Capital Flight and Economic Performance

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Capital Flight and Economic Performance: Growth Projections for the Philippines

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ABSTRACT
Capital flight aggravates resource constraints and contributes to undermine long-term economic growth. Counterfactual calculations on the Philippines suggest that capital flight contributed to lower the quality of long-term economic growth. Sustained capital flight over three decades means that capital flight had a role for the Philippines to lose the opportunities to achieve economic takeoff. Unless decisive policy actions are taken up to address enduring capital flight and manage the macroeconomy more effectively, the Philippines remains caught in the perpetuity of crises, its economy hollowed-out, the people trapped in poverty, and once again, the country is frustrated from realizing a takeoff.

Key Words
Capital flight, economic growth, Philippines

JEL Classification E10, O40, O50

1. INTRODUCTION

Why capital is flowing out of developing countries rather than to them where resources are most needed to finance economic growth and human development is a puzzle that has produced some very interesting papers (see, e.g., Lucas 1990; Tornell and Velasco 1992; Alfaro et al. 2007). But, not only is capital flowing out from developing countries, studies have also established that capital has been fleeing developing countries in large amounts (see, e.g., Lessard and Williamson 1987; Pastor 1990; Boyce and Ndikumana 2001; Epstein 2005). Capital flight was pronounced in the 1980s during the Latin American debt crises and again in the 1990s after a series of crises hitting developing and transition economies. Clearly, crises propel capital to flee to seek safer places for capital. The persistently dismal economic performances and limited possibilities such as in Africa since the 1980s necessarily drive out capital out of these countries. Yet, during periods of robust macroeconomic performances, research finds that capital continues to flee.
The stylized fact is that when capital flees resources are lost to the domestic economy and these have serious implications on long-term macroeconomic performance. Even if resources first came in foreign investments, the fact that they enjoy implicit guarantees against losses means that when they flee the burden is transferred from foreign to the domestic residents. Also, the stylized fact is that capital flight is carried out by elites, while the burden of the losses is socialized. Thus, the rest of society (i.e., non-elite) suffers from the consequences of capital flight even as the elites protect themselves from the harm when they move elsewhere and/or shelter their wealth abroad. Indeed, the poor do not have any choice on the matter but must face the costs head-on, ending up in a much worse situation than before because of the simple reality that the social institutions and insurance mechanisms in developing countries are weak, if not missing. The worse part is that the impacts persist over time. Hence, from “an economic justice point-of-view, there are distributive dimensions to capital flight that must not be ignored” (Beja 2006a: 264).

This paper does not deal with the question where capital flight went, who was engaged in it, or even how it was undertaken (on the latter point see, e.g., Ingo 1987; Ingo 1990; Baker 2005; Henry 2005). The dynamics of capital flight has been analyzed using general regression analyses, such as those by Cuddington (1987), Mikkelsen (1991), Schineller (1997a; 1997b), Harrigan et al. (2001), and Alam and Quazi (2003), or using a specific setup like the revolving door model, such as those by Boyce (1992), Chipalkatti and Rishi (2001), Ndikumana and Boyce (2003); Demir (2004), Pincus and Ramli (2004), and Beja (2006b). This paper is more modest in its goal, by focusing on one aspect of capital flight, which is to find out the costs of capital flight in terms of long-term macroeconomic performances. More specifically, it presents results for the Philippines, a country that has suffered from capital flight since the 1970s (see, e.g., Boyce 1992; Boyce 1993; Vos 1993; Vos and Yap 1996; Beja 2006a; Beja 2006b; Beja 2007). The Philippines prior to the mid-1990s was labelled as the “economic basket case of Asia”, the “sick man of Asia”, or the “Latin American economy in Asia” because when compared to the Asian economic miracle economies that averaged at least 7 percent economic growth rates between 1970 and 1996, the
country was only able to manage a respectable average of 3.7 percent, which is comparable to the averages in Latin America. In fact, the Philippines could not sustain economic growth for more than four years, because economic busts almost always obstruct the Philippines’ prospects for growth accelerations. Poverty indicators for the Philippines remained high over the same period, towering those of the Asian economic miracle economies that realized drastic reductions in their poverty indicators. The Philippines is therefore an interesting study on the elusiveness of sustained economic expansions that also concerns many developing countries today. It is an interesting case on why capital flight must not be ignored by the governments in policy-making and for rethinking about re-regulation in the present context of deregulation, financial liberalization, and economic integration. How large are the costs that capital flight has imposed on the Philippines?

The results presented in this paper suggest that capital flight has non-trivial and negative consequences on Philippine long-term macroeconomic performances. The results also support the contention that sustained capital flight since the 1970s meant large lost opportunities. Of course, the results in this paper do not deny that there are also other factors that contributed to undermine macroeconomic performances and enlarge these losses, which can be measured as well. But over three decades of capital flight are undeniable to the contention that capital flight contributed to the Philippines’ failure to realize an economic takeoff. If the Philippine government does not act today – if it pretends not to see capital flight or continues to introduce policies that facilitate capital flight – it is condemning the country to the perpetuity of crises, the continuity of narrow, shallow and hollow macroeconomic performances, and the permanence of poverty of the Filipinos that, in the end, the Philippines cannot again realize an economic takeoff.

