economy is externally supportive. The low level of the net direct foreign investments may be attributed to the unattractive investment climate in the domestic economy. This is particularly true of the Structural Adjustment Programme embarked upon. This analysis can be discerned on the following table.

TABLE EIGHTEEN:

COMPOSITION OF CAPITAL INFLOWS TO NIGERIA (1970-1990) IN BILLIONS OF US DOLLARS AND PERCENTAGE

DIR		B		UFC		DIR+B+UFC	
$bn	%	$bn	%	$bn	%	$bn	%
8.739	21.9	31.171	78.1	0	0	39.91	100

Source: Calculated from Table Sixteen.

Private capital outflows are only one of the many forms in which foreign borrowing in absorbed. The most frequent forms of absorption are the current account deficits plus net negative errors and omissions (CAD + EOD) and the building up of the official reserve assets plus the counterpart items of the balance of payments (ΔR+CPD). With external borrowing as the reference figure the following three 'absorptive ratios' were calculated in the following table.

- the capital flight absorptive ratio, KO/B
- the current account deficit absorptive ratio (including net negative errors and omissions), (CAD + EOD)/B, and
- the reserve component absorptive ratio (including counterpart items), (ΔR + CPD)/B.

TABLE NINETEEN

ABSORPTION OF FOREIGN BORROWING (B) IN NIGERIA 1970-1990 (PERCENTAGE)

$\frac{B}{B}$	$\frac{(CAD+EOD)}{B}$	$\frac{(\Delta R+CPD)}{B}$	$\frac{KO}{B}$
100	22.5	18.2	87.1

Source: Calculated from Table Sixteen.

Naturally, an increase in external debt should mainly serve the purpose of financing current account deficits. However, the result on table Nineteen has brought up an unusual scene which basically justifies the basis for this study. Among the three absorptive ratios, the capital flight absorptive ratio, KO/B took 87%. This is unnecessarily high. It is either the debt creating inflow was never brought into the country or the bulk of it was exported back after reaching Nigeria. The debt crisis in Nigeria had to persist so long as the incurred debt was not invested in Nigeria and both the capital inflows and the returns on them were hidden

from the government. At the same time the country was borrowing and so much of this debt flew out of the country.

4.3 ESTIMATION OF THE DETERMINANTS OF CAPITAL FLIGHT FROM NIGERIA

Ordinary least-squares estimation of equation (13) gave the following results (absolute values of t-ratios in parentheses).

$$KF = -822.9 + 0.63B - 61.2\,BS + 72.6\,GDPGR + 27.2\,MER + 0.68RES + 135.5\,CINF + 38.4SAP \quad \ldots\ldots (13a)$$
$$(-1.4)\quad (1.88)\quad (-0.44)\quad (1.07)\quad (0.87)\quad (0.34)\quad (0.10)\quad (0.02)$$

$R^2 = 0.75$; $\bar{R}^2 = 0.58$; DW = 1.60

$$KF = 6334.3 + 0.82B + 2.08BS + 6.7MER + 2.89RES - 1021.1CINF + 2061.8\,SAP \quad \ldots\ldots\ldots (13b)$$
$$(1.08)\quad (2.31)\quad (0.02)\quad (0.21)\quad (1.25)\quad (-0.79)\quad (0.87)$$

$R^2 = 0.75$; $\bar{R}^2$ 0.59; D.W = 1.58

$$KF = 2622.6 + 0.64B - 5.32BS + 25\,MER + 1.97RES - 0.05GDP + 1.55CPI \quad \ldots\ldots\ldots (13c)$$
$$(0.47)\quad (2.19)\quad (-0.04)\quad (1.02)\quad (0.93)\quad (-0.70)\quad (0.35)$$

$R^2 = 0.73$; $R^2 = 0.60$; D.W = 1.47

$$KF = 4796.8 + 0.68B - 18.2BS + 19.8\,MER + 2.31RES - 0.07GDP + 1058SAP \quad \ldots\ldots (13d)$$
$$(0.88)\quad (2.24)\quad (-0.15)\quad (0.72)\quad (1.07)\quad (-1.0)\quad (0.54)$$

