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**Léonce Ndikumana & James K. Boyce, *Africa's
Odious Debts: How Foreign Loans and Capital Flight
Bled a Continent*. Zed Books, 2015, 152 pp. \$20
Paperback.**

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1. Introduction

After a period when the discourse on capital flight was largely coined for a rhetoric aimed to feed into the Marxist argument that capitalism could not lead to the development of the Third World, the debate on capital flight has increasingly become part of mainstream economics since the 1990s. This move has been accompanied by unprecedented efforts to refine the concept of, and measurement approach to capital flight, and better understand the challenges and opportunities of capital flight curbing or reversal for developing countries. *Africa's Odious Debts* is one of the outcomes of such efforts.

Still, analyses of capital flight in recent years have yielded findings that differ significantly, based on differences in the definition, data, and approaches used, period covered, and policy options considered. These factors overlap to an extent—as the methodology retained to estimate capital flight raises the issue of which data are required, their quality, periodicity, and availability. *Africa's Odious Debts* records substantial progress in many of these aspects. However, no analysis is perfect, and *Africa's Odious Debts* is not an exception to this rule. The objective of this review is precisely to look at Africa's Odious Debts' strengths and weaknesses, and to discuss *its* value addition vis-à-vis the existing corpus of knowledge on the topic.

2. On the Definition and estimated magnitude of capital flight

The authors of *Africa's Odious Debts* define capital flight as unrecorded financial outflows. Accordingly, to estimate the magnitude of a country's capital flight, they take the residual of that country's balance of payment as a starting point. In fact they innovate by developing a variant of the usual residual approach by taking into account unrecorded workers' remittances, in addition to the traditional adjustments for interest rate and trade misinvoicing. Thus, the authors find that for the 33 sub-Saharan African countries for which they had adequate data

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Journal of Economic and Social Thought

for the period 1970 - 2008, more than \$700 billion illicitly fled the continent during this period. The authors argue that if these financial flows were invested abroad and earned interest at the going market rates, the accumulated capital loss for the 33 countries over the 39-year period was \$944 billion. By comparison, total GDP for all of sub-Saharan Africa in 2008 stood at \$997 billion. Of course, no methodology can be perfect when analyzing a topic whose complexity poses daunting difficulties, and this one is not an exception, as illustrated by the methodology used to adjust the balance of payments residual for unrecorded workers' remittances.

Workers' remittances have gained increasing importance in Africa over the past decade or so, as their amount has passed the level foreign direct investment and aid combined. Given this importance and the informal share of workers' remittances, such adjustment is a major move that has potential to improve capital flight estimates. Still, the way the authors estimate the volume of unreported remittances deserves close attention. To estimate the volume of unreported remittances, the authors compare the IFAD estimates of inflows from industrialized countries to the total inflows from all countries recorded a country's official Balance of Payments statistics. Where the former exceeds the latter, the authors take this to be evidence of workers' remittances underreporting. They calculate the discrepancy for the year 2006—the only year for which IFAD's estimates are available—and extrapolate from this to generate estimates of discrepancies for other years based on the trend in overall African remittance inflows reported in the Balance of Payments. The results show that workers' remittances alone represented 17 percent of total capital flight for the 33 countries during the period 1970-2008, but obviously, deriving estimates for a 39-year period by extrapolating from data for one single year obviously raises a concern on the reliability of the results.

Also, the methodology of estimating trade misinvoicing which, according the authors' computations, accounted for a quarter of the total estimated capital flight for the same set of countries and same period illustrate the problem. Trade misinvoicing is estimated as the difference between trade data provided by an African country and the corresponding data provided by its trading partners in industrialized countries. To account for misreported trade with non-industrialized countries, the authors obtain a global total misinvoicing estimate by scaling up such discrepancies, namely by multiplying them by the inverse of the average shares of industrialized countries in the African country's exports and imports. This methodology relies on the implicit assumption that an African country capital flight's share of its trade is similar among its partner countries, no matter the differences in property rights standards in those countries.

Such an assumption can be questioned in principle, on the basis of the authors' core argument throughout the book. Specifically, the authors' analysis of the motives that drove capital flight in Africa supports the idea that the distribution of the continent elites' wealth in partner countries was skewed toward those industrialized countries where higher property rights standards ensure a safer environment for African elites' assets. Of course, while the assumption is questionable in principle, it may have limited impact on the estimates, as such impact depends on the share of African countries' trade with non-industrialized countries. This share is tiny, although it has been increasing over the past decade or so. Should the ongoing shift in Africa trade's geographical direction continues in the future, this may pose a problem of relevance of the methodology used to estimate trade misinvoicing in the medium and long term.

