



**GROWTH WITHOUT
DEVELOPMENT:
A TRAJECTORY ANALYSIS OF
AFRICA'S DEVELOPMENT
PATH SINCE INDEPENDENCE**

*Essays in Honour of
Professor Ademola Ariyo*

Musibau Adetunji Babatunde
Babajide Fowowe

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Nigeria's Illicit Capital Deposits in Tax Havens: Implications for Tax Revenue Losses to Government

Akanni O. Lawanson

Abstract

In response to the growing global concern about the role of tax havens, through illicit financial flows and tax evasion, which deprived developing countries of their domestic resources in the last two decades, this study estimate the return on investment and tax losses to the Nigerian economy and government, respectively. Using a conservative rate of return on investment, the Nigerian economy annually lost between 3.8 per cent and 7.5 per cent of GDP through leakages of private assets to tax havens. The fiscal position of the government was hampered to the tune of roughly 4.9 per cent of GDP, lost per year.

15.1 Introduction

In the last two decades, there has been a growing concern by economists, financial analysts, policy makers and government of major economies about the role of tax havens, through illicit financial flows and tax evasion, in depriving developing countries of their domestic resources. A number of developing countries are confronted with inadequate resources to execute most development programmes and

activities. The emergence and adoption of Millennium Development Goals (MDGs) in 2000 is an acknowledgement of the persistent developmental shortfalls of most less developed countries (LDCs), and the need to annex resources to prop them into development terrain. Progress in the Sub-Saharan region continues to lag behind all other regions in the world in terms of the MDGs (UN, 2009).

Three main sources of resources are available to governments of developing countries to fund their development agenda. They are resource mobilisation through tax levies, external borrowings, and aid flow from developed countries. The flow of aid has been one means by which developed world has demonstrated their concern and assistance in promoting development process in the LDCs. This developed world's disposition has further been reinforced by recent debt relief programme of the heavily indebted poor countries (HIPC) initiative in response to decades of large foreign debt accumulation. Debt burden has hindered economic growth and also truncated the development initiatives of developing countries.

While additional resources for development are generated through aid flows and debt relief programmes, capital flight and tax evasion thwart development efforts of most Sub-Saharan African (SSA) countries. Despite the insufficient resources in these countries, tax havens have continued to stimulate flight of capital out of them. While there exist an implicit link between tax evasion and capital flight, as tax evasion is often the motive for the capital flight, tax havens facilitate and provide the landing sight and enabling environment.

Capital flight diverts scarce resources away from domestic investment and other productive activities; and it results in loss of taxes for African governments - which are important not only from the point of view of lost revenue, but in terms of the institution-building stimulus provided by the revenue imperative (GFI, 2010). It impacts negatively on capital-scarce economies: the loss of domestic savings leads to reduced levels of internally funded investment and the loss of tax revenues flowing from those savings leads to reduce revenues available for public spending on health, education and public infrastructure (Epstein, 2005).

In fact, the scale of capital flight and tax evasion far outweighs aid flows and debt relief programmes (Christensen, 2009). For each dollar that goes to the developing world in aid, almost US\$10 find their way back to

developed countries through illicit means, thus between US\$ 850.1 trillion yearly disappears without a trace from developing countries, ending up in tax havens or rich countries (Froberg and Waris, 2011).

The governments of the major economies for the first time at the 2009 G20 Summit acknowledged the impact of international tax rules and illicit capital flight from developing countries. The British Prime Minister Gordon Brown promised in advance of the summit that:

We will set out new measures to crack down on the tax havens that siphon off money from developing countries: money that could otherwise be spent on bednets, vaccinations, economic development and jobs.

The flow of resources out of developing countries creates deficits, increases dependence on aid, makes recipients vulnerable to conditionality and renders debt cancellation less worthwhile (Eurodad, undated). A revolving door relationship has been identified between debt and capital flight. In some cases, as much as 80 per cent of the public loans have left the continent as private assets through capital flight (Cerra et al., 2008; Ndikumana and Boyce, 2008).

Of the three available sources of resources to developing countries' governments, tax has been identified as the most sustainable source of development finance, providing developing countries with revenue for investment in essential services and infrastructure, while promoting accountability between state and citizen. While the basic pillar of tax is that it forces government to be accountable to citizens, reliance on international aid makes donors the focus of government accountability. However, tax evasion undermines this basic pillar of civil accountability and reduces respect for the rule of law (Christensen, 2009). While the bulk of most developing country governments' spending is made up of tax revenue; the amount represents a relatively small proportion of their national income. While the world's richest countries raise on average 37 per cent of their national income from taxes, smaller proportion of less than 15 per cent is raised by low-income countries. The tax mobilisation performance is even worse among the SSA countries, as it constitutes less than 12 per cent of their national income. According to the IMF (2005), a reasonable minimum level that should be prevalent in low-income countries to ensure the financing of basic government tasks such as the

rule of law, health and education is a tax revenue equivalent to 15 per cent of GDP. Ability of developing countries to raise just 15 per cent of their national income as tax revenue will translate to realising at least an additional US\$198 billion per year, more than all foreign development assistance combined, and enough to meet and exceed the annual MDGs funding gap (Action Aid (2009)).