$R^2 = 0.74$; $R^2 = 0.61$; D.W = 1.47

$KF = -685.2 + 0.64B - 79BS + 74.4GDP\,GR + 25.7\,MER$

(-1.21) (2.27) (-0.73) (1.33) (1.01)

+ 132.4 SAP ..... (13e)
(0.88)

R^2 = 0.74; R^2 = 0.64; D.W = 1.58

KF = -829.5 + 0.64B - 56.6BS + 69.8GDPGR + 25.7MER
(-1.21) (2.21) (-0.45) (1.18) (0.97)

+ 0.73RES + 133.6 SAP ---------- (13f)
(0.40) (0.08)

R^2 = 0.75; R^2 = 0.62; DW = 1.60

KF = -671.7 + 0.63B - 78.2BS + 74.4 GDPGR + 27.1MER ... (13g)
(1.29) (2.40) (-0.76) (1.38) (1.54)

R^2 = 0.74; R^2 = 0.67; D.W = 1.59

The results displayed above are reasonably good. In equation (13a), we are able to see that about 75 percent of the total variation in capital flight is explained by foreign borrowing, the government budget surplus or deficit as a percentage of gross domestic product, the gross domestic product growth rate, the degree of appreciation or depreciation of the exchange rate, the level of the country's official foreign exchange reserves, the change in inflation, and the structural adjustment programme. However, all these factors were insignificant except the foreign borrowing. That is, only foreign borrowing hath the capability of explaining the changes in capital flight.

In our quest to see if the results could be improved upon a few adjustments were done which gave the results

presented in equations (13b)-(13g). In equation (13b) the gross domestic product growth rate was removed and the remaining variables were run on capital flight. The result was not any better, for though, the R^2 was about 75 percent only Foreign Borrowing emerged as the significant determinant of capital flight. In equation (13c), the gross domestic product growth rate and the change in inflation were replaced with the gross domestic product and the consumer price index respectively. Also, the Structural Adjustment Programme was removed from the model. Despite all these, the results were not improved upon, such that, foreign borrowing was the only significant explanatory variable of capital flight from Nigeria in this study period.

In all the seven estimated equations for capital flight, that is, equations (13a)-(13g) the explanatory variables accounted for between 73 percent and 75 percent of the total variation in the dependent variable, capital flight. In each of these equations only foreign borrowing was significant. The results indicated that foreign borrowing was a highly determinant of capital flight from Nigeria during 1970 - 1990. Greater borrowing went hand-in-hand with greater capital flight.

This result implies the existence of what in this thesis are termed "debt-fueled" and "debt-driven" capital flight. This is particularly evident as the foreign

borrowing had remained the single significant determinant of capital flight from Nigeria during this period. This is further elucidated by the correlation matrix results presented below. Here, about 81 percent positive correlation between capital flight and external borrowing is depicted. We have not ruled out the importance of inappropriate macro economic policies within the domestic economy triggering off capital but that they are insignificant as far as this work is concerned.

TABLE TWENTY

COVARIANCE AND CORRELATION METRICES

	COVARIANCE	CORRELATION
KFA, KFA	6367871.6	1.00000000
KFA, B	4644631.4	0.80874940
KFA, BS	-83.518762	-0.0071810
KFA, GDPGR	-26.334239	-0.0015221
KFA, MER	65779.641	0.72072530
KFA, CINF	124.08202	0.13307300
KFA, RES	-996.11008	-0.0016378
KFA, SAP	526.08339	0.51137020
B.B	5179403.7	1.00000000
B, BS	-1419.5785	-0.1353376
B. GDPGR	-3913.5410	-0.6922376
B, MER	56979.628	0.24461800
B, CINF	205.70737	-0.0322222

B, RES	-17674.503	0.42657020
B, SAP	395.77869	1.00000000
BS, BS	21.242328	0.31252000
BS, GDPGR	9.8756784	0.38517310
BS, MER	64.206872	0.03446760
BS, CINF	0.0586994	-0.5226591
BS, RES	-580.59307	0.46630380
BS, SAP	0.8761773	1.00000000
GDOGR, GDPGR	47.008476	-0.04009619
GDPGR, MER	-10.157646	-0.34043343
GDPGR, CINF	-0.8624681	0.01517990
GDPGR, RES	25.084678	0.03815430
GDPGR, SAP	0.1066482	1.00000000
GDPGR, MER	1308.1246	0.10252276
MER, MER	1.3702093	0.27938200
MER, CINF	-2435.4277	0.82514130
MER, RES	12.166759	1.00000000
MER, SAP	0.1365348	0.05818340
CINF, CINF	5.1817064	0.25946340
CINF, RES	0.0390859	1.00000000
CINF, SAP	58090.434	-0.2959546
RES, SAP	-29.080333	1.00000000
SAP, SAP	-0.1662050	1.00000000

