February 27, 2012

Elites Loot Africa While Foreign Debt Mounts

James K. Boyce & Léonce Ndikumana

It was an African equivalent of stealing the Brooklyn Bridge, and for four years, nobody noticed. From 2007 to 2010, $32 billion in public funds went missing from Angola. The unexplained money outflow from sub-Saharan Africa’s second largest oil exporter was revealed in a December International Monetary Fund report, which pegged the loss as equivalent to one-quarter of the country’s GDP.

This financial hemorrhage comes at a staggering human toll. Despite its great oil wealth, Angola is home to some of the world’s poorest people. Human Rights Watch, which reports periodically on corruption and mismanagement of the country’s oil revenues, notes that “social indicators remain low in Angola and the population has limited access to social services.” Of every 1,000 children born in Angola, 160 die before reaching their fifth birthday, according to World Bank data.

Angola’s missing billions are only the latest example of a perverse phenomenon that operates in the shadows of the international financial system: massive outflows of capital from some of the most impoverished countries in the world. As documented in Africa’s Odious Debts, sub-Saharan Africa has experienced more than $700 billion in capital flight since 1970. This far surpasses the region’s total external debts, which amount to roughly $175 billion. Some capital flight is motivated by a search for higher returns and lower risks, but in Africa much has been driven by the aim of hiding illicitly acquired wealth in safe havens abroad.

Far from being heavily indebted, Africa is in this sense a net creditor to the rest of the world. But there is a fundamental difference between the continent’s external assets and its external debts. The assets are privately held by a small stratum of wealthy individuals: Capgemini and Merrill Lynch estimate in their latest World Wealth Report that Africa has about 100,000 “high net worth individuals” with a total of $1.2 trillion in liquid assets. The debts, on the other hand, are owed by the African people as a whole through their governments.

Capital flight does not disappear from the face of the Earth: Every dollar that leaves Africa lands somewhere else. The favored destinations are bank secrecy jurisdictions – euphemistically called “tax havens” – where a cloak of anonymity protects wealth holders not only from the taxman but also the rule of law. In 2002, the non-governmental organization Global Witness traced $1.1 billion from Angolan oil revenues to a single private bank account in the British Virgin Islands.
Bank secrecy jurisdictions are not confined to treasure islands. The United States itself is a major destination for illicit funds. US Treasury Department officials concede that banks routinely accept deposits of money that enters the country in violation of existing laws. Moreover, under current law US banks are not prohibited from handling proceeds from many activities, including tax evasion, that would be considered crimes if committed within the United States.

The complicity of banks in African capital flight goes beyond the provision of safe havens. Banks also provide loans to African governments. Some of the borrowed money has wound up in private accounts at the same banks that made the loans. In 2007, for example, a French police investigation identified multiple bank accounts held by Gabonese president Omar Bongo at BNP Paribas and Crédit Lyonnais, both of which had also provided loans to Gabon’s government.

Africa’s Odious Debts traces links between foreign borrowing and capital flight. There is a strong correlation between the two: For every dollar of foreign borrowing in sub-Saharan Africa, on average more than 50 cents leaves the borrower country in the same year. This tight statistical relationship suggests that Africa’s public external debts and private external assets are connected by a financial revolving door. Common mechanisms for diversion of borrowed money into private pockets include inflated procurement contracts for goods and services, kickbacks to government officials, and direct deposits of public funds into the bank accounts of politically influential individuals.

In the case of oil-exporting countries like Angola, many of the loans are backed by a lien on future oil revenues. Oil-backed loans are doubly attractive to creditors: first, because they typically pay interest rates well above the average and, second, because the contracts stipulate that the proceeds from the country’s oil sales will go into offshore accounts from which debt service is deducted before any revenues go to the oil-exporting country.

A “key component” of Angola’s unexplained loss of $32 billion, according to the International Monetary Fund report, “appears to be due to the transfer of funds to escrow accounts held abroad in excess of the debt servicing for which those accounts were intended.”

The revolving door is an example of what economists call a “principal-agent problem” that occurs when some people depend on others as agents to conduct business on their behalf. In finance, the hazards arise on both sides of transactions when banks lend other people’s money and governments borrow in other people’s names.

On the creditor side, bankers are supposed to serve the interests of their depositors and shareholders by making prudent loans that will be repaid with interest. In practice, however, loan officers often are rewarded mainly for “moving the money,” getting the loans out the door – an issue that has attracted attention at the US Federal Reserve in the wake of the subprime mortgage crisis.

On the borrower side, government officials are supposed to negotiate and disburse loans to serve the interests of their citizens. Instead they may borrow in the name of the government, line their personal pockets and those of their cronies, and leave the public saddled with the debt.

The hemorrhage of Africa’s scarce resources can be curbed. Efforts by African governments to recover wealth stolen by past officials have won international backing from the Stolen Asset Recovery...
Commentary from

Initiative launched by the World Bank and United Nations Office on Drugs and Crime. Internationally, tougher anti-money laundering laws and tougher enforcement of existing laws are needed to staunch illicit financial flows from Africa to safe havens abroad.

More transparent information about financial inflows to African governments would also help. The Publish What You Pay campaign, launched by global civil society organizations a decade ago in the wake of disclosures about the theft of Angolan oil revenues, promotes disclosure of corporate payments for natural resource extraction. Similarly, a Publish What You Lend campaign could strengthen transparency and accountability in financial markets.

Last but not least, African countries can and should selectively repudiate odious debts incurred by past regimes where the borrowed funds were not used for the benefit of the public, and creditors knew or should have known this to be the case.

Bankers threaten that repudiation of such debts would bring new hardships as the debtor country is cut off from access to new borrowing. But with selective repudiation, legitimate creditors would have no reason to fear, as their debts would continue to be honored. Moreover, repudiation will benefit the many countries that currently pay more in debt service than they receive in new loans.

These steps would not only benefit the people of Africa today, but also strengthen future incentives for the exercise of due diligence by creditors and for responsible borrowing by governments. Banking on capital flight is a symptom of deeper defects in our international financial architecture. What’s needed, in Africa and abroad, are reforms tough enough to ensure that banks serve the people rather than fleecing them.