2. PHILIPPINE SETTING

Studies have documented that capital flight has been a serious problem to the Philippines. Boyce (1992), Vos (1992), Boyce (1993), Vos and Yap (1996), Beja (2006a), and Beja (2007) present estimates of capital flight from the Philippines, and these are compiled in Table 1 below. Despite the differences in the estimates, these studies found large amounts of capital flight from the 1970s
to the 1990s, regardless of whether or not the Philippines was in a crisis or in a recovery phase. A large amounts of the capital inflows (mostly, external debts) ended up squandered into kickbacks and corruption-related activities, illicitly transferred abroad into private bank accounts and assets, or simple fled as political conditions became increasingly unstable and the level of indebtedness worsened. Crises also contributed to capital flight. The “reverse” capital flight in the early 1990s (shown as a negative number in the table) is attributed to efforts of the government to introduce wide-scale deregulation and financial liberalization programs, which were aggressively pursued to attract foreign capital into the country and/or give the domestic players easier access to the international capital markets. It needs to be noted, however, that after 1988, more than half of the debt-equity conversions for the Philippines were transactions with Filipinos (see, e.g., Dytiianquin 1989). By the end of the mid 1990s, there was another surge of capital flight with already more avenues for unrecorded transactions, and were exploited quite well, and because most of the capital inflows could not be absorbed by the economy, as well as the instabilities generated by the crises abroad. In fact, Beja (2007) shows that capital flight continued to be high even in the mid-2000s because of still similar reasons that made capital flee the Philippines in the late 1990s.

<table>
<thead>
<tr>
<th>Period</th>
<th>Boyce</th>
<th>Vos</th>
<th>Vos and Yap</th>
<th>Beja</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975-1979</td>
<td>3,625</td>
<td>2,967</td>
<td>2,718</td>
<td>4,533</td>
</tr>
<tr>
<td>1980-1984</td>
<td>3,222</td>
<td>6,945</td>
<td>5,761</td>
<td>7,427</td>
</tr>
<tr>
<td>1985-1989</td>
<td>-</td>
<td>3,166</td>
<td>2,487</td>
<td>4,627</td>
</tr>
<tr>
<td>1990-1994</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-1,418</td>
</tr>
<tr>
<td>1995-1999</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>12,400</td>
</tr>
</tbody>
</table>

Note: The compiled figures follow the residual method: \( KF = CDET+NFI-CAD-CRES+MIS \). Adjustments on both CDET and unrecorded remittances were not added (for the Beja figures) for easy comparison of the estimates from Boyce, Vos, and Vos and Yap. Differences in the estimates are due to the differences in data sets.

No doubt, capital flight occurred during crises in the Philippines. The balance of payment crisis in 1983-84 triggered massive capital flight, although scholars have also pointed out that the economy was already vulnerable to an external shock because of the weaknesses produced by the oil price shocks, external debt build up, and political instabilities, implying that capital flight was intensifying even before 1980. The assassination of Benigno Aquino in 1983 unleashed massive
political and social unrests against the Marcos government, and thus, capital was further propelled to flee. The ensuring years were not easy for the Philippines with the economy plunging to its worst state in the post-World War II period. A respite came in 1986, when Mrs. Corazon Aquino became president after the people power revolt and riding on the high-level international confidence on her government as democracy was re-established, raising hopes that the Philippines could then put itself together for sustained recovery. Unfortunately, the reactionary nature of the policies pursued by the Aquino government resulted in perverse outcomes like the cutting of funds for essential infrastructure development, limited administration support to the agencies associated with the Marcos government, the institution of structures that guaranteed unstable bureaucracies, and so on. It only took about five years before institutional bottlenecks emerged that crippled the economy. One important example of an outcome of such misguided policies was the electricity power supply crisis in 1991, when on average 12 hours of power outages occurred daily in Metro Manila. Another is when the Aquino government declared that it will pay all the external debts of the country, including the illegitimate debts incurred by the Marcos government, thus crowding out essential funds from basic social services. It took the Philippine government 32 years to fully pay the debt (principal and interests) incurred to build the mothballed Bataan Nuclear Power Plant – the initial project cost was US$ 500 million. The Aquino government also faced a series of coup attempts between 1987 and 1989 and natural disasters in the early 1990s, both contributing to the domestic insecurity. The combination of economic, political, and natural instabilities that plagued the Philippines produced the doldrums that pushed the economy into another economic recession in 1992. Once again, the crises and ensuing capital flight took part in aborting economic takeoff.

