Capital Flight and Money Laundering in Nigeria: Causes, Methods and Effects

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Abstract
Capital flight and money laundering are twin phenomena whose impacts on an economy are little known to ordinary Nigerians, whom are observed to have already been negatively affected by the capital outflows and the process of laundering funds on account of the inflationary impact of the funds on the Nigerian economy. Capital flight has gross negative economic connotations and international banking system is considered as the veritable "bed fellow" and conduit pipe for channelling the illicit money acquired largely from drug trafficking, theft, embezzlement and organized crime, the procedure of which is so much organized in such a way as to completely elude the discovery gadgets and machineries of financial regulators and law enforcement agencies. The paper adopted the methodology of literature review and exposed the roles of developed and developing countries on the advancement of capital flights and money laundering. It also highlighted the role and effects of economic liberalization and corruption in public offices on the advancement of the ugly economic "leprosy" generated by capital flights and money laundering. It recommended a stable and macroeconomic environment for Nigeria.

Keywords: *Capital flight, money laundering, economic destabilizers, liberalization.*

1.0 Introduction

Liberalization is one of the policies commonly advocated for by world international agencies. It is also a human policy instrument often adopted by both developed and developing countries. Through liberalization, countries open up and allow easy capital movements. This leads to emerging markets allowing their domestic financial markets grossly unprotected. According to Bhagwati in Ezegejue (2008), had banks and companies in Asia's emerging markets not been allowed to borrow freely in foreign currency, they would not have built up huge foreign currency debts, and international creditors could not have demanded repayment just as liquidity was drying up and foreign currency was becoming very expensive.

Perhaps the best evidence in favour of open capital markets is that despite the international financial turmoil in most developing countries, the countries still liberalize their capital and money markets as a long-term goal. As domestic economies grow increasingly sophisticated, particularly regarding the depth and breadth of their financial instruments, policy makers are relentlessly seeking ways to live with open capital and money markets.

Even though a continued move toward greater capital mobility is emerging as a global norm, absolute unfettered global capital mobility is not necessarily the best long-term outcome. Temporary controls on capital outflows may be important in dealing with some modem day financial crises, while various kinds of light handed taxes on capital inflows may be useful for countries faced with sudden surges of inflows.

One way or the other international community find ways to encourage equity investment and foreign direct investment, such as physical investment in plants, equipment and other properties so long as the flows are coming into such countries. While this is allowed as has been the case, movers of capital tend to favour flows to developed countries where such investments are assured of safety considering the fact that such countries are relatively safe and conducive for such private capitals. Odoh (2003:224) opined that

> *Capital movement may take place between a reporting economy and the rest of the world. A special case of capital outflows has been identified as the possible cause of the slow growth being experienced by debtor countries and for the debt crisis itself.*

A paradox of the problem is that while the governments of the less developed countries are heavily indebted to governments and institutions in the developed countries, some private residents of the less developed countries, have substantial amounts of foreign assets in the developed countries. It follows that while the governments of many of these countries were borrowing abroad on a large scale over the years, private citizens of these same countries were busy transferring funds to their private accounts in the creditor developed countries at the same time, hence capital flight (Williams, 2006).

According to Dooley (1986) capital flight refers to those external assets held by the private sector that do not generate income reflected in the balance of payments of a country. It is money that is "fleeing" from the country rather than external investment guided by long-term economic considerations. It excludes those outflows that are considered normal in the sense that they correspond to ordinary portfolio diversification and business transactions of domestic residents. Capital flight can be associated with short-term outflows for speculative purposes or outflows resulting from economic or political instabilities in the domestic economy. Furthermore, capital flight is the difference between total private capital outflows and the part for which income is identified and reported. It is generally synonymous with all forms of capital outflows from less developed countries, be they short-term or long-term, equity or portfolio investments.

2.0 What Are The Causes And Channels Of Effecting Capital Flights In Nigeria?

Capital flight can result from fiscal deficits on one hand and surpluses on the other. In the past, Nigeria recorded huge fiscal deficits giving rise to high rate of inflation, which was aggravated by government's resort to money creation or imposition of tax. This invariably sent wrong signals to investors who responded by massively transferring their funds to safer and healthier economics in foreign countries. On the other hand, capital flight may also result from budget surpluses, as has been the case in Nigeria over the years, "resulting largely from proceeds of public sector corruption and looting of funds by public servants" (Ribadu 2005:18)

Fluctuations in foreign exchange rate could have an impact on domestic external trade position, exchange rate being the domestic price of foreign currency or its reciprocal, the foreign price for domestic currency. Foreign companies and non- Nigerian residents found it profitable over the years to repatriate profits and earnings in order to obtain higher foreign currency (Agbebiyi, 2000).

In the same vein, domestic investors face higher risks at home. These include expropriation and imposition of exchange controls so that domestic residents face the possibility' of losing the value of their assets without compensation. This therefore, explains the "safe haven" theory

of capital investment •According to Odoh (2003), the theory holds that wealth holders would like to hold their wealth in a “safe abode"', a place where the risk of holding such a wealth is at minimal. Thus, the domestic wealth holders in many- developed countries including Nigeria have a preference to acquire assets in developed countries which serve as “safe haven” for their wealth. Perhaps this explains why many political leaders in Nigeria indulge in money laundering; in favour of developed countries such as USA. Britain. Switzerland United Arab Emirates etc where they operate fat bank accounts and have substantial private assets, hoping to run away from their home countries to the developed countries in case of any political or economic upheaval in their home countries, where they would enjoy their ill-gotten wealth. The case of public office holders during the second republic of 1979 to 1983 who were being probed by the Buhari/Idiagbon regime in 1984/85 readily comes to mind.