These methodological shortcomings notwithstanding, *Africa's Odious Debts* has become a must-read for those interested in finance and development, particularly in Africa. This is due to the fact that the book is more than just an

Journal of Economic and Social Thought

attempt to measure capital flight. Present in the book's first and third chapters, the qualitative analysis proposed by *Africa's Odious Debts* judiciously complements the panel data based estimates. Indeed, whereas the latter largely rely on analytical tools that are dominantly employed in economics, and which are sensitive to time series data's quality and availability, the former uses a narrative form that is more commonly employed in history. Such combination has been strongly advocated by Bates, Greif, Levi, Rosenthal, and Weingast, on the grounds that it has an important comparative advantage when analyzing phenomena where both structural and strategic elements are at play.²

Africa's Odious Debts particularly illustrates such advantage from a two-pronged approach, firstly as the authors examine the structure of incentives that have prevailed on both the lending and the borrowing sides of the international credit markets over the considered period, and secondly, as they analyze how the resulting massive external borrowing and lending have nurtured capital flight. Once combined, these economic and historic analyses significantly contribute in making the earlier mentioned estimates of Africa's capital flight highly plausible. In the process, *Africa's Odious Debts* provides an illuminating illustration of how the reality of international finance differs from textbook principles and theories meant to guide it. In particular, the book's narrative illustrates how the consideration of the political economy that characterized the international environment in which development financing decisions were taken led to what was, and still is, largely counterintuitive. That is, Africa being net creditor to the rest of the world, as the continent's financial resources outflows by far outweighed inflows.

3. Accounting for corruption

In some way, *Africa's Odious Debts* can be viewed as not primarily being about corruption, either in Africa or elsewhere. This is reflected not only by the book's title and sub-title, which emphasize relatively more external borrowing and capital flight. This is also magnified by the metaphor of 'revolving door' in chapter 2, as it suggests the quasi-automaticity of external borrowing proceeds' exit in the form of private assets. However, throughout the narrative, the authors develop arguments that barely leave doubt about the centrality of corruption, particularly in the transformation of external debts into private assets, typically held abroad by African elites.

Specifically, the authors consider four modalities whereby foreign borrowing can be translated into capital flight. The first is that of flight-fuelled foreign borrowing, whereby private wealth holders first move funds into an offshore bank account, and then 'borrow' back the money from the same bank. The second modality is that of debt-driven capital flight. Under this modality, the influx of borrowed money pushes up the value of the domestic currency in the short run while, in the long run, as the stock of debt and the prospect for depreciation of the domestic currency grow, it prompts the concerned elites to send money abroad in hard currency accounts offshore while the value of the local currency is artificially inflated. The third modality is that of flight-driven foreign borrowing, whereby capital flight generates demand for replacement funds that are borrowed from foreign lenders. The fourth modality is debt-fuelled capital flight, whereby the beneficiaries of loan-siphoning arrangements such as kickbacks, government contracts, inflated procurement costs, ghost projects, etc. then park part or all of the proceeds in safe havens abroad.

² See, for example, Bates, R. H, Greif, A., Levi, M., Rosenthal, J.-L., and Weingast, B. R. (2000): "The Analytic Narratives Project." *American Political Science review* 94 (3): 696-702.

Journal of Economic and Social Thought

According to the authors, foreign loans have indeed fueled capital flight in the short run, as confirmed by their computations. These reveal that for every dollar of foreign loans to sub-Saharan Africa, roughly 60 cents flow back out as capital flight in the same year, while a one-dollar increase in the stock of external debt was associated with 2-4 cents of additional capital flight annually *in subsequent years*, suggesting that the accumulated stock of debt drives additional capital flight in the long run. Based on these findings, the authors demonstrate that corruption, rent-seeking, and special interests have played a pivotal role in the transformation of Africa's massive public debts into private assets held abroad by African elites. The centrality of corruption in the transformation of foreign public debts into private assets held abroad is also illustrated by the qualitative analysis that the authors develop around several country case studies including, among others, the cases of Nigeria, Congo-Brazzaville, and Gabon.

Another major merit of the book is to shed crude light on the fact that corrupt practices that have driven Africa's external borrowing and capital flight equally resided on the borrowing side and the lending side. On the latter, factors such as the practice of syndicated loans, the myth that sovereign countries don't go bankrupt, the approval culture in International Financial Institutions and the associated incentives to 'move the money' that have put short-term lending targets above long-term repayment prospects, export promotion policies, and bank secrecy jurisdictions that have been adopted by developed countries, account for large part of Africa's external debts. The mutually enforcing character of the factors on both the demand and supply sides is supported by the authors' demonstration that overall, only international commercial banks and top African elites actually gained from the African external borrowing to the expense of African ordinary people and industrialized countries' taxpayers, among other things.

While *Africa's Odious Debts* usefully complements the existing literature on corruption, it achieves something that is original. Indeed, few studies on corruption have so brilliantly succeeded in analyzing the problem of corruption from the perspective of a small open economy. Also original, to an extent, is the repudiation of part of Africa's debts, the policy solution that the authors suggest as a way to tackle the problem of the continent's debts. It is in one of the most captivating chapters of the book that the authors develop the arguments supporting the idea of repudiation of Africa's debts. For that purpose, they argue, based on an insightful historical analysis, that the doctrine of odious debt can apply to much of Africa's debt, and justify its repudiation.