By 1993, the outlook became positive after the quick resolution of the electricity supply crisis. Initial fears of the business sector that Mr. Fidel Ramos would setup a pseudo military government were quickly doused off with his no-nonsense leadership, work ethic, and steadfast actions to introduce reforms, highlighted by the introduction of wide-scale – sometimes painful – programs to deregulate key sectors and industries and embark aggressively on trade and financial
liberalization. In fact, the Ramos government turned out to be a period of relative economic and political stability, attracting large investment flows, raising confidence in the economy to record heights, and producing rapid economic growth.

Despite the positive developments in the 1990s, scholars point out that some aspects were overlooked. While economic performances were commendable as the Philippines experienced its longest streak of expansion during the Ramos government, economic growth was concentrated in a few industries (particularly, electronics), while large segments of Filipino society did not benefit from the rosy developments nor actively contributing to sustain the growth. Moreover, on closer inspection, one finds that economic reforms were introduced with limited complementary build up of the requisite prudential regulations and the upgrading of the institutional infrastructures to handle the new conditions shaped by the constellation of deregulation, financial liberalization, and globalization. Also, as the institutional setup that guaranteed unstable bureaucracies matured, it ensured that the possibilities for long-term economic planning were limited. Problems manifested as the continuity in the programs were compromised as short-term programming was encouraged rather than long-term objectives. Uncertainties even filtered into administrative positions from the Minister and, in some cases, down to Directors of Ministries as politicization intensified. These positions became coterminous to the presidency, thus the timeframe of planning cover at best six years. In short, the façade of economic robustness was vacuous when examined on its institutional setup that a shock in 1997 could easily spoil another attempt at economic takeoff.

As the 1997 Asian Crisis intensified, economic growth of the Philippines dropped to zero. As expected, capital consolidated in safe foreign locations and, as in the past, domestic conditions contracted even more. Fortunately, there was not much capital accumulated since the early 1990s to fuel capital flight that the amount that fled the country was not as large as those experienced by other Asian countries. The impact of the Asian Crisis was also relatively smaller when compared to the other Asian countries. Nonetheless, the Asian Crisis was enough to prove that by the 1990s the economic foundations of the Philippines remained weak, not as strong as government pundits
declared them to be. The Ramos government did not lack efforts to jump start the economy. It even went on to push for amendments in the 1987 Philippine Constitution, arguing that the poor structures in the country are products of the nationalistic provisions. But those efforts erupted in a political crisis as the public realized that these were actually attempts at removing the term limits of elected officials and remain in power after 1998, establishing in the end a Marcos-like regime. What thus looked as a different context in the 1990s was on closer analysis the same economic boom-and-bust cycle that the Philippines experienced since the 1980s. As in the past, a bust meant a booming capital flight, and vice versa, in which the cycle only decreased in the latter stages of a crisis when most of the capital had already left. Similarly, political crisis intensified capital flight, while political stability moderated it.

Political optimism returned with the election of Mr. Joseph Estrada to the presidency, but his government was quickly frustrated it failed to institute substantial policies. Mr. Estrada’s pro-poor agenda and an unprecedented popularity were not capitalized to embark on serious reforms and broad-based programs. Exposes that the president relied on his midnight-drinking buddies for national policies, and then in 1999, that Mr. Estrada was involved in the small-numbers gambling (including receipts of payments from the gambling syndicates) produced widespread revulsion that caused his impeachment in 2000. Despite ongoing economic recovery in the immediate post-Asian Crisis period, the political crises hampered the economy from growth accelerations that cost its economic takeoff. What was thus produced in the late 1990s into 2000 in terms of capital flight was much like the earlier experiences of the Philippines, wherein political and economic panic made capital flee, contributing to worsen the domestic conditions, and further inducing capital to flee. By 2000, when the impact of the 1997 Asian Crisis was starting to dissipate and the affected economies in the region were recovering fast, the Philippines somehow could not regain its earlier momentum of economic recovery. Economic growth has been encouraging since 2000, but it still concealed shallow, narrow and hollow economic performances, which constrain the country from raising to higher growth trajectories. Again, capital flight has persisted and remained large after...
the 1990s.

3. FRAMEWORK

People perceive of capital flight as money running away from a country and going into haven places abroad to avoid government taxation, wealth expropriation, or unfavourable developments; to search for a better treatment of and investment returns to capital; or some other reasons. People also have a notion that flight is something illicit or illegal. Such commonsensical interpretations are valid; but they are rather difficult to translate into some rigorous form for estimation. This paper takes a definition of capital flight that was presented in Beja (2006a: 265), as “movement of capital from a resource-scare developing country to avoid social control” or losses due to higher domestic risks and uncertainties. This definition raises some problems because capital flight is not only an expression of disapproval of prevailing domestic conditions, it is also a manifestation of hidden motives, and both are inherently difficult if not impossible to quantify. As such, Boyce and Ndikumana (2001), Epstein (2005), and Beja (2006a) use a proxy measure of capital flight.

