

THE U.S. DRUG CULTURE AND CAPITAL FLIGHT

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I. Introduction

One of the United States' major imports is drugs -- illegal drugs -- for which we pay cash -- large amounts of cash. This exchange is not without economic and social aspects. This paper focuses on one of these aspects. For us to maintain such large cash outflows, we must somehow be offsetting them with inflows. A look at the inflows reveals also a large unregulated inflow -- capital flight.

The capital flight phenomenon is