Tax a potential source of more funds to invest in public services, and also more advantageous compared to aid, because of its relatively stable form of income, as well as its close link to improved governance and accountability (Froberg and Waris, 2011). Notably, the tax base of African countries is being persistently eroded by illicit flow of domestic resources, losing enormous investable capital to tax havens. Estimates of capital flight from Nigeria appeared to reflect a more pathetic scenario among SSA countries. Thus, raising enough tax revenue to cater for development activities has become more challenging than ever. As a result, government of Nigeria has continued to frantically search for other means to raise additional revenue for development or reduce spending on some activities. Such measures include the withdrawal of subsidy from petroleum at the beginning of year 2012, and increase in the unit price to be paid by consumers of electricity, as well as adoption of concessional option for the rehabilitation and construction of major roads in the country.

Despite the central and rising concern about flight of illicit capital from developing countries, especially Nigeria to tax havens, studies that address questions relating to: the magnitude and mechanism by which illicit capital flight from Nigeria ends up in tax havens; and the implications on the capacity of Nigerian government to raise tax revenue to execute development programmes, such as MDGs are scarce. Estimating the resource leakage to tax havens and implication for fiscal position of government in Nigeria may be a useful starting point to realistically articulate developing policy measures to arrest the trend, and possibly initiate the return of Nigerian resources offshore. To effectively ascertain and combat flight of illicit capital to tax havens and its consequences on tax revenue mobilisation and development of Nigeria, this paper proposed to contribute to the understanding of the portfolio dimension of the magnitude of illicit capital flight to tax havens and implications for tax revenue in Nigeria.

Stylised Facts on Nigeria

Nigeria with a population of over 160million is classified among the world low-middle income group. The per capita real GDP of the country at year 2000 prices, for the first decade of the twenty-first century is around US\$428.00, is the highest in the history of the country. After the initial improvement in the country's per capita real GDP from US\$407 in the first half of the 1970s, to US\$422 in the second half of the same decade, the value significantly dropped by about 25 per cent in the first half of the 1980s. However, there was a steady increase throughout the remaining years of the twentieth century, though it remained less than US\$370. The observed trend in the per capita GDP for the country is also reflected in the growth rate of the GDP. The highest growth rate of nine per cent, yet to be surpassed was experienced in the first half of 1970s.

Apart from the negative growth rate of the economy experienced in the first half of 1980s, the economy has consistently experienced growth. In the first decade of the twenty-first century, the economy significantly improved by growing at an average of more than six per cent. For the most part of the last three decades of the twentieth century, the relatively significant inflationary experience made the real interest rate in the country negative. However, the last 15 years has witnessed consistent positive real interest rate in the country. The interest rate trend has implication on investment decisions by private and foreign investors. Apart from the initial increase in the real investment share of GDP from less than 20 per cent to more than 28 per cent between the first and second half of 1970s, the share has consistently declined over the decades to all time low of 7.4 per cent in the first decade of the twenty-first century. Foreign direct investment (FDI) has however increased over the years, it reached the pick of 4.7 per cent in the first half of 1990s, while it has remained at less than 3.5 per cent on the average since then. The trend in the total external reserves and debts of the country has been typical.

While the worth of the reserves in terms of months of imports is very low at less than four months and consistently dropped between 1971 and 1995, an appreciable improvement started to emerge from the second half of the 1990s. In terms of external reserve vis-à-vis external debts, the trend appeared to reflect the debt management policy direction of the country. In the 1970s, the country maintained a reserve that is more than enough to offset the debt obligations of the country. However, with increased accumulation of external debt, coupled with depletion of the country's reserve, an insignificant proportion of the debts can best be

settled by the maintained reserves. The country reversed this, with the advent of debt forgiveness initiative which the country benefited from, and the increased effort at building up external reserves. The average external reserves rose to more than 200 per cent of total external debt.

The real government consumption which has been moderate between 1.2 per cent and 2 per cent in the first three decades of 1970s to 1990s, witnessed a significant increase to all time high of 5.7 per cent on the average between 2000 and 2008. The limited information on capital flight incidence trend in the country from literature shows a steady increase from US\$1.4 billion on the average in the first half of 1970s to over US\$4.3 billion in the first half of the 1990s (Table 15.1).

Table 15.1: Some Selected Macroeconomic Indicators for Nigeria (1971-2008)

Macroeconomic Indicators	1971-75	1976-80	1981-85	1986-90	1991-95	1996-00	2001-08
Real GDP per capita (2000, US\$)	407.7	422.7	327.0	329.7	363.5	363.7	427.5
GDP growth rate (%)	9	4.0	2.7	5.4	2.5	3.1	6.2
GDP per capita growth rate (%)	6.4	0.9	5.3	2.7	0.1	0.6	3.7
CPI	0.21	0.52	1.06	2.6	12.84	41.88	91.28
Real interest rate	5.7	4.9	1.0	3.2	14.9	4.74	3.2
Exchange rate	0.66	0.61	0.74	5.14	18.63	51.94	124.79
FDI net inflow (% of GDP)	2.4	0.3	1.04	3.06	4.74	3.48	3.3
Current account balance (% of GDP)	NA	0.38	5.64	4.3	2.12	3.18	16
Reserves in months of imports		3.88	1.60	3.0	2.0	5.4	7.4
Reserves (% of total external debt)	151.1	156.9	15.9	6.7	6.9	23.4	177.0
Openness (% of GDP)	31.9	45.1	35.0	53.2	83.5	78.8	72.4
External debt stocks (% of GNI)	9.1	10.9	45.7	131.6	136.2	89.5	34.2
Real govt. consumption share of GDP	1.18	1.51	1.61	1.96	1.85	1.78	5.71
Real investment share of GDP	19.60	28.67	18.86	9.05	9.96	8.40	7.40
TDS/ GNI (%)							
EDT/EXPT (%)							
TDS/EXPT (%)							
Real capital flight (billion 1996 US\$)	1.4	3.75	2.88	4.24	4.32	NA	NA
Real Exchange Rate			474	132.7	81.1	115.6	97.4

15.2 Review of Relevant Literature

Quite a number of issues have been the focus of debate on illicit capital flight studies and tax havens. It ranges from definition and measurement issues of capital flight, through issues bothering on tax havens definition, identification to effects on tax revenue of source countries.