Though there may be some positive reasons why capital flight is acceptable. But surely, the negative reasons and impact far outweigh the positive ones. For instance, economists believe that capital flight is criminally inspired. In Nigeria, political office holders have fraudulent activities as the motive behind their acts. The most common avenues of capital flight on the part of government officials is to keep part of government's foreign borrowing in their personal accounts abroad. Another avenue for capital flight is outright smuggling of currencies or foreign exchange instrument or the movement of foreign assets. At this point, the cases of some Nigerian public office holders readily come to mind. In any case, the government loses revenue through the capital transferred by illegal channels, thereby aggravating capital flight (Odoh, 2003; Williams, 2006)

Over the years, capital flight has been perpetuated in Nigeria by direct transfers of funds at the prevailing official exchange rate. This is clone through commissions and agency fees by foreign contractors directly into the foreign accounts of residents, dummy foreign branches or overseas offices of certain companies or institutions, students remittances, oversees medical treatment remittances among others (Oseni, 2006).

False invoicing is yet another method of effecting capital flight. False invoicing can be under or over-invoicing. The later implies that exports are assumed or stated as being less than the actual value of the exports thus transferring greater funds than are contained on the face value. On the other hand, a foreign supplier could issue an invoice in excess of the agreed or normal price of the product for which the buyer has already been granted a valid import license as was the case with Nigeria in the time past. This implies over-invoicing of imports and the difference between the invoiced and the actual amounts is left in foreign banks. The existence of parallel market or "black market’’ for buying and selling foreign currencies has served as a formidable method of effecting capital flights (Oseni, 2006).

3.0 Resultant Effect to the Economy

Capital flights have far-reaching devastating effects on the economy and citizens of the developing country, because it only benefits the developed countries to which the capital flight on the economy of developing countries are felt in the following economic indices: interest rates, exchange rates, international reserves etc. The outflow creates shortage of funds in the system which in turn pushes interest rates higher, thus leading to a deterioration of the already bad situation. Where the situation continues, residents would foresee the possibility of increasing inflation, devaluation, imposition of exchange control and are likely to increase transfers abroad. The effects of capital plight are therefore multifarious having both short and long run effects (Owolabi, 2004; Owoyemi, 2005; Williams, 2006).

- Capital flight greatly reduces the resources available to finance domestic investment leading to decline in the rate of capital formation,
- Capital flight denies the domestic economy the opportunity of utilizing resources shipped abroad in direct productive activities thereby limiting the growth potential of the Nigerian economy,
- It reduces the country's access to external resources ’as international financial institutions cite the existence of capital flight as the justification for their reduced exposures to the highly indebted countries,
- Capital flight reduces the country's ability to tax all its residents as it is difficult to tax wealth held abroad as well as the income generated by the wealth.

Together with other factors in a 'basket' of economic destabilizers, capital flight has contributed to the sad situation where Nigeria exhibits all the characteristics of less developing country, namely;

- Low levels of living standards- low income, poor life, poor health. low life expectancy and inadequate education,
- Low levels of productivity,
- High rates of population growth and dependency,
- A mono economy,
- Low human development index,
- High international brain drain, and
- Insecurity among others.

This fact was underscored by Obasanjo (2000:2) during his 2000 budget speech that:

> *"Nigeria is a postrate economy, characterized by declining capacity utilization in the real sector, poor performance of major infrastructural facilities, unsustainable liquidity position and rising unemployment and inflation .... basic structural inbalances persist. They include lingering problems of import dependence, reliance on a single economic sector, weak industrial base, inefficient public utilities and un abating unemployment".*

4.0 Conclusion

Financial and public sectors in Nigeria have witnessed different types of fraud over the years including misrepresentation of financial information, embezzlement, cheque and credit card fraud, pension fund as w ell as fund' diversion and misappropriation (Ribadu, 2005:19). Capital flight has contributed immensely to the current economic crisis in Nigeria. Therefore, for sustained economic recovery to take place, Nigeria must not only arrest capital flight but must also reverse it. Therefore, in Nigeria's current drive for poverty reduction and economic growth, reversal of capital flight is mandatory for the country if it has to improve access to external capital and restore economic growth in consonance with the demands of the Millennium Development Goals.

The paper has, therefore, highlighted the causes, consequences and remedies to circumvent the effects of capital flight in Nigeria. It has identified the major causes of capital flight to include the fulfillment of the “safe haven” theory of capital investment and embezzlement of public funds by those in positions of authorities.

5.0 Recommendation

The present administration appears to have developed a strong political will to fight corruption and other economic and financial crimes in Nigeria. That can explain why anti-corruption agencies are still prevalent in the country. Sound economic policies in Nigeria are the single most important element for improved performance in Nigeria and renew the country's access to external capital and financial markets for inflow of investment opportunities.

The most important policy to flight capital flight, therefore, is the restoration of confidence in the domestic economy. This should be augmented by providing a stable macroeconomic environment which could go a long way towards reducing domestic uncertainties, in order to arrest capital flight.

In addition to the above, the underlisted recommendations are posited to ameliorate capital flight.

- Sustenance of the domiciliary account regime whereby accounts can be maintained in Nigerian banks in foreign currencies.
- Enhancement, development and further liberalization of the capital market. A deregulated capital market widens the menu of domestic and foreign currency denominated capital and financial assets.
- Greater surveillance over imports and exports and the maintenance of efficient and acceptable controls on the movement of private capital abroad.

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