EXTERNAL DEBT ORIGIN, CAPITAL FLIGHT AND POVERTY REDUCTION IN THE FRANC ZONE: DOES THE ECONOMIC CONSEQUENCES OF SINO-AFRICAN RELATIONSHIP MATTER?

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Introduction

Review of Capital Flows, Investment and poverty reduction of Franc zone Countries

Difference between Chinese debt origin and Western debt origin: A conceptual framework

External debt origin-capital flight-poverty reduction nexus: The directly and indirectly statistic and econometric analyses

Result discussion and policy implication

Concluding Remarks

INTRODUCTION

Globally, more than 700 million people live below the extreme poverty line of $1.90 per day (in 2011 purchasing power parity),

More than half of the 700 million, live in sub-Saharan Africa (SSA),

Poverty rates have declined marginally since the 1990s SSAs.

The bottom line is that the income gap between SSA's countries and the rest of the world is still wide.

For SSA countries to address the issues of poverty alleviation, create jobs, build infrastructure and promote economic growth, the problem of financial resource gaps need to be addressed, and one avenue is through external financing.

The recourse to external resource mobilization in the early 1980s resulted into economic glitches continued into the 1990s as Africa crashed into financial crises.

INTRODUCTION…

First, was the debt crisis, most SSA countries could neither service their debts nor pay the principal due.

Forty-eight (48) countries of sub-Saharan Africa were spending approximately $13.5 billion every year repaying debts.

The debt size grew to four times their export income in the early 1990s; while the debt burden was twice that of any other region in the world.

SSAs GNP during this era stood at $308 per capita only, while its foreign debt was $365 per capita.

To address the debt crisis- debt swaps, debt restructuring, and rescheduling were designed, yet, governments of developing countries were unable to repay the debts, and financial rescue operations became necessary.

REVIEW OF CAPITAL FLOWS, INVESTMENT AND POVERTY REDUCTION

According to Asongu and Aminkeng (2013),"*a number of positive signs suggest that China is heading toward the direction which would provide openings for a multipolar dialogue. While benefiting in the short-run, African governments have the capacity to tailor this relationship and address some socio-economic matters arising that may negatively affect the nexus in the long-term*".

We can deduce that a development of Sino-African relation especially concerning the external debt origin could be useful in the fight against capital flight and poverty reduction

Specifically, we attempt to empirically debunk the following myths: "*inter alia, China targets aid to African states with abundant natural resources and bad governments, Chinese do not hire Africans to work on their projects, Chinese workers and managers live in extremely simple conditions as compared to Western advisors, China outbids other companies by flouting social and environmental standards and, low linkage levels between Chinese and local businesses*" (Freschi, 2010; De Grauwe et al., 2012).

DIFFERENCE BETWEEN CHINESE DEBT ORIGIN AND WESTERN DEBT ORIGIN: A CONCEPTUAL FRAMEWORK.

Practices governing Chinese aid and development finance clearly diverge from OECD (traditional aid) standards and norms on mainly the following aspect: transparency and definitions, management of concessional export credits and management of sovereign debt.

Regarding governance, both China and the traditional sources of development finance have rules that discourage corruption in the procurement of aid, but export credits are less well policed.

DIFFERENCE BETWEEN CHINESE DEBT ORIGIN AND WESTERN DEBT ORIGIN: A CONCEPTUAL FRAMEWORK.

As Qi Guoqiang (2007), we can suggest a typology for more clarification. Chinese assistance consists of grants, interest free loans and preferential rate loans:

- Grants: Mainly used to help recipient countries to implement small social projects, such as: hospitals, schools, low cost housing, provision of clean drinking water etc.

- Interest free loans: Not always reimbursed - Chinese authorities estimate that around 90% of these debts are cancelled.