15.2.1 Definitional Issue

Illicit Capital Flight Definition, Measures and Magnitude

Conceptually, there are divergent views on the definition of illicit capital flight in the literature, this has generated varieties of definitions with

different meanings implied. This controversy is due partly to lack of precise and universally accepted definition of capital flight in economic theory, and partly, because of the way the term is used between developed and developing countries (Ajayi, 1997). Capital flight can generally be defined as an outflow of capital, not part of normal commercial transactions from a country where capital is relatively scarce (Epstein, 2005). Loosely defined, illicit financial flows involve capital illegally earned, transferred or utilised and cover all unrecorded private capital outflows that drive the accumulation of foreign assets by residents in contravention of applicable laws and the country's regulatory framework (Kar, 2012). Capital flight is defined as the deliberate and illicit expatriation of capital, money, by those resident or who have tax obligations in the country of origin (Christensen, 2009). It is the unrecorded and (mostly) untaxed illicit leakage of capital and resources out of a country (Kapoor, 2007).

According to Fröberg and Waris (2011), capital flight takes two forms: legal and illegal. The legal component stays on the books of the entity or individual making the outward transfer. The illegal component is intended to disappear from records in the country from where it comes. Money that is illegally earned, transferred across borders or utilised constitutes what is considered illicit. If it breaks laws or regulatory frameworks in its origin, movement or use, it merits the illicit label. By far, the vast majority of unrecorded transnational financial flows are illicit, because they are violating the national criminal and civil codes, tax laws, customs regulations, VAT assessments, exchange control requirements and banking regulations of the countries from which unrecorded/illicit flows occur (Kar and Cartwright-Smith, 2008).

Ruiz and Baranes (2008) identified three main types of transactions that will constitute illicit capital flight to include criminal activities, corruption and commercial transactions. According to Fröberg and Waris (2011), criminal activities such as drug trade, human trafficking and illegal trade with weapons constitute about 30 to 35 per cent of the illicit capital flows from developing countries, while corruption arising from bribery and embezzlement of national wealth accounts for only about three per cent. The bulk of illicit capital flight is transacted through tax evasion and avoidance practices by multinational companies, accounting for 60 to 65 per cent.

Apart from taxation which causes capital outflow from developing countries (Fuest and Riedel, 2009), other factors that stimulate it were identified by Boyrie et al. (2005) to include economic and political uncertainty, fiscal deficits, financial repression, devaluation and the threat of expropriation and potential confiscation of wealth. Hermes and Lensink (1992) also cited a set of studies which suggest that the outflow of capital from developing countries is driven by macroeconomic and political instability.

Epstein (2005) identified certain characteristics that help distinguish capital flight from normal monetary and resource flows to include the following:

- Flight capital is domestic wealth permanently put beyond the reach of appropriate domestic authorities. Much of it is unrecorded due to deliberate misreporting;
- Because no (or little) tax is paid on wealth transferred as capital flight, it is associated with a public loss and private gain.
- Because tax evasion is illegal and subject to criminal sanction in most countries, the management of flight capital is a form of money laundering. Offshore secrecy arrangements play a crucial part in the laundering process by enabling the origin and ownership of the capital to be effectively disguised.

Also, Alemayehu (2010) identified the mechanisms through which capital flight is facilitated to include: tax leakages (mainly due to predatory business practices); opaque and disadvantageous investment protocols; odious debt contracting and servicing; corruption; and the consequences of capital market liberalisation and the deregulation of financial markets. Kapoor (2007) also identified the main channels of capital flight to include: mis-invoicing trade transactions, transfer mispricing, mispriced financial transfers, unscrupulous wire transfers, cash smuggling, as well as paying bribes and corrupt monies offshore.

Measurement of illicit capital flight has remained a subject of dispute, despite its importance. Basically a number of measures of capital flight are found in the literature. Murinde et al. (1996) identified four major methods: Residual (RD); Hot Money (HM); and Dooley (DL). Boyce and Ndikumana (2001) and Ajayi (1997) identified accounting for 'trade-faking' activities as additional methods of measuring capital flight. The starting point for all measures is the balance of payments figure.

The RD appears to give a rather straightforward calculation of capital flight, and this may be responsible for its being the most widely accepted and applied method in the literature. The RD starts by not only considering all private capital outflows as capital flight, but also by comparing the sources and uses of such capital flows. If there are more funds coming in than funds being used, the resulting shortfall is considered to be illicit flows (Kar and Cartwright-Smith, 2008). The RD relies on collected raw data from each country and then purposefully calculates (as opposed to simply taking the leftovers) the discrepancy between the sources and the uses of funds to identify illicit flows (Fontana, 2010).

HM method views capital flight as the capital outflows responding to short-term variations in the various domestic and international financial market conditions. This measure considers all errors in a country's external accounts as reflected in its balance of payments as illicit flows. The Net Errors and Omissions (NEOs) which capture the unexplained leftovers in BOP are considered to be illicit capital flows. This method measures capital flight as the sum of short-term capital outflows and the NEOs. One very important drawback of this method is that it fails to consider long-term capital outflows when capital flight is measured (Murinde, et al., 1996).