4.4 ESTIMATION OF THE DETERMINANTS OF FOREIGN BORROWING IN NIGERIA

This measures the reverse linkages from capital flight to debt. Estimation of equation (12) yielded the following results:

$$B = \underset{(1.19)}{668} + \underset{(1.88)}{0.39\,KF} - \underset{(-1.48)}{147.9\,BS} - \underset{(0.28)}{15.5\,GDPGR} + \underset{(2.08)}{44.8\,MER}$$

$$- \underset{(-0.58)}{0.89\,RES} + \underset{(1.22)}{1212.4\,CINF} - \underset{(-1.19)}{1776.5\,SAP} \quad \text{------} \quad (12a)$$

$R^2 = 0.81$; $\bar{R}^2 = 0.69$; D.W = 1.90.

$$B = \underset{(-0.73)}{-4541.8} + \underset{(1.77)}{0.42KF} - \underset{(-0.95)}{119.9BS} + \underset{(0.89)}{52.1\,MER} - \underset{(-0.94)}{1.9\,RES}$$

$$+ \underset{(1.02)}{0.086DP} - \underset{(-0.72)}{3.1CPI} - \underset{(-1.33)}{2335.2\,SAP} \quad \text{---------} \quad (12b)$$

$R^2 = 0.80$; $\bar{R}^2 = 0.65$; D.W = 1.78

$$B = \underset{(0.59)}{224.8} + \underset{(2.09)}{0.39KF} - \underset{(-2.10)}{161.1BS} + \underset{(2.19)}{30.9MER} + \underset{(1.14)}{911.1\,CINF} \quad ...(12c)$$

$R^2 = 0.77$; $\bar{R}^2 = 0.70$; D.w = 1.79

$$B = \underset{(1.0)}{390.6} + \underset{(1.94)}{0.36\,KF} - \underset{(-1.82)}{138.5\,BS} + \underset{(2.58)}{48.5\,MER} + \underset{(1.57)}{1290.7\,CINF}$$

$$- \underset{(-1.36)}{1866.9\,SAP} \quad \text{----------} \quad (12d)$$

$R^2 = 0.80$; $\bar{R}^2 = 0.72$; D.W = 1.74

The results here are quite impressive. between 77 percent and 81 percent of the total variation in foreign borrowing is captured by the capital flight, the government budget surplus or deficit as a percentage of the gross domestic product, the gross domestic product growth rate, the degree

of appreciation or depreciation of the exchange rate, the level of the country's official foreign exchange reserves, the change in inflation, and the structural adjustment programme. It is evident from equation (12a) that only capital flight and the degree of appreciation or depreciation of the exchange rate possess the capability to explain foreign borrowing in this country. The remaining factors are insignificant given this equation.

As we do know that foreign borrowing is determined by other variables apart from these two, a few adjustment was done to see if the significance level of other variables would thrust up. In equation (12b), the gross domestic product growth rate and the change in inflation were replaced with the gross domestic product and the consumer price index respectively. However the results was not any better. Further, the gross domestic product growth rate, the level of the country's official foreign exchange reserves and the structural adjustment programme were removed from the model to have equation (12c). At this juncture, the government budget surplus or deficit as a percentage of the gross domestic product had become significant along with capital flight and the degree of appreciation or depreciation of the exchange rate. This is very important for our consumption. It is important because the debt crisis can be traced to the government budget deficit which has been externally financed over the years.

The results indicate that foreign borrowing was significantly and positively affected by capital flight. Taken with the results reported in equations (13a)-(13g), this supports the hypothesis that the causal linkages between foreign borrowing and capital flight do infact run in both directions. In addition, foreign borrowing was positively related to the degree of appreciation or depreciation of the exchange rate. This suggests that the demand side factors drove the credit market because it is assumed that the supply side is negatively related to this factor. At the same time, the negative impact of the government budget surplus or deficit as a percentage of the gross domestic product is a demand side phenomenon.