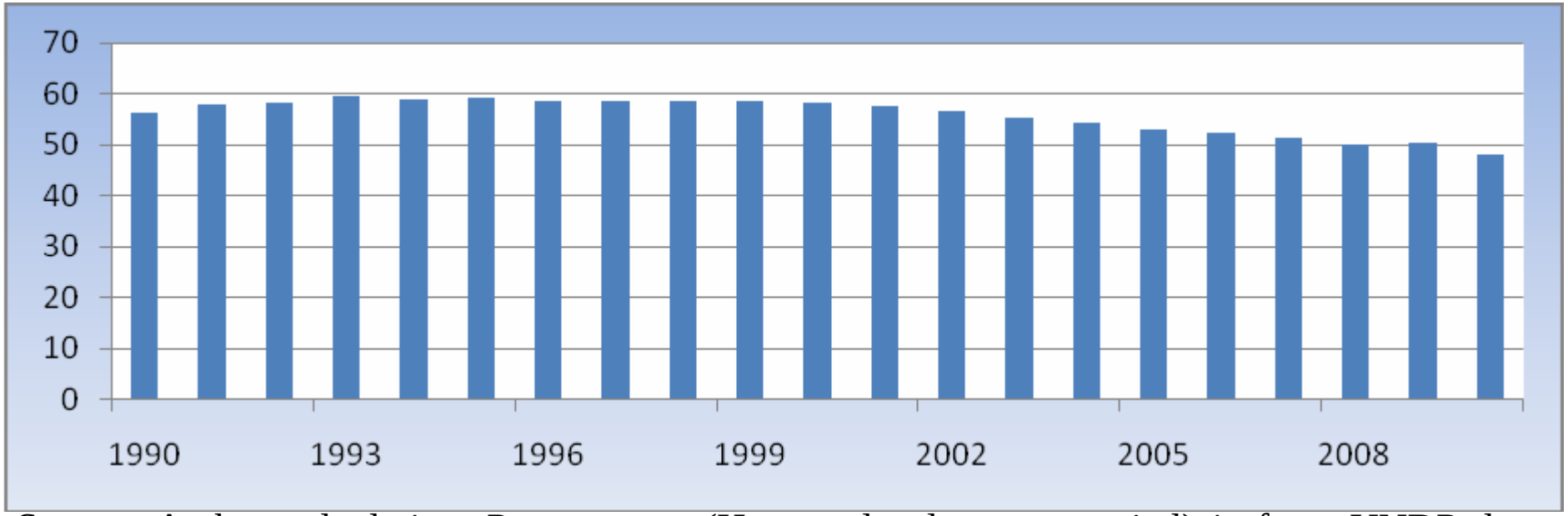
- Preferential rate loans for industrial and infrastructure projects. These are implemented by the Export-Import Bank of China (Exim Bank), which was established in 1995.

DIFFERENCE BETWEEN CHINESE DEBT ORIGIN AND WESTERN DEBT ORIGIN: A CONCEPTUAL FRAMEWORK.

Overall the difference between Chinese aid and traditional aid is clear: the traditional one is constraint by several exogenous conditions before and within the execution which tend to lengthen the procedure and exposure to economic issues such as funds distractions, corruption…etc. The Chinese aid is less conditional with a very fast and focused implementation characteristic; we assume that it can therefore been more suitable for African countries where democracy and good practises is not a reality in general.

EXTERNAL DEBT ORIGIN-CAPITAL FLIGHT-POVERTY REDUCTION NEXUS: THE DIRECTLY AND INDIRECTLY STATISTIC AND ECONOMETRIC ANALYSES