The DL measures capital flight as illegal capital outflows or all capital outflows based on the desire to place assets beyond the control of domestic authorities. It considers all outflows that do not receive and/or register interest payments as illicit capital outflows. It incorporates the NEOs, as well as the difference between the World Bank data on the annual change in the stock of external debt and debt flows as reported in the BOP statistics. In its simplest form, capital flight magnitude is measured as the excess of total capital outflows over the stock of registered interest-receipt external assets.

Transfer mispricing and trade misinvoicing of import and export transactions are other channels for illicitly sending money abroad. Transfer mispricing is a situation where multinational companies charges different prices on transaction with related subsidiary and unrelated firms. It is also known as "abusive transfer pricing" commonly used by companies to exploit a low tax jurisdiction, while evading taxes in high tax jurisdiction, by charging low prices on exports to and high

prices on imports from subsidiaries located in tax havens. Trade misinvoicing on the other hand involves falsification of prices on customs invoices. This is often done by firms or individuals colluding with an unrelated party abroad to shift money between countries. In the context of developing countries, practices like this not only exploit the weak capacity or corruption of customs and tax authorities, but they cheat the country of needed tax revenues (Fontana, 2010).

Review of Some Illicit Capital Flight Estimates from Developing Countries

A study of 40 African countries between 1970 and 2004 by (Ndikumana and Boyce, 2008b) reveals that real capital flight over this period amounted to about US\$420 billion (in 2004 dollars) for the 40 countries as a whole. When the imputed interest earnings on this amount are considered, the accumulated stock of capital flight as at end-2004 was about US\$607 billion compared to a total external debt of US\$227 billion of these countries in 2004. Global Financial Integrity (GFI), a research institute based in Washington, DC, also estimated the amount of money that leaves developing countries as a result of transfer mispricing for 2006, to be between US\$471 billion and US\$506 billion (Action Aid, 2009).

Recent report released by GFI reveals that in 2008, illicit capital flight from developing countries had increased to between US\$ 1.26 trillion and US\$1.44 trillion, with Africa having the largest real growth of illicit capital flight, amounting to 21.9 per cent between 2000 and 2008 (Kar and Cartwright-Smith, 2010). It has been estimated that Africa's political elite alone hold between US\$700 billion and US\$800 billion in offshore accounts outside the continent (Baker, 2005). An estimate of illicit capital flight from 2002 to 2006 by Kar and Cartwright-Smith (2008) reveals that US\$371.4 billion per year was shifted out of developing countries through trade mispricing. The volume increased at an average rate of around 18 per cent per annum (Kar and Cartwright-Smith, 2008), while another estimations of illicit capital flight from Africa between 1970 and 2008 show that it grew at an average rate of around 12 per cent per year (Kar and Cartwright-Smith, 2010). About 38.6 per cent total illicit capital flight from SSA from 1970 to 2008 originated from West African countries, with Nigeria accounting for more than two-third. As percentage of GDP, the burden of capital flight from African countries is

the highest among regions of the world. Between 1991 and 2004, around \$13 billion representing 7.6 per cent of annual GDP yearly left the African continent (UNCTAD, 2007b). Boyce and Ndikumana (2008a) report on four African countries: Côte d'Ivoire, Zimbabwe, Angola, and Nigeria that their external assets are 4.6, 5.1, 5.3, and 6.7 times higher than their debt stocks, respectively. Cumulatively, more than \$230 billion is believed to have fled Nigeria, and some 17 SSA countries were estimated to have lost in excess of 100 per cent of GDP since 1970 (Boyce and Ndikumana, 2008a).

Tax Havens: Definition and Characteristics Issues

Tax motivated income shifting out of developing countries is more likely to be routed through tax havens (Fuest and Riedel, 2009). Meanwhile, defining the term "tax haven" remains controversial in the literature. Different proposed definitions appear to capture different combinations of the features of tax havens locations. The term tax haven has been defined from different but related perspectives, which leaves no specific definition in the literature to be exhaustive. Dharmapala and Hines (2006) define tax havens broadly as locations with very low tax rates and other tax attributes which appeal to foreign investors. It has been suggested that definition of tax havens should reflect their major features, namely strong bank secrecy and/or low to zero taxation. Tax havens are entities that effectively impose (almost) no taxes on foreign income and scarcely exchange information about the foreign income with source countries (Hebous, 2011). Froberg and Waris (2011) describe tax havens as jurisdictions that use secrecy and low tax rates as a selling point to attract businesses for their financial services industries. Tax havens potentially harbour criminal activities and illicit flows of money, because their secrecy feature prevents disclosure of account ownership, worth and origin.

Common characteristics among tax havens include lack of natural resources compared to non-haven states (Addison, 2009), thus resulting to the use of financial services to compete in the global economy, having a "relatively sophisticated communication infrastructure" (Dharmapala, 2008). OECD (1998) describes tax havens as countries that offer themselves as places to be used by non-residents to escape tax in their country of residence. Tax havens or secrecy jurisdictions do transfers in a way that makes it impossible to trace the movement of goods and money.

OECD definition of tax havens is based a combination of four characteristics: no or only nominal taxes on relevant income; lack of effective exchange of information with other tax authorities; lack of transparency in the operation of legislative, legal or administrative provisions; and no requirement that activity be substantial to qualify for tax residence. Tax Justice Networks (TJN) in 2007 used the following four criteria (strong bank secrecy; low or zero taxation; no requirement of economic activity; and substance for the transactions booked ring fence between its domestic regime and the regime offered to non-residents) to identify 69 tax havens (Ruiz and Baranes, 2008).