The cost of capital flight is measured in terms of its impacts on long-term macroeconomic performances, particularly on the Philippines, for which estimates of capital flight are available in Beja (2006a). But to carry out the calculations, it is necessary to use counterfactual assumptions. The first assumption is that the socio-economic and political conditions under the counterfactual are not only desirable but also constructive in obtaining what might have been the macroeconomic circumstances in the Philippines if the alternative settings happened. Another assumption is that if the capital did not flee the country it was not held in financial assets but was utilized to finance productive domestic investments, and by extension, all capital inflows were utilized in productive endeavors. These assumptions are important in order to obtain ideal scenario that the Philippines could have realized, again, if the alternative settings happened. Of course, the counterargument to the counterfactual is that crises would inevitably affect the Philippines after a period of economic expansion, that the country experience deteriorations in economic performances by the late-1990s, or that the capital are actually not utilized properly, and so on. But the point of the counterfactual
is that if a deceleration indeed happened, it would not be as dramatic as that experienced by the Philippines in the 1980s to 1990s. Implicit in the counterfactual is that some adjustments could have been done to avert an economic debacle. Likewise, the point of the counterfactual is that some adjustments could have been done on the way capital was employed if it were not exploited fully. In short, under the counterfactual, the calculations reveal what the potential macroeconomic performances might have been in the alternative scenarios. As such, the difference between the counterfactual and actual performances would measure the lost opportunities or, in this case, the cost of the capital flight.

The starting point in the calculations is to take capital flight (KF) estimates as though the amounts were available for domestic productive investments (henceforth, KF-qua-investments). Accordingly, KF suggest the lost resources that did not contribute to the expansion of domestic production or the improvements in domestic social welfares. Similarly, the accumulated capital flight is lost resources that did not contribute to the tax revenues of the government. Given the fiscal constraints in the Philippines, lost tax revenues represent foregone public infrastructures, health services, and basic education that are crucial for engendering long-term economic growth. In the same manner, too, the lost resources are funds that were no longer be available for external debt servicing, making the social burden of debt heavier, which in turn contributing to aggravate the resource mobilization problems of the Philippines. In such and other related considerations, therefore, capital flight undermines macroeconomic integrity of the country.

The potential additional output (Y) if the KF-qua-investment was engaged is obtained by multiplying KF of the Philippines with the reciprocal of the country’s incremental capital-output ratio (ICOR), obtaining the year-on-year potential output due to KF.\(^4\) Since KF-qua-investments provide a stream, a more sophisticated calculation encompasses the accumulated increases in \(Y_1\) over time due to each year KF-qua-investments and adjusted for depreciation.\(^5\) For instance, in the present period, \(KF_1\) increases output as defined by basic formula, but the same \(KF_1\) further increases output in the succeeding periods, but not as high as in the first period because of the
depreciations on the initial KF-qua-investment. The same process continues until KF_1 becomes fully depreciated at some future period. The same reasoning applies also for KF_2 in the second period, and so on of other KF amounts in the following years – they also generate increases in output in the year KF was initially put to use and the following years until KF-qua-investment is fully depreciated.⁶

Lastly, a further set of calculations are done using Philippine KF-qua-investments with an identified counterfactual economy’s ICOR. The key step here is therefore to identify that country with proximate socio-economic characteristics as the Philippines. But the same equation is used to obtain the potential output. In particular, Thailand was chosen as the counterfactual economy of the Philippines because the former is known as the “twin” economy of the latter, as both share commonalities in their population sizes, resource endowments, the extent of integration with the international economy, just to mention a few (see, e.g., Oshima 1987). In fact, in recent years, the two countries share similarities in their policy trajectories, particularly deregulation and financial liberalization (see, e.g., Bello 2004). Because of this feature, Balicasan (2006) also used Thailand as counterfactual economy when calculating the costs of rapid population growth to Philippines economic growth. In a way, the Philippine ICOR obtains the minimum scenarios of lost output, while the Thailand ICOR obtains the maximum scenario of lost output. What is obtained from the calculations does not yet include the long-term social impacts of capital flight, which can enlarge the total costs, so the figures presented give an indication of the magnitude of the losses due to capital flight in this case.

4. THE INCONVENIENT RESULT

This section presents the analysis of the cost of capital flight between 1970 and 1999. Estimates of capital flight are taken from Beja (2006) and presented in Figure 1 (not the figures in Table 1). Other relevant data were compiled from the World Bank’s World Development Indicators and the Philippine Statistical Yearbooks. Figure 1 thus presents the trends in capital flight, which includes all the possible adjustments as identified by the literature.⁷ For the 1970s, the total amount was
USD 16 billion. The figures increased in the 1980s, reaching the total of USD 36 billion – the low levels in 1989 and 1990 reflects the “reversal” of capital flight that was pointed out earlier. Over the 1990s, capital flight reached became even larger, especially after the mid-1990s. Total capital flight for the decade was USD 43 billion. Thus, between 1970 and 1999, US$ 95 billion was lost to capital flight.