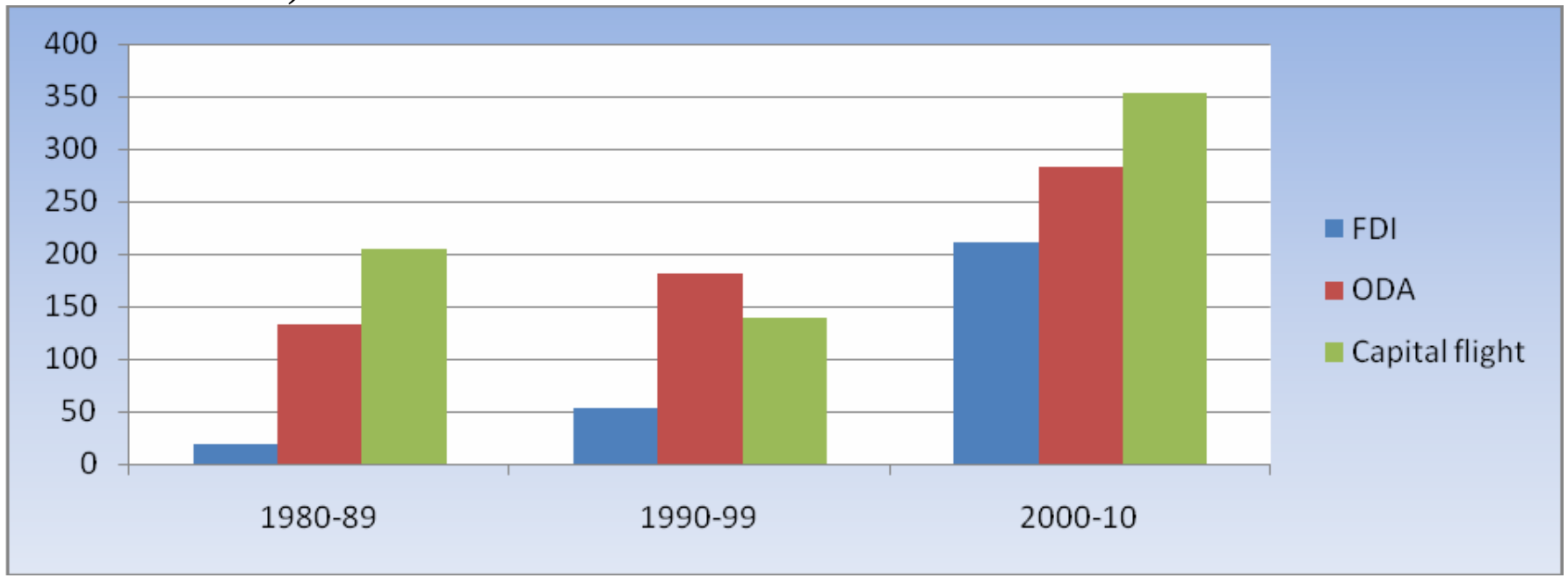
Figure 1: Evolution of poverty in French Zone African countries (1990-2010).



Source: Author calculation. Poverty rate (Human development capital) is from UNDP data base.

EXTERNAL DEBT ORIGIN-CAPITAL FLIGHT-POVERTY REDUCTION NEXUS: THE DIRECTLY AND INDIRECTLY STATISTIC AND ECONOMETRIC ANALYSES

Figure 2: Capital flight, FDI, and ODA in French Zone African countries (1980-2010; 10-year cumulative flows).