Some other terms are often synonymously used to describe tax havens: such as legislative space, offshore centres, or secrecy jurisdiction, though definitions and listing under these terms have some differences. Measuring the size of the offshore economy has been a peculiar task, due to its secrecy feature. They are described as 'legislative space' because they are characterised by legislation that ease transactions undertaken by non-residents in their domain. The legal allowance in the tax havens transactions allows for separation between the real and the legal locations, and ensures that transactions are not linked to perpetrators based on its legally protected secrecy. Many tax havens are small entities with a number of inhabitants smaller than one million (Houber, 2011), in line with the predictions of international tax competition models that include countries of different sizes (Bucovetsky and Haufler, 2008; and Kanbur and Keen, 1993).

Tax havens could be an independent or sovereign state, a component of a federal or con-federal state, a dependent, associated or overseas territory or an internal zone to which a special legal regime has been applied (TJN, 2007). Contrary to general political environment in most African countries, Dharmapala and Hines (2009) empirically find that several tax havens exhibit a high quality of governance, at least in the sense of being politically stable, in addition to offering low taxes and confidentiality of information. It should be noted that some of the tax havens are located in poor and small countries that heavily rely on the income that the financial activities in the tax havens produce (Froberg, 2011).

Tax Havens and Tax Revenue Losses Estimates from Developing Countries

Tax havens activity was first recognised in 1961, but has rapidly grown in the past three decades to over 70 locations. Collection of tax havens identified by major studies runs to about 80, with most important ones located in Europe. While recent statistics reveals that tax havens account for only about three per cent of global GDP, more than half of global trade is channelled through tax havens. TJN (2009) claimed that 60 per cent of all global trade is routed through tax havens. Offshore deposits in the tax havens have been growing at an average of nine per cent per annum since the early 1990s, which significantly outpace the rise of world wealth in the last decade (GFI, 2010). Froberg (2011) suggests that the gap between these two growth rates may be caused by increases in illicit financial flows from developing countries and tax evasion by residents of developed countries.

It is estimated that half or more of tax revenue due to the government have not reached the treasury because of corruption and tax evasion (Christian Aid, 2008). Massive flow of illicit money out of Africa drains hard currency reserves, heightens inflation, reduces tax collection, cancels investment, and undermines free trade (GFI, 2010). The South African Revenue Service estimates that it loses up to US\$8.6 billion each year in revenue because of tax evasion in tax havens (Action Aid, 2009). For 2005, TJN (2005) estimated US\$11.5 trillion as globally held assets offshore, which based on a conservative average return on these assets of 7.5 per cent, yields US\$860 billion. From this amount TJN (2005) calculated a revenue loss of US\$255 billion based on assumption of 30 per cent tax rate on these assets.

Oxfam (2009) estimated that US\$ 6.2 trillion of developing country wealth is held offshore by individuals, which amounted to an estimated annual tax loss of between US\$ 64 billion and 124 billion to developing countries. Developing countries yearly loss tax worth of more than US\$225 billion on income from assets held in offshore accounts (TJN, 2005). In the same vein, Christian Aids (2008) reveal that developing world losses in a year US\$160 billion to tax evasion, through transfer mispricing and falsified invoicing, and Christian Aids (2009) put the illicit outflow of capital at US\$1 trillion, amounting to yearly tax revenue loss of US\$121.8 billion per year. Attempt by GFI in 2010 to measure the total deposit of non-residents in tax havens, estimated close to US\$10

trillion, of which US\$1.5 trillion tax revenue could be raised at conservative 15 per cent tax rate¹, 15 times more than total global aid. Data from six African countries² reveals that profit taken away from the countries between 1995 and 2003 was US\$11,783 million in excess of the FDI that came into the countries over the same period (Ruiz and Baranes, 2008). The excess of profit export over FDI entrance ranged from US\$10 million in Mali to US\$4,678 million in Botswana.

15.3 Method of Analysis and Results

The methodology for this study is based on stock accumulation approach to the analysis of capital flight estimates. Two channels have been established in the literature as the media through which international activities lead to tax revenue losses of developing countries. The first is the offshore wealth holding of domestic residents which reduces the personal income tax base, while trade price falsification and corporate profit shifting activity which reduce the tax base of corporate taxation is the second. For these two channels, this study relied on the illicit capital flight flows estimates reported on Nigeria in Kar and Cartwright-Smith (2008). The study reports three different estimates, based on two well-established models, the World Bank Residual (RES) method, indicative of assets held abroad by residents, and the Trade Misinvoicing method (Gross Excluding Reversals or GER method using bilateral IMF Direction of Trade Statistics), suggestive of flight of capital by corporate organisations, to estimate the volume of illicit flows from African countries, including Nigeria. These two methods are to a great extent mutually exclusive, capturing different facets (private and corporations) of capital flight. In addition, the Kar and Cartwright-Smith (2009) report computed the real illicit capital flight as the sum of the above two estimates, deflated by 2004 prices (RCF). The methodological procedure followed in this paper involves the accumulation of these illicit capital flight flows into stock, subsequently used as the basis for estimating the investment return/yield opportunity loss to the economy, and the tax revenue loss to government. The accumulation of illicit capital flight into stock allows for the determination of the magnitude of the domestic resources deposited abroad, that would have been available for investment purpose in Nigeria. Based on conservative yields on investment within the Nigerian economy, we estimate the corresponding returns on such illicit capital flight the economy is losing. Apart from the loss to the economy in terms of returns on investment, the government

tax base is eroded. Applying the applicable company profit tax rate in the country, we compute the equivalent tax revenue out of the reach of government ambit.