**Figure 1: Capital Flight from the Philippines (in US$ Millions, 1995 Prices)**

Table 2 presents capital flight and the calculated potential outputs using the Philippine and Thailand ICORs, respectively, on KF-qua-investments. Between 1970 and 1999, the average potential was US$ 432 million using Philippine ICOR and US$ 864 million using Thai ICOR. Table 2 also shows that that bigger potential output could be had in the 1990s if the Philippines had the counterfactual setup of Thailand. Then with Table 2, the potential economic growth rates of the Philippines were calculated, and the results are in Table 3. Clearly, higher growth rates would have been possible with KF-qua-investments, with an average of 1 per cent higher than the actual performance using Philippine ICORs or an average of 2.3 per cent when using the Thai ICORs. It is also interesting to note that the 2.3 figure is similar to the result reported by Balisacan (2006) obtained using econometric techniques. In fact, the figures for 1970s and 1980s
in Table 2 using only Philippine ICOR give an average of 0.9 percentage point higher growth rate, which is also what Lamberte, et al (1992) obtained using gap analysis for the same period.

Table 2: Capital Flight and Potential Output, in US$ Millions; 1995 Prices

<table>
<thead>
<tr>
<th>Capital flight</th>
<th>Phil. Output 1</th>
<th>Phil. Output 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>5-year Ave.: 1970-74</td>
<td>903</td>
<td>41</td>
</tr>
<tr>
<td>1975-79</td>
<td>5,800</td>
<td>310</td>
</tr>
<tr>
<td>1980-84</td>
<td>11,936</td>
<td>699</td>
</tr>
<tr>
<td>1985-89</td>
<td>8,733</td>
<td>713</td>
</tr>
<tr>
<td>1990-94</td>
<td>5,946</td>
<td>230</td>
</tr>
<tr>
<td>1995-99</td>
<td>14,210</td>
<td>600</td>
</tr>
<tr>
<td>10-year Ave.: 1970-79</td>
<td>3,352</td>
<td>176</td>
</tr>
<tr>
<td>1980-89</td>
<td>10,335</td>
<td>706</td>
</tr>
<tr>
<td>1990-99</td>
<td>10,078</td>
<td>415</td>
</tr>
<tr>
<td>30-year Ave: 1970-99</td>
<td>7,922</td>
<td>432</td>
</tr>
</tbody>
</table>

Note: Source of capital flight data is Beja (2006a); calculations of the author.

From Table 2, the growth pattern using the Thai ICOR suggests a smoother trajectory of economic growth. As such, possible growth accelerations can be had. To capture the acceleration effects on the growth figures, a further calculation was done on the results from the Thai ICOR, particularly by calibrating the Thai ICOR results using the differences in the actual and counterfactual economic growth rates to obtain compounded growth rates. The results shown in Table 3 suggest that the Philippines could have reached much higher averages, reaching 6.2 percent for the period 1970 to 1999, which is comparable to the average growth rate of Indonesia at 6.1 per cent, Malaysia at 6.7 per cent, or Thailand at 6.5 per cent.

Table 3: Capital Flight and Economic Performance

<table>
<thead>
<tr>
<th>Actual growth</th>
<th>Growth-1</th>
<th>Growth-2</th>
<th>Adj. Growth-2</th>
</tr>
</thead>
<tbody>
<tr>
<td>5-year Ave.: 1970-74</td>
<td>5.4</td>
<td>6.0</td>
<td>6.1</td>
</tr>
<tr>
<td>1975-79</td>
<td>6.2</td>
<td>6.8</td>
<td>6.9</td>
</tr>
<tr>
<td>1980-84</td>
<td>1.4</td>
<td>2.5</td>
<td>4.8</td>
</tr>
<tr>
<td>1985-89</td>
<td>2.7</td>
<td>4.0</td>
<td>6.2</td>
</tr>
<tr>
<td>1990-94</td>
<td>1.9</td>
<td>2.2</td>
<td>4.8</td>
</tr>
<tr>
<td>1995-99</td>
<td>3.7</td>
<td>4.5</td>
<td>5.8</td>
</tr>
<tr>
<td>10-year Ave.: 1970-79</td>
<td>5.8</td>
<td>6.5</td>
<td>6.6</td>
</tr>
<tr>
<td>1980-89</td>
<td>2.0</td>
<td>3.2</td>
<td>5.5</td>
</tr>
<tr>
<td>1990-99</td>
<td>2.8</td>
<td>3.3</td>
<td>5.3</td>
</tr>
<tr>
<td>30-year Ave: 1970-99</td>
<td>3.6</td>
<td>4.5</td>
<td>5.9</td>
</tr>
</tbody>
</table>

Note: Actual growth figures are from the World Development Indicators. Growth-1 uses Philippine ICOR, Growth-2 uses Thailand ICOR, and Adj. Growth-2 is Growth-2 accounting for possible acceleration effects. Calculations of the author.
Of course, if the contribution of past crises or constraints (e.g., the results of Balisacan (2006)) to potential output and economic growth were factored in the calculations, the adjusted figures would be much higher. The point to stress is that the potential outputs – hence, the lost opportunities – between 1970 and 1999 were quite significant to be simply dismissed as bygones. Therefore, the conclusion from Tables 2 and 3 is clear: Philippine economic performances could have been higher and comparable to the fast growing Southeast Asian economic tigers if the lost resources (in this case, capital flight) were channelled into domestic productive endeavours. In addition, based on the five-year and decade growth averages, Philippine economic performances could have been a lot more stable that would have sustained economic expansions over the long term. Given these results, the capital flight therefore means large lost opportunities. Considering that in the counterfactual scenario the Philippines could have realized an Asian economic tiger status, one important implication with these calculations is a failed economic takeoff.

5. LET BYGONES BE BYGONES?

The calculations above demonstrate that capital flight means lost resources, which result in lost outputs. In the case of the Philippines, sustained capital flight points to serious problems that are unaddressed, the more serious ones are: the disinterest or unwillingness of investors to put funds into productive domestic endeavours, the reluctance of the banking sector in providing credit to those who want to undertake domestic production, a bureaucracy crippled by corruption and public distrust on the government, unending domestic political crises characterized by pointless squabbles in the government, reversals in policies done for political survival and expediency, and absence of an autonomous political base for carrying out government programs. These issues reinforce the prevailing uneasiness that the leadership has compromised the direction of policies in the Philippines. They also strengthen doubts about the ability of the leadership to shepherd the country to sustained economic recovery and ultimately realize real improvements in the social conditions of Filipinos. As such, capital flows are short-term that finance speculative endeavours (e.g., stock and property markets) or non-productive activities (e.g., consumption binges), fuelling
financial and asset bubbles, encouraging risky behaviour, and in the end, producing economic crises. Similarly, as the volumes of resource flow increase and as their streams fluctuate, more of the funds end up being misallocated, especially because they are not supported with productive investment opportunities. Resource flows also take advantage of the opportunities made available by deregulation and financial liberalization. Given the nature of crises, economic conditions are further deteriorated with capital flight, thus aggravating the reductions in domestic investments, intensifying uncertainties, and so on, generating more capital flight and aggravating the economic contraction. Hence, crises in the Philippines are not only repetitive but also extended. So the costs are magnified. There are therefore a lot of opportunities lost.

Even though the recent economic conditions indicate that robust performances have been realized, the increasing resource flows can still end up contributing to capital flight given that there are now wider avenues for flight with deregulation and financial liberalization. At the same time, the ever larger amounts of capital fleeing the country become much more difficult to control and slowly impinge on government capacities to effectively regulate domestic economic activities for the public welfare. Actually, the government misjudges the situation of increasing resource flows in trade and finance as votes of confidence to the state-of-affairs in the Philippines. It thus fails to see the increasing volumes of capital fleeing the country and concludes that its withdrawal from active management of the economy is in the right direction. In turn, when the government finds the need to intervene, it is unable to do so as capital would go on strike against any form of regulation. With government capacities weakened, capital strikes are more effective mechanisms in further disarm the government. Because of this disappointment, the government then embarks on self-deprecation for embarking the role of an economic manager.

In the end, the results presented earlier support the contention that capital flight played an important role for the difficulties that the Philippines faced in trying to realize economic take-off. The crises that inflicted the Philippines and the capital flight that ensued made things worse in the country.
Given the large costs, it is logical to argue that government action is needed to redress the situation. There is a thus need to rethink what government interventions mean in the Philippines. Contrary to the current thinking that the withdrawal of the government is desirable, it is rather important to re-articulate and re-define the role of the government today. It goes without saying that the government remains the only institution that is capable of wielding an influence on the behaviour of various players in society and how institutions work, including the market. Of course, some adjustments are needed for the government to maintain solid foundations to carry out its role and for it to negotiate effectively the various challenges on its role. Such mandate is important because an unsuccessful government faces increasing pressures to remove itself from further participation in the economy; in turn, the government’s exit make it much weaker and ineffective or worse, it becomes a failure. A failed government finds that it is unable to regain stability, secure the economy, or provide quality basic services. If the government casually waits for other non-state agents (including the market) or for events to produce the stability and security for them, it is bound to fail. A government that refuses to act fails. A weakening government finds it increasingly difficult to maintain the level of effectiveness it once enjoyed. While a government that allow non-state agents and developments in the global economy and polity to undermine its autonomy and capacities finds that it degenerates quickly that, in the end, it too fails. Where the government becomes weak or fails, it violates the fundamental human rights and liberties of its citizens to a decent, meaningful, and substantive existence. In these cases, the government is responsible for the injustice and misery of the people.

In the context of capital flight, a first step to reclaiming the capacity of the government is the re-introduction of capital flow management techniques. Yet this intervention should not be interpreted as a reversion to economic repression. Rather, the goal for introducing such techniques is to regain effective management of the direction of policies and the economy. Regulations on resource flows are needed because unregulated capital is dangerous in the long run. As another example, capital controls can be applied as a tool to restrain capital and, in the process, direct the
resources into the productive sectors of the economy. In other words, maintaining control over the resource flows is essential for commodity production to occur. Capital controls can also be used as a screening mechanism, for instance, to discourage short-term or speculative inflows but to encourage long-term inflows to support industrialization, deepen capital accumulation, and push the economy to higher levels of production to maintain a high growth path. In the process, capital management techniques can remove the vulnerabilities to financial swings, panic and contagion; in the process, insulate the economy from destructive capital, avert crises, but more importantly, purge capital flight.

Part of this rethinking is to understand that the Philippine government needs to guarantee the domestic interests. Economic targets and development need to consider the historical, socio-cultural and institutional realities in the Philippines. At the same time, the government must also secure broad-based macroeconomic performances. In other words, the economy must be able to reach high levels of outputs and also provide jobs to Filipinos. It must regain autonomy so that constructive engagements with domestic and external demands both to the government itself and to the execution of government functions. It must be decisive in regulating economic and social processes that are counter-productive to realizing a robust macroeconomy and in dealing with attempts to undermine its capacities. It must maintain sound economic and macro-organizational foundations. It must also allow for constructive partnerships with the private sector and the civil society. It must not obstruct initiatives toward broad-based progress. In short, the best approach is for the Philippine government is to continuously adapt – to redefine and refine its role – to the changing conditions to maintain autonomy and capacities, to successfully negotiate globalization, but more importantly, to provide the needs of the Filipinos. Policies based on compromises are not helpful. Therefore, the government must rethink its role if it wants to remain relevant.

The results revealing the large potential output with KF-qua-investments is manifestation of the costs of an anti-development Philippine government and an economy that is caught in a saga of crises and capital flight. There is thus a need to challenge the Philippine government to
take up decisive policy actions to regain control of the economy and stabilize the political crises. Progressive policies that bring about robust macroeconomic performances to pull the economy out from its present low growth path are imperative. Given that the costs of capital flight are large, government intervention must be demanded. As such, it is very important that Filipino progressives confront their government with unsympathetic criticisms, even to the extent of condemning the current direction of policies to “open the government’s eyes” to the need to have sound governance but not revert to economic repression. It is also very important to challenge the Philippine government to re-think about how reforms have been executed, to think about how to reform the reforms, to remove the internal and external vulnerabilities, to establish autonomy, and to maintain an effective political base to carry out its programs. Yet, it is equally important to be vigilant when engaging the government in the re-thinking process so that actions are not taken to divert attention from dealing with the causes of economic weaknesses, identifying the legitimate alternatives, and pursuing the broad-based reforms. This advocacy is crucial for meaningful and collective engagements among all the stakeholders in the country. Finally, the government must be brought back into the centre-stage of policy-making and discussions. Unless the Philippine government responds pro-actively, it is condemning the country to the perpetuity of crises, the continuity of the narrow, shallow and hollow macroeconomic performances, the permanence of poverty of the Filipinos, and the failure to realize economic takeoff.

Let Bygones be Bygones

What can be said of the Philippines in the 21st Century? If capital flight slowed down or reversed since 2000, would it be possible to discount the past and consider the present prospects of the Philippines for economic growth? Unfortunately, recent estimates find that more capital flight occurred since 2000, and there are indications that the state of affairs to continue in the coming years (see, e.g., Beja 2007). As in the past, economic and political crises pushed capital to flee to avoid the unfavourable developments in the country. It is expected that the tendency for capital to flee is much stronger today with a financially liberalized economy and more determined
efforts at removing the remaining restraints on capital flows. As in the past, the impact of capital flight during crises is to enhance the consequences of crises, thereby not only increasing the costs but also prolonging the outcomes. Again, because elite are able to move elsewhere to both shelter themselves from harm and their wealth from the unfavourable developments in the country, the burden is necessarily and disproportionately imposed on the majority of the Filipinos. For as long as the capital flows in a revolving manner (see, e.g., Boyce 1992; Beja 2006b) and the government is convinced that the situation is acceptable in a financially liberalized environment, Philippine economic performances cannot reach full throttle. In addition, resource flows will end up in non-productive domestic endeavours. Lastly, unless the Philippine government regains control of the macroeconomic conditions in the country, the Philippines will continue on a low growth path and violate the fundamental rights of Filipinos to a decent, meaningful, and substantive existence. In these cases, the Philippine government is responsible for the injustices and miseries of Filipinos.

6. CONCLUSION

The Philippines has experienced capital flight since the 1970s, and studies have shown that it continues to experience this problem today. If the capital flight was used to finance productive domestic endeavours (i.e., KF-qua-investments), the results presented in this paper suggest that the Philippines would have realized stronger macroeconomic performances. The average loss in output was calculated at US$ 432 million to US$ 864 million, or an average loss in growth rate of between 1 per cent to 2.3 per cent, between 1970 and 1999. Computing the compound growth rate that would be possible with stable growth over three decades, the Philippines could have reached an average of 6.2 per cent, a level comparable to the Southeast Asian miracle economies. Such figures could also mean the amount of lost welfare of the average Filipino, who could have been raised out of poverty.

In the case of the Philippines, capital flight therefore is an important factor to consider in understanding why it failed to sustain rapid economic growth and realize economic takeoff. When the Philippines was already lagging behind on the economic ladder, capital flight played a role in
pulled the country several rungs further down. Of course, unending political crises contributed to propel capital to flee. Yet it is clear from the results is that sustained capital flight over a long period ultimately meant a lost and arguably an unrecoverable lost opportunities. Unless decisive policy actions are taken up by the Philippine government today to reverse the current dismal trend of economic growth, the Philippines will remain in perpetuity of crises, hollowed out, trapped in poverty, and fail to realize economic takeoff.

REFERENCES


ENDNOTES

1 The National Capital Region remains to be the center of economic production in the Philippines, contributing at least a third of gross domestic product in 2006.

2 See Cumby and Levich (1987), Gordon and Levine (1989), Claessens and Naude (1993), Chang et al. (1997), Kant (2002), and Beja (2005) for discussions covering definitions and measurements of capital flight. As Boyce (1993) and Beja (2006a) elaborate, social control refers to the actual or potential, including formal and informal, regulations on the use of resources, covering the expectations and norms on the use of foreign exchange, the extra-legal exactions on capital, the capacity of the government to direct resources into domestic productive endeavors, among others. See also Bowles and Gintis (1988) for a related use of social control.

3 Detailed estimation procedures and results are presented in Beja (2006a), and regression analysis on the same dataset is available in Beja (2006b) using the procedure presented in Boyce (1992) for the Philippines. Also, Boyce and Ndikumana (2001), Epstein (2005), and Beja (2006a) use the same procedure for estimating capital flight.

4 ICOR is a measure of the marginal efficiency of capital; that is, how much output can be had for a unit of capital in production, all other things held constant. Five year averages of the ICORs are used in the calculations. In addition to assuming productive domestic investments, the following are also important: there is an exogenous demand for investments; and the sectoral impact of KF-qua-investment is the same across sectors (i.e., there is fixed proportion in factor inputs).

Researchers on the Philippines agree that the country is immersed in a vicious supply-side cycle in which capital scarcity lowers economic growth, aggravating the capital scarcity problem and limiting investments even more. Using the ICOR in the counterfactual calculations is consistent with this supply-side problem argument. It is also assumed that the sectoral impact of KF-qua-investment is the same across all economic sectors, or the best case scenario. “Capital scarcity” refers to the lack of financial resources and infrastructural underdevelopment, while
“infrastructure” refers to the physical and social capitals. See, e.g., Pastor (1990), Lopez (1996), and Vos and Yap (1996) for related techniques in calculating the lost output.

Mathematically, the formula is $Y_t = \frac{K_{Ft} + \sum_{m=1}^{t-1} K_{Fm}[\prod_{n=1}^{m-1}(1-d_m)]}{ICOR_t}$, where $t$ is the present period, $m$ is the time period up to $(t-1)$, $n$ is time up to $(m-1)$, $d$ is the depreciation rate, and $\Pi$ is the product operator.

Estimates are sensitive to the starting point of the calculations. Also, a five-year moving average was used in the calculation. KF-qua-investment will be fully depreciated in some future period. If it is assumed that the capital flight was invested in financial assets, say, abroad before it was used in the domestic economy, the accumulation of foreign assets plus accrued earnings must be used in the numerator; that is, $CSK_{Ft} + dSK_{F,t-1}$, where SKF is the stock of capital flight imputed using a rate of return; $CSK_F$ is the change in SKF; and $d$ is the depreciation rate.

Recall, the basic formula is $KF = CDET + NFI - CAD - CRES$, where CDET is the flow of debt-related capital, NFI is the flow of non-debt capital, CAD is the current account deficit, and CRES is the accumulation of international reserves. In Table 1, $KF$ was adjusted for trade misinvoicing, or MIS. The extended formula for computing capital flight is $KF = CDET_{ADJ} + NFI_{ADJ} - CAD_{ADJ} - CRES_{ADJ}$, where the subscript ADJ refers to the adjusted value. Details on how to calculate the adjustments are available in Boyce and Ndikumana (2001) and Beja (2006a).