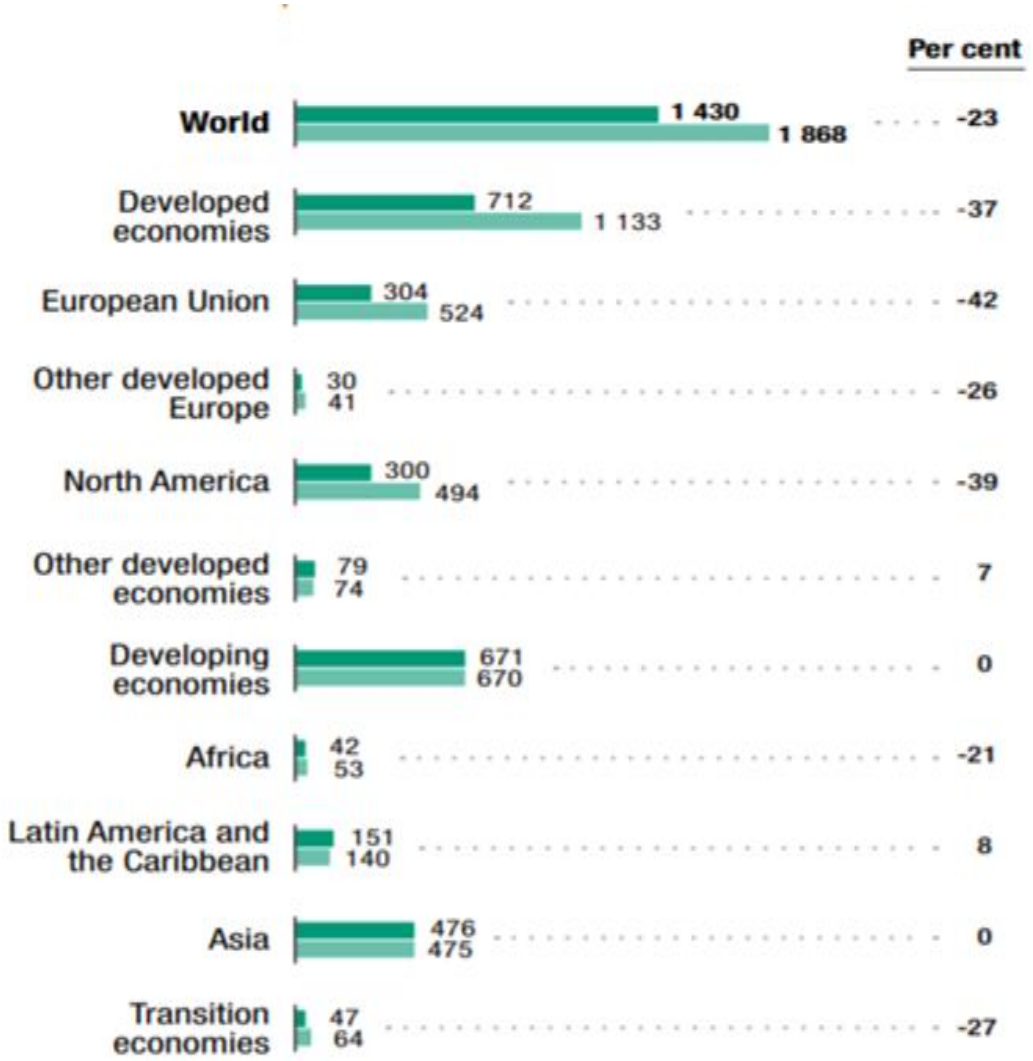
Source: Author calculation. Capital flight data are from Boyce and Ndikumana (2013) data base; FDI are from World Development Indicators and ODA are from OECD data base

FIGURE 3. FDI INFLOWS BY REGION, 2016 -2017 (BILLIONS OF DOLLARS AND PERCENT)

Why decline of FDI in developed economies did not flow to Africa?

One reason adduced to the relative sharp decline was partly the fall in commodity prices during the period, (World Investment Report, 2018: 3)

Decline in gross inflows to SSAs, may be because of illicit financial flows



REVIEW OF CAPITAL FLOWS, INVESTMENT AND ECONOMIC GROWTH OF ECOWAS COUNTRIES…

Region	2012	2013	2014	2015	2016	2017
World	**8.1**	**7.8**	**7.9**	**6.8**	**7.0**	**6.7**
Developed economies	**6.7**	**6.3**	**6.6**	**5.7**	**6.2**	**5.7**
Developing economies	**10.0**	**9.8**	**9.5**	**8.5**	**8.1**	**8.0**
Africa	12.3	12.4	10.6	7.1	5.4	6.3
Asia	10.5	10.8	10.6	9.9	9.5	9.1
East and South-East Asia	11.5	11.8	11.7	11.0	10.3	10.1
South Asia	7.2	6.7	6.1	5.5	6.4	5.7
West Asia	5.5	5.4	4.9	4.6	4.6	3.4
Latin America and the Caribbean	7.9	6.7	6.6	5.2	5.3	5.6
Transition economies	**14.4**	**13.9**	**14.6**	**10.2**	**11.1**	**11.8**

Source: UNCTAD based on data from IMF Balance of Payments database.
Note: Annual rates of return are measured as annual FDI income for year *t* divided by the average of the end-of-year FDI positions for years *t* and *t* – 1 at book values.

Table 5. Inward FDI Rates of Return, 2012-2017 (Per cent

METHODOLOGY, DATA AND ECONOMETRIC TEST:

Data and model

We examine a sample of 14 FZ countries data from Boyce & Ndikumana (2013), ICRG, African Development Indicators of the World Bank, OECD and UNDP data base.

The data-set spans from 1983-2013.