15.3.1 Stock Accumulation of Illicit Capital Flight Estimates

The capital flight estimates from the preceding section are basically flows. Stock estimate is however required in the portfolio choice framework adopted in this study. The flow figures are accumulated into stock based on the methodology presented in Collier et al, (2004). The procedure is well enumerated in Lawanson (2007). The accumulated stock of illicit capital flight (ASCF) at time t is computed as:

$$ASCF_t = ASCF_{t-1}(1+r^f) + CF_t, \quad \dots\dots\dots(13)$$

Where CF_t and r^f are the capital flight estimates at time t and foreign rate of return. Though CF_t may take negative values for some years, $ASCF_t$ and $ASCF_{t-1}$ are not allowed to be negative.

All stocks of capital flight prior to the starting period of observation are treated as zero. The interest rate on treasury bills in United State is used for the foreign rate of return. Given the different estimates obtained from the two primary methods, the cumulated stock of illicit capital flight also differs. The cumulative stock series is presented in Table 15.2. As would be expected, the cumulative estimates progressively increased over the years. The incentives for private individuals to shift their assets to tax havens appeared not to exist until 1976, when the first set of this category of capital flight was recorded for the country, though traces of capital flight by international companies through trade misinvoicing has been recognised since 1970. Thus, while the RES method estimates was zero between 1970 and 1976, the GER method estimates starting with about US\$120.4million in 1970, increased to US\$2.9billion 1976. The real value grew from US\$2.2million in 1970 to US\$83.6million in 1976. By the turn of the decade of the 70s it has grown to between US\$2.97billion and US\$7.4billion in 1979 for RES and GER, respectively, while in real value the sum of the two estimates amounted to US\$3billion. By the end of the 1980s, the stock of illicit capital flight had built up to US\$40.5billion and US\$28.1billion and to US\$86.6billion and US\$53.4billion by 1999 for CED and GER, respectively. The stock of illicit capital abroad reached the mark of US\$463.2billion and US\$104.2billion in 2008 for RES and GER, respectively, while the real stock of illicit capital flight was US\$296.6billion.

Table 15.2: Accumulated Stock of Capital Flight Estimates (\$ Million)

YEAR	Real Illicit Financial Flows (CED)	Real Illicit Financial Flows (GER) US\$	Real Illicit Financial Flows (CED+GER) US\$ Million 2004	ASCF _T = ASCF _{T-1} (1+R ^F) + CF _T			
	US\$ Million	Million	Deflated	(1+R ^F)	ASCF (CED)	ASCF (GER)	ASCF (CED + GER) (2004 Deflated)
1970	0	120.4	2.2		0.0	120.4	2.2
1971	0	198.8	3.8	1.0434	0.0	324.4	6.1
1972	0	130.9	2.7	1.0407	0.0	468.5	9.0
1973	0	192.3	4.4	1.0703	0.0	679.9	13.8
1974	0	393.7	10.5	1.0787	0.0	1,101.3	24.9
1975	0	408.6	12.5	1.0582	0.0	1,554.7	38.4
1976	0	1,271.2	43.7	1.0499	0.0	2,889.2	83.6
1977	2,056.3	1,082.1	2,098.4	1.0527	2,056.3	4,088.9	2,185.5
1978	497.3	1,787.7	573.4	1.0722	2,702.1	6,043.0	2,847.8
1979	0	1,156.1	55.4	1.1004	2,973.4	7,445.0	3,019.1
1980	2,733.6	986.2	2,789.2	1.1162	6,052.5	8,734.2	5,931.2
1981	1,543.4	112.9	1,550.8	1.1408	8,448.0	9,202.6	7,723.4
1982	0	465.1	35.6	1.1073	9,354.5	10,042.3	8,073.3
1983	2,053.1	2,794.3	2,301.2	1.0862	12,214.0	13,245.3	10,703.1
1984	44	1,181.4	165.8	1.0939	13,404.9	14,965.8	11,304.5
1985	3,455.5	1,508.4	3,636.2	1.0749	17,864.4	17,083.3	15,400.8
1986	4,426.4	3325	4,872.8	1.0597	23,357.3	21,103.6	20,900.4
1987	7,307.5	996.2	7,460.8	1.0583	32,026.5	22,958.7	29,211.9
1988	1,187.5	873.7	1343	1.0667	35,350.2	24,766.8	31,743.8
1989	2,289.1	2,349.6	2,762.1	1.0812	40,509.7	28,124.4	35,797.9
1990	6,415.2	2,956.9	7,191.4	1.0751	49,967.2	32,226.0	44,446.3
1991	1,363.3	5,210.1	2,984.4	1.0541	54,033.7	38,747.7	49,239.6
1992	2,382.8	2.6	2,383.8	1.0346	58,286.1	40,327.3	53,627.5
1993	1671	8.2	1,674.5	1.0302	61,717.3	41,976.8	57,484.6
1994	1,861.1	0	1,861.1	1.0427	66,213.8	43,685.3	61,685.3
1995	0	17	10.8	1.0551	69,862.2	45,480.3	64,206.7
1996	0	7.7	5.3	1.0502	73,369.2	47,339.0	66,825.2
1997	0	3.7	2.7	1.0507	77,089.1	49,269.4	69,547.7
1998	0	21.6	16.9	1.0482	80,804.8	51,296.3	72,395.2
1999	1,994.3	20.9	2,011.5	1.0466	86,564.6	53,404.9	77,353.2
2000	6,335.8	0	6,335.8	1.0584	97,955.7	55,578.5	86,837.3
2001	2,846.5	2,915.9	5,463.5	1.0345	105,729.4	60,756.5	95,835.0
2002	5,135.4	0	5,135.4	1.0467	115,802.4	63,229.2	104,870.9
2003	9,750.6	0	9,750.6	1.0502	131,366.2	65,802.7	118,889.8
2004	12,333.2	2,657.5	14,990.8	1.0470	149,873.6	71,138.3	138,719.4
2005	15,162.7	3,373.3	18,662.7	1.0493	172,425.1	77,407.0	163,028.0
2006	28,597.5	4,165.6	23,217.4	1.0496	209,574.9	84,723.0	192,880.6
2007	43,638.0	5,392.3	34,620.2	1.0523	264,173.7	93,563.6	235,351.1
2008	185,821.0	6,810.4	51,694.6	1.0500	463,203.4	104,182.0	296,624.4
Aver.,					66,521.2	33,719.9	57,304.3

Sources: Computed by the author

15.3.2 Returns on Stock of Illicit Capital Abroad

Domestic capital formation plays a significant role in the growth of the economy. When domestic capital begins to leak out of the economy, the loss to the economy is usually not limited to the capital exports but also the yields from the resources expected to accrue to the economy. The rate of return to investment in an economy not only differs from economy to economy, but also different across sectors of the economy. Since capital flight may not be traceable to the sector from which it emanated in the originating country, the expected returns on such capital flight can be proxy by the average rate of returns to investment in the economy. Conservatively, the average rate of returns on investment in Nigeria is about 7.5 per cent. We present in Table 15.3 the associated returns on the illicit capital flight lost to the Nigeria economy. Given the increasing capital shifted abroad from Nigeria to tax havens, potential returns to GER and RCF progressively increased over the years. The loss to the economy in terms of returns on investment from private assets shifted abroad increased from US\$154.2million in 1977 to US\$454million in 1980, representing about 200 per cent increase. By 1990, the loss of return on private assets abroad to the Nigeria economy soared to US\$3.75billion, and to over US\$7.3billion in 2000. By 2008, the loss to the economy had risen to over US\$34.7billion. These estimates show that on the average, more than 7.5 per cent of GDP was lost to the economy through leakage of private assets to tax havens. When considered from the perspective of the concept of multiplier effect, the Nigerian economy is denied far more than this value in actual loss.

The flight of capital by international companies through trade misinvoicing also has a significant impact on the economy, as returns on investment equivalent to an average of about 3.8 per cent of GDP was annually lost to tax havens. Potential returns on investment to the Nigerian economy amounted to US\$9.03million were put out of reach of the economy in 1970, which increased to US\$655.1million in 1980. Two decades later, the loss in return on the capital flight by corporate organisation reached the mark of US\$7.17billion, being more than US\$7.8billion by 2008. In real value, the loss of potential returns due to the Nigeria economy from the sum of capital flight by individuals and corporate organisations amounted to about 16 per cent of GDP annually. While a minimal amount of less than US\$0.2million is lost in return on investment in 1970, it rose to US\$444.8million in 1980. By 2000, it was US\$6.5billion, and over US\$22.2billion in 2008. The implication of this

resource loss to the economy has a prominent negative impact on the growth of the economy. Despite the flow of FDI and external loans, the implication of investment returns loss to capital flight in tax havens is partly responsible for the inability of the economy to experience significant growth.

Table 15.3: Estimates of Returns on Investment and Tax Revenue Loss to the Nigeria Economy (\$ Million)

YEAR	Returns on Investment Loss			Tax Revenue Loss		
	(CED)	(GER)	RCF	(CED)	(GER)	RCF
1970	0.00	9.03	0.17	0.00	2.71	0.05
1971	0.00	24.33	0.46	0.00	7.30	0.14
1972	0.00	35.14	0.68	0.00	10.54	0.20
1973	0.00	50.99	1.04	0.00	15.30	0.31
1974	0.00	82.60	1.87	0.00	24.78	0.56
1975	0.00	116.60	2.88	0.00	34.98	0.86
1976	0.00	216.69	6.27	0.00	65.01	1.88
1977	154.22	306.66	163.91	46.27	92.00	49.17
1978	202.65	453.22	213.59	60.80	135.97	64.08
1979	223.00	558.38	226.43	66.90	167.51	67.93
1980	453.93	655.07	444.84	136.18	196.52	133.45
1981	633.60	690.20	579.25	190.08	207.06	173.78
1982	701.59	753.17	605.50	210.48	225.95	181.65
1983	916.05	993.40	802.73	274.82	298.02	240.82
1984	1,005.37	1,122.43	847.84	301.61	336.73	254.35
1985	1,339.83	1,281.25	1,155.06	401.95	384.38	346.52
1986	1,751.80	1,582.77	1,567.53	525.54	474.83	470.26
1987	2,401.99	1,721.90	2,190.89	720.60	516.57	657.27
1988	2,651.26	1,857.51	2,380.79	795.38	557.25	714.24
1989	3,038.23	2,109.33	2,684.84	911.47	632.80	805.45
1990	3,747.54	2,416.95	3,333.47	1,124.26	725.09	1,000.04
1991	4,052.53	2,906.08	3,692.97	1,215.76	871.82	1,107.89
1992	4,371.46	3,024.55	4,022.06	1,311.44	907.37	1,206.62
1993	4,628.80	3,148.26	4,311.35	1,388.64	944.48	1,293.41
1994	4,966.03	3,276.40	4,626.40	1,489.81	982.92	1,387.92
1995	5,239.66	3,411.02	4,815.50	1,571.90	1,023.31	1,444.65
1996	5,502.69	3,550.43	5,011.89	1,650.81	1,065.13	1,503.57
1997	5,781.68	3,695.21	5,216.08	1,734.50	1,108.56	1,564.82
1998	6,060.36	3,847.22	5,429.64	1,818.11	1,154.17	1,628.89
1999	6,492.34	4,005.37	5,801.49	1,947.70	1,201.61	1,740.45
2000	7,346.68	4,168.39	6,512.80	2,204.00	1,250.52	1,953.84
2001	7,929.70	4,556.73	7,187.63	2,378.91	1,367.02	2,156.29
2002	8,685.18	4,742.19	7,865.32	2,605.55	1,422.66	2,359.60
2003	9,852.47	4,935.20	8,916.73	2,955.74	1,480.56	2,675.02
2004	11,240.52	5,335.38	10,403.95	3,372.16	1,600.61	3,121.19
2005	12,931.88	5,805.52	12,227.10	3,879.56	1,741.66	3,668.13
2006	15,718.12	6,354.23	14,466.05	4,715.44	1,906.27	4,339.82
2007	19,813.03	7,017.27	17,651.33	5,943.91	2,105.18	5,295.40
2008	34,740.25	7,813.65	22,246.83	10,422.08	2,344.10	6,674.05