In sum, statistical analysis of the relationship between foreign borrowing and capital flight in Nigeria between 1970 -1990 indicates that the two variables were strongly linked. Larger foreign borrowing led to greater capital flight, and more capital flight led to larger foreign borrowing. While neither capital flight nor debt can be completely explained in terms of the other, our analysis suggests that this vicious circle was an important feature of the financial interactions between Nigeria and the world economy in recent decades, interactions which culminated in Nigeria's continuing debt crisis.

The fact that foreign borrowing and capital flight are mostly strongly correlated with each other's values in the

same year suggests that they not only drove each other by providing motives, but also fueled each other by providing capital for the reverse flow.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

In this research work, emphasis has not been on Nigeria's external indebtedness, per se, but rather on the relationship there exist between it and capital flight from the country. This approach has been followed because of the attraction which external debt as a topic had received from the people of this country in the recent times. Therefore, in order not to go into duplication we have decided to really uncover the aspect of capital flight which we still find fallow as a research gap and then considered its linkages with Nigerian external debt.

The use of the term "capital flight" arouses strong emotions in some quarters. The controversy surrounding the term is due partly to the lack of a precise and universally accepted definition for it in economic theory and partly because of the way the term is used between developed and developing countries.

Following from the problem of establishing what constitutes capital flight, it is difficult to measure it as most estimates reflect the differences in definition and approaches adopted by the various researchers. We estimated capital flight from Nigeria between 1970 and 1990 as a residual using Duwendag's approach. This followed from our desire to estimate the private capital outflows rather than the public ones.

The conduits for capital flight are not only many but varied. It can take place through cash or monetary instruments, bank transfers from a local affiliate of a foreign owned bank to designated recipients abroad and through precious metals and collectibles including works of art. False trade invoicing, the black marketing, brain drain and the repayments on the external debt are others.

The causes of capital flight have been grouped under relative risks, exchange rate misalignment, financial sector constraints and/or repression, fiscal deficits, external incentives and disbursement of new loans or foreign borrowing. In addition to these, there are other non-economic causes of capital flight. The corruption of political leaders or public officials and extra-ordinary access to government funds are vitally important here.

Nigeria, like many other Third World Countries, simultaneously experienced large outflows of private capital and rising external indebtedness in recent decades. The relationship between capital flight and foreign borrowing is open to a variety of interpretations. Indirect linkages, in which both borrowing and flight are caused by other factors such as economic mismanagement by domestic authorities, contribute to a positive cross-sectional correlation between debt and capital flight in a multicountry sample. But a strong, positive time series correlation in any given

country, as reported in the case of Nigeria, suggests the existence of direct causal linkages.

The fourfold classification of direct linkages between external debt and capital flight proposed in this work is based upon the direction of causality and upon whether the linkage is limited to motivations or it also extends to the provision of capital involved. The results of our econometric analysis support the hypothesis that debt-fueled capital flight and flight-fueled external borrowing were important aspects of the Nigerian experience in this study period.

This finding is important for a number of reasons. Firstly, it has implications for the political legitimacy of Nigerian external debt. The present government and the citizenry at large might well wonder why they should bear the cost of repayment of debts not of their making, from which they derived no benefit. Our situation today resembles a "case where the contractor absconds with the mortgage money, the banker, who helped him take it out now comes to collect from the owner of the empty lot and no one will lend the lot owner any more money because his 'debts' are too high" (Henry, 1989, P.82).

Rather than continue to service the entire debt, Nigerians might instruct the creditors to seek repayment from the owners of the private external assets which are the real counterpart of a substantial component of the public

external debt. Felix (1985) proposed compulsory mobilization of foreign private assets for debt service, arguing that creditor banks and governments might collaborate in this unorthodox endeavour so as to collaterize otherwise uncollectible debts. Pastor (1990) notes the practical problems of implementing such a plan: identification of assets, the banks reluctance to damage the relations with private clients, and the political resistance from holders of foreign assets. In addition, unless such a plan were implemented on a world-wide scale, it could be evaded by shifting assets to third countries.