Appendix 1: Summary Statistics

	Variables	Observation
Dependent Variables	Poverty rate (HDI)	420
•		
Independent/dependent Variables	Capital flight (CAPF)	420
First-Stage Control Variables	Traditional external Debtstock (ODAL)	395
	Exchange term (TOT)	420
	Inflation rate (TXINF)	420
	Economic growth (TXPIB)	420
	Commercial openness (OUV)	420
	Financial openness (KAOPEN)	420
	Real exchange rate (TXCHA)	420
	Governance (CORRUP)	290
	Foreign direct investment (FDI)	420
Second-Stage Control Variables	Density (DENS)	405
	Employment rate (TXEM)	386
	Human capital (CAPHUM)	290
	Investment rate (TXINV)	420
	Urbanization rate (URBAN)	205

Source: Observation of data bases by the author.

METHODOLOGY, DATA AND ECONOMETRIC TEST:

Data and model

Appendix 2: List of the FZ Countries (by sub-regions).

Sub-region	Country name	Num.
CEMAC (Central African Economic and Monetary Community)	Cameroon; Chad; Gabon; Equatorial Guinea; Congo; Central African Republic.	06
WAEMU (West African Economic and Monetary Union)	Togo; Burkina Faso; Senegal; Ivory Coast; Guinea Bissau; Mali; Benin; Niger	08

Num.= Number of countries.

Source: Observation of data bases by the author.

METHODOLOGY, DATA AND ECONOMETRIC TEST:

Choice of methodology justification

The main conclusion of the previous sections on conceptual framework and literature review allows the following assumption:

Firstly, there is a direct link between capital flight and external debt origin in one hand and between capital flight and poverty in other hand; secondly, there is an indirect link between external debt origin and poverty through capital flight channel. The situation can been illustrate as follow:

Thirdly, there are some exogenous variables explaining capital flight and not explaining directly poverty such as real exchange rate, inflation rate, financial openness…etc.

METHODOLOGY, DATA AND ECONOMETRIC TEST:

Choice of methodology justification

Taking into consideration the above assumption and in line with Lalountas et al. (2011) we use Two-Stage Least Squares (TSLS) as estimation approach which more appropriate to this case.

Indeed as explained above, estimation with OLS technic may have a problem of endogeneity bias because the Capital flight variable is likely to be endogenous that is it is explained by other variables which cannot directly explain our problem variable.

Even by increasing the sample size, the OLS estimator will remains inconsistent. Therefore the use of instrumental variable to estimate our equations is justified.

First-stage regression:

$$ln(CAPF)_{i,t} = \alpha_0 + \alpha_1 ln(ODAL)_{i,t} + \alpha_2 ln(X)_{i,t} + \varepsilon \quad \text{..... (1)}$$

Second-stage regression:

$$ln(HDI)_{i,t} = \alpha_0 + \alpha_1 ln(CAPF)_{i,t} + \alpha_2 ln(X)_{i,t} + \mu \quad \text{..... (2)}$$

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RESULT 1 (FIRST STAGE):

EXTERNAL DEBT ORIGIN AND CAPITAL FLIGHT

(1) Traditional external debt stock have a significant at 1% and positive impact on poverty level and are not therefore good useful in a pro poor approach. .

(2) The exchange term has a significant and negative effect on capital flight. This is consistent with the theoretical point of view its degradation positively impact capital flight.

(3) Economic growth is positively related to capital flight;

(4) The other variables do not have a significant impact on the dependent variable.

RESULT 2 (SECOND-STAGE):

EXTERNAL DEBT ORIGIN, CAPITAL FLIGHT AND POVERTY

(1) Capital flight impact positively on poverty when instrumental external debt origin variables are linear.

(2) Control variables are not all significant. However we can notice the negative impact of investment rate and employment rate on one hand and positive impact of human capital and density on poverty rate.

CONCLUSION

Our analysis demonstrates that traditional external debt instrumented on capital flight impact positively on poverty in Africa. Chinese external debt is a tool for poverty reduction.

Based to the above conclusions and our previous result interpretation, we can recommend to African states irrespective of religion, to permit and/or develop Sino-African relationships in their countries; the government can for example implement a proactive external debt contract policy as an alternative in order to encourage the development of this specific initiative.

For African states without any initiative of contracting external debt from China until now, we recommend their governments to concretely contract external debt from China to encourage the private sector to follow them; for the others we recommend to the government to encourage, regulate and formalize this type of initiative.


Thank you
for listening