15.4. Estimates of Tax Revenue Loss on Capital Flight to Tax Haven

Based on a conservative tax rate of 30 per cent on company profits, we present in the last three columns of Table 3, the estimates of annual tax revenue loss to Nigerian government between 1970 and 2008. The loss of tax revenue on private assets held abroad amounted to an annual average of US\$1.5 billion, equivalent to 2.24 per cent of annual GDP. This has a significant effect on the development activities of Nigerian government. From a minimal loss of US\$46.3 million tax revenue to tax havens in 1977, it increased to more than half a billion US dollars in 1990. By 2000, the tax revenue loss has increased to over US\$2 billion, it reached a height of US\$10.4 billion in 2008. This is partly responsible for the running of budget deficit by the government, and the resultant external debt accumulation over the years. Similarly, the tax revenue loss associated with international companies' export of capital from Nigeria is substantial. Between 1970 and 2008, an average of US\$758.6 million tax revenue, constituting about 1.2 per cent of GDP was annually lost by the Nigerian government, as a result of illicit capital flight to tax havens. In the 1970s, an average estimate of US\$55.6 million tax revenue was lost per year, while it rose to annual average of US\$383 million tax revenue loss in the 1980s. Over the years, there has been a persistent increase in tax revenue leakages to Nigerian government due to flight of capital to tax havens. Roughly around a billion US dollar of tax revenue was annually lost in the 1990s, while it reached annual average of over US\$1.7 billion between 2000 and 2008.

In real value at 2004 prices, the Nigerian government appeared to have lost more tax revenue to capital flight activities of tax havens, as about US\$1.3 billion of tax revenue, equivalent to roughly 4.9 per cent of GDP is lost per year. This amount of tax revenue loss is far in excess of aids flow into the country through the activities of development operating in the country. It therefore shows that a reversal of capital flight incidence in Nigeria and most developing countries has the potential of stepping up their development trajectory.

15.5 Summary and Policy Implications

The paper attempts to address the consequence of capital flight to tax havens on the Nigeria economy and tax revenue losses to government on the development agenda of the country between 1970 and 2008. The paper applies the portfolio approach to flight of capital by generating

capital flight stock from Nigeria. Utilising a conservative investment return rate of 7.5 per cent, and 30 per cent tax rate, we estimated the magnitude of investment loss to the Nigerian economy and tax revenue loss to the Nigeria government due to activities of tax havens. Between 1970 and 2008, an average annual stock of capital of between US\$47.3billion and US\$73.4billion, equivalent to over seven per cent of GDP is taken away from the country.

The study shows that on the average more than 7.5 per cent of GDP is lost to the economy through leakage of private assets to tax havens. Far more than this value in actual loss is denied the Nigerian economy when considered from the perspective of the concept of multiplier leakages.

The flight of capital by international companies through trade misinvoicing was found to have a significant impact on the economy, as returns on investment equivalent to an average of about 3.8 per cent of GDP was annually lost to tax havens. The potential returns on investment to the Nigerian economy taken out of the reach of the economy rose steadily from US\$9.03million in 1970 to more than US\$7.8billion in 2008. In real value, the return on investment loss steadily rose from a minimal amount of less than US\$0.2million in 1970, to US\$22.2billion in 2008. The paper observed that the trend is partly responsible for the inability of the Nigerian economy to experience significant growth.

The paper estimated that from a minimal loss of US\$46.3million tax revenue to tax havens in 1977, there was an upsurge to over US\$10billion in 2008. This is partly responsible for the running of budget deficits by the government, and the resultant external debt accumulation over the years. The tax revenue loss associated with international companies' export of capital from Nigeria was substantial. Between 1970 and 2008, an average of US\$758.6million tax revenue, constituting about 1.2 per cent of GDP was annually lost by the Nigerian government, as a result of illicit capital flight to tax havens. Similarly in real value at 2004 prices, about US\$1.3billion of tax revenue, equivalent to roughly 4.9 per cent of GDP was lost per year by the Nigerian government due to capital flight activities of tax havens. The country experienced a tax revenue loss in excess of aids flow into the country through the activities of development partners operating in the country.

Endnotes

1. Attention has however been drawn to non-account for the existence of tax incentives that demand very low zero corporate taxes (Fuest and Riedel, 2009).

2. Democratic Republic of Congo, Gabon, Nigeria, Guinea, Mali and Botswana.

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