Boyce (1992) notes that the debtor nations could capitalise upon the debt-flight connection in yet another fashion. Rather than seeking to recapture the flown capital, either by luring it home or by impounding it abroad, governments of debtor nations can tell their creditors that, resources permitting, they would scrupulously repay all loans or portions thereof, which were used for bona fide investment or consumption in the debtor country. However, until such time as the creditor furnishes evidence of such use, the debtor country shall assume no obligation to repay.

Such a move could claim a legal basis in the "doctrine of odious debt", which holds that for sovereign debt:

> "An interest which a creditor possess in a debt must, in order to constitute an acquired right protected by international law, be an interest in funds utilized for the needs and interests of the

> state. any debt contracted for other purposes is a debt intrinsically hostile to the interest of the territory" (O'Connell, 1967, P.459).

The only exact test of whether or not a debt is odious is the extent to which it is unbeneficial to the population of the territory it burdens. "On this topic, politics assume dominance over legal analysis" (O'Connell, 1967, P.460).

The debts foisted upon the Nigerian government via debt-fueled capital flight and flight-fueled external borrowing were unquestionably unbeneficial to the populace. Hence, there is considerable scope for legal and political challenges to the legitimacy of a significant fraction of the country's external debt.

Secondly, the finding gives a clearer understanding of the Nigerian external indebtedness. Although, we can not state categorically the direction of causal linkages between external debt and capital flight, we can yet tell that capital flight is a major cause of the Nigerian external indebtedness. This point will launch the country on a new path entirely. This is because efforts to solve the Nigerian debt crisis is embedded in the solution to the capital flight from Nigeria rather than the various debt strategies that the country had embarked upon. A good attention should be paid to the economic factors which determine capital flight from the country. To achieve our objective of staunching capital flight from Nigeria the investment climate in the country had to be conducive. This could be

conceived as an unattained objective in the Structural Adjustment Programme embarked upon since June 1986.

Following from above, intervention of the state is considered paramount. The government can embark upon capital controls. Such controls generally consist of government regulations that make it difficult for residents to obtain large quantities of foreign exchange (at the official exchange rate) without some requisite import or licenses. Orthodox economists (such as the advocates of SAP) dismiss such controls as impediments to the enhanced social welfare possible with a "free market" and likely to actually encourage capital flight because of the negative signal such government interference sends to local investors (Cuddington, 1986; Cumby and Levich, 1987; Khan and Ul Huque, 1985).

Corruption of political leaders or public officials and extra-ordinary access to government funds deserve some emphasis if we are to be out of this mess. This involves exports of capital to a "safe haven' abroad outside the reach of the government for their own selfish use in the future. To curb the outflow of capital and bring sanity to the economy of Nigeria, corruption must be reduced to the bearest minimum. There is need for honesty and transparency on the part of these officials. To see this work every government should be tried after her tenure in office and public officials must not be allowed to go on exile outside

the country after their regimes.

5.1 POLICY RECOMMENDATIONS

It is the finding of this study that capital flight phenomenon has made it impossible for Nigeria to get out of her external debt problems. This is substantiated by the fact that capital flight has been found to be the major determinant of external debt in Nigeria. Given this scenario, it is evident that the solution to the country's external debt problems is located within the panacea to the capital flight syndrome.

For this cause, the following have been proffered.

1. Nigeria should embark upon sound macroeconomic policies which are the obverse of those factors that triggered off capital from the domestic economy in the first place. By this we mean that the macroeconomic policies in the country should possess the ability to attract both domestic and foreign investments alike.
2. The direction of causality between external debt and capital flight is not well defined. There exists in Nigeria a year-to-year direct correlation between these two variables. Therefore, we recommend that Nigeria should desist from loans that are odious in nature.
3. Given the level of corruption in this country, we wish to recommend that the War Against Indiscipline (WAI) be

reactivated. This is particularly important for the public officials who use the privilege of their offices to siphon money out of this country.

4. One major problem in many Less Developed Countries (Nigeria inclusive) is political instability. This factor has a lot to tell on the flight of capital from these countries as it affects the investment climate of the country. The role of the military should be clearly stated and adhered to. Infact, no military government should stay more than one year in power.

It is believed that Nigeria will launch out of her present external debt problems if she makes use of the above recommendations.

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