The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

# Capital Flight Calculation Open for Debate

By Irina Filatova

December 16, 2012



Kirill Dmitriev, CEO of the Russian Direct Investment Fund.

The real size of capital outflow last year was actually half as much as reported, and only reached about $40 billion, with the figure having no correlation to the investment climate, according to a survey released Monday.

Some components considered by the Central Bank, such as cash leaving the country, shouldn't be calculated as part of capital flight per se, since such transactions don't necessarily affect the country's economy negatively, according to the survey conducted by the Russian Direct Investment Fund, Ernst & Young and Moscow State University.

The methodology used by the Central Bank to measure capital flows inside and outside the country doesn't take "the economic essence of transactions" into account, so the resulting figure can include transactions that in fact shouldn't be considered capital outflow, the survey said.

Purchases of aircraft by Russian companies, which they use for domestic flights, are an example of such transactions. Since the planes are registered abroad, the deals — which could be considered direct investment by Russian companies — are recorded as capital leaving the country, said Kirill Dmitriev, chief executive of RDIF, the government's $10 billion investment vehicle.

The overall size of last year's capital outflow should also be adjusted to take into consideration the total value of mergers and acquisitions by Russian companies abroad. This should be seen as the country's expansion on international markets, rather than capital flight, he said at the presentation of the survey. The size of such transactions reached at least $10 billion last year, the survey said.

Other transactions that are positive for the country's economy but are formally considered capital outflow include paying off loans to foreign banks by domestic companies, as well as distributing dividends by Russia-based subsidiaries of foreign companies among foreign shareholders, according to the survey.

The country has bled money almost every year since at least 1994, when Russia saw a total of $14.4 billion in net capital outflow, according to statistics available on the Central Bank's website.

Russia recorded inflows only in 2006 and 2007, of $41.4 billion and $81.7 billion respectively, before a record of $134 billion left the country in the 2008.

Concerns over the size of capital outflow have intensified over the last few years amid government efforts to make the business climate more favorable for investors.

President Vladimir Putin called for a drastic improvement of Russia's position in the global ranking of the most attractive countries for doing business compiled by the World Bank. He set the goal for Russia to reach 20th place by 2018, up from 120th last year.

Analysts have differing opinions on the nature of capital outflow from the country, with a negative investment climate and money laundering cited among the possible factors affecting the total figure.

The authors of Monday's survey argued that the dynamics of capital outflow from Russia over the past years result from changes in the global macroeconomic situation rather than any internal factors, like the level of corruption or the business environment.

More money left the country during periods when the global economy was experiencing a crisis, like in 2008 and 2011, said Alexander Ivlev, Ernst & Young's managing partner for Russia.

According to Central Bank's statistics, almost $81 billion left the country last year.

The survey also indicated that the funds, which settle in offshore zones, are being repatriated to Russia later.

Putin pushed for a greater transparency of the country's transactions by "deoffshorization" of Russia's economy in his state of the nation address last week.

The figure put together by the Central Bank comprises any changes in the balance of payment's financial account related to transactions by Russia's private sector, as well the item called net errors and omissions that reflects discrepancies in the country's balance of payments.

This methodology reflects the reality in a very common way, as the components measured as capital outflow include both capital flight — capital withdrawal by entities and individuals as a result of unfavorable market conditions — and strategic acquisition of foreign assets by Russian companies, which are positive for the economy, said Yaroslav Lissovolik, chief economist at Deutsche Bank in Russia.

For a transaction to be recorded as capital outflow, money doesn't have to leave the country physically, he said in an interview. One example of this type of transaction is when Russian residents buy convertible currency using rubles, as a result of market volatility.

RDIF is pushing for using an alternative method of recording capital flows, with the World Bank's private capital flows indicator being a possible option.

The World Bank's statistics includes the size of direct and portfolio investments across all economic sectors and thus could be a more appropriate indicator for investors, Dmitriev said.

According to the World Bank's figures about $32 billion left the country last year.

Dmitriev said the Central Bank "supported the main highlights" of the survey, including the thesis that the officially reported figure can't be considered capital flight. He added there's hope that the bank will clarify that in the future, although it's unlikely to change the existing methodology.

"We're not trying to argue with Central Bank, as they calculate their figure properly," Dmitriev said.

The Central Bank said in e-mailed comments that any inaccuracies in its calculations, "are reduced to the minimum" thanks to the net errors and omissions item.

Government officials, who participated in the presentation, praised the effort to break down the capital outflow figure into its components, saying that it allows them to understand the structure of capital flows from the country to fight the problem of capital flight more effectively.

The lack of understanding of the components contributing to the figures recorded by Central Bank might result in the government "turning off oxygen to Russian companies entering the international market," Deputy Economic Development Minister Sergei Belyakov said.

But he pointed out that the results of the survey showing a smaller figure than the Central Bank's can't be considered an indication that Russia has no investment climate problems.

Large-scale capital outflow, which is developing "a chronic nature," poses a threat to the investment growth in the country that the government is trying to ensure, Lissovolik said. "When the outflow is seen as a permanent factor, this affects the country's potential to attain economic growth, as well as its image."

This results in Russia's efforts to improve the investment climate being viewed negatively by financial markets, he added.

Net capital outflow reached $61 billion for the period January to October, mainly as a result of the negative economic situation in euro-zone countries and Russia's unfavorable investment climate, Central Bank chairman Sergei Ignatyev said last month.

Lissovolik said one of the main reasons behind the outflow is volatility on the global markets. Russia remains especially sensitive to that kind of fluctuations as a result of its dependence on oil prices, he said.

The other factor, which might have caused money to leave the country is that, despite investors' expectations, Putin's return to the Kremlin wasn't followed by a new stage of decisive economic reforms, as in 2000 when he first took office as a president.

"Expectations have been very high this year ... A certain disappointment we've seen this year was likely to become an additional impetus for the outflow," Lissovolik said.

The Central Bank expects that net capital outflow is unlikely to exceed $67 billion this year before slowing down to $10 billion to $15 billion in 2013, Ulyukayev said last week.

However, the Economic Development Ministry is less optimistic. It expects the figure to reach up to $75 billion, Deputy Economic Development Minster Andrei Klepach told reporters earlier this month.

The contribution by individuals to the total capital outflow figure has been steadily growing over the last five years, Alfa Bank said in a research note last week. Individuals contributed 30 percent of the net capital outflow of $54 billion over the first nine months of this year, up from 10 percent and 20 percent in 2010 and 2011, respectively, the note said.

The two main channels for Russian residents to withdraw capital are buying property abroad and depositing money on foreign bank account, with a total of $13 billion leaving the country that way last year, according to the note.

In his state-of-the-nation address, Putin called for restrictions on the Kremlin and government officials' ability to open foreign bank accounts and buy foreign equities.

The contribution by individuals in net capital outflow was less significant before the economic crisis of 2008, with capital flows being rather of an "institutional nature," Alfa-Bank said. "This trend indicates that capital outflow will be hard to moderate."

The bank forecasts that net capital outflow will reach about $50 billion next year. Lissovolik said Deutsche Bank expects the figure to reach $20 billion next year.

**Related articles**:

- The Crusade Against Inflation, Tax-law Style
- Capital Flight Estimated at $70Bln by Year-End
- Economist Guriev Sees Risk of Instability

Original url:
https://www.themoscowtimes.com/2012/12/16/capital-flight-calculation-open-for-debate-a20258