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## Capital Costs

Capital flight does not lend itself easily to accurate estimation, given the variety of means by which it takes place and the criticality of the assumptions made. Recent research by three American economists estimates that a minimum of \$4 billion capital left India for the US through wrong invoicing of exports and imports during 1994 and 1995. Though the study has been dismissed by finance minister P Chidambaram, it might be useful to examine what the authors have to say. Their case, in fact, is that the figure may be even as high as \$11 billion, depending upon the assumptions made. And that is the capital flow to just one country and in two years. If one were to consider the cumulative outflow and to all countries, the figure would be many times higher. In other words, the recent unofficial IMF estimate of \$100 billion of such offshore funds may not be too far off the mark. It is also possible that liberalisation has pushed up this flow in recent years, with import deregulation in particular opening up greater possibilities of import overinvoicing. And as MNCs expand their presence in the domestic market, there could be additional outflows through practices such as transfer pricing.

What all of these suggest is that, if the government were to take steps to contain the flight, large amounts of fresh hard currency resources would be available for investment in the domestic economy; such measures would also yield higher revenues to the exchequer. However, it would be simplistic to look at the matter as merely one of wielding the stick. The phenomenon of capital flight is not unique to India — many Latin American countries and even some South East Asian ones like Philippines have witnessed large volumes of such outflows — and is linked in many ways to the political and economic uncertainties that characterise these nations. It is important that the government sees its primary responsibility as one of ensuring stability in macro fundamentals, thereby minimising at least the incertitude associated with the economy. In India, the issue of capital flight is further complicated by the fact that, despite all the amendments to the Foreign Exchange Regulation Act in 1993, the Act as it stands still places hurdles in the way of many legitimate business practices. Some like the CII have called for a wholesale scrapping of the Act. This would be premature, considering that India still has controls over global movements of capital, controls which most regard even now as necessary. The need is really for some further simplification and amendments to the Act, which the present government has promised. The question finally is also one of whether political parties can muster the willingness to address the problem of capital flight, given that they are themselves beneficiaries of the prevailing set-up. The hardening of hawala rates in periods immediately preceding major elections is indicative of the reverse flow of funds placed abroad to fund political parties. This once again underlines the urgent need for electoral reforms to impart health to the political economy.