According to the authors, external public debts are deemed odious if three conditions hold: (a) the debts were incurred without the consent of the people (absence of consent condition); (b) the borrowed funds were not used for the public benefit (absence of benefits condition); and (c) the creditors were aware – or should have been aware – of both the above conditions (creditor awareness condition). Further, the authors turn to legal precedents, to reveal well entrenched principle that in cases of odious debts, the burden of the proof rests with the lender, not the borrower. In other words, to contest the repudiation of the debts by proving that they are not odious, it is up to the lender to demonstrate that none of the abovementioned three conditions holds. Considering the daunting obstacles that pave a highly indebted poor country's way toward proving the odiousness of its debts, this is probably where the concept of odious debt is interesting for African countries. But yet, this concept may not be as easy to handle to address the problem of Africa's external debts. The difficulty can be illustrated using the condition of the absence of benefits.

Broadly speaking, international borrowing practice revolves around two main modalities including project financing and budgetary support. While a lender could

face insurmountable difficulties to prove the public benefits in the case of budgetary support that she may have provided to a corrupt government, this may be different in the case of specific projects, which often have specific objectives and expected results. Thus, for example, schools, clinics, and bridges could have been actually built as a result of loans intended to finance education, health, and infrastructure projects while, at the same time, a sizable amount might have fled the country as a result of the loans' availability due to the problem of resource fungibility, which is largely overlooked by the concept of odious debt by definition. That is, a loan that finances a project that the government was willing to finance anyway may result in the embezzlement of the government's resources and possibly in capital flight, no matter the public benefits resulting from the loan-funded project.

Other illuminating illustrations of the difficulty to address the problem of Africa's debts using the concept of odious debt are provided by the authors, particularly as they present two alternative strategies aimed at helping tackle odious debt, and discuss their strengths and weaknesses. The *ex-ante strategy* would consist in vesting an international institution such as the IMF with the power to designate specific governments as odious, after which designation any new debts contracted by that regime can be declared odious by successor governments. One shortcoming of this strategy is that it would leave untouched the burden of past odious debts. It could also perpetuate or exacerbate moral hazard, as regimes not designated as odious can continue to divert borrowed funds into private pockets, and creditors can happily turn a blind eye to these diversions, being assured that their loans cannot be labeled odious debts.

The authors also acknowledge the difficulty of entrusting an international institution with the task of deciding which regimes are odious, given that donor governments, the international financial institutions, and even non-governmental organizations often have political interests in supporting some regimes no matter their odiousness, or at least in refraining from alienating them. Finally, by virtue of its all-or-nothing character, the *ex-ante* designation of odious governments would deter legitimate lending even to odious governments, if and when the loans would benefit the people of the country.

Under the *ex-post strategy*, current regimes would repudiate odious debts contracted by previous regimes. As the authors argue, this strategy presents an important challenge, as it would require an independent institution to adjudicate odious debt disputes between African governments and creditors. While the authors conclude, after comparing the *ex-ante* with the *ex-post* strategies in light of the above considerations, that the latter offers a superior way to address the problem of odious debt, the authors' discussion of the two strategies actually shows that the implementation of the doctrine of odious debt with a view to tackling Africa's external debts is still facing substantial challenges, which require substantial further work to be resolved.

4. Conclusion

In 1968, Gunnar Myrdal published '*Asian Drama*', depicting a hopeless continent severely undermined by systemic flaws including dysfunctional markets and policy failures, just to name a few. In some way, *Africa's Odious Debts* provides a similar picture about Africa, although from a different angle. *Africa's Odious Debts* paints a picture of a continent that has been bled by external debt service, corruption, and capital flight, and could have been titled '*African Drama*'. *Africa's Odious Debts*' authors demonstrate that the diversion of foreign borrowing into capital flight thanks to corrupt practices on the part of both African borrowers

Journal of Economic and Social Thought

and non-African lenders does not owe to a few African officials helped by a few complacent or complicit bankers. Rather they argue that it is the product of complex factors, suggesting that the problem cannot be tackled simply by identifying bad actors and weeding them out. They argue that the solution will require fundamental reforms that change the framework of incentives and opportunities in global finance, and assert that the repudiation of those debts that meet the characteristics of 'odious debt' as a possible way out of the trap where the continent is locked. Despite the challenges still facing the implementation of this idea, the authors are opening a new area of thinking of Africa's development. The case of Asia, which has largely changed its fate and become an engine of the world's economy a few decades after the publication of 'Asian Drama' tells us that the worst is never certain, and suggests that one should never stop thinking and exploring new avenues to tackle development problems. In this regard, Africa's odious debts is a brilliant example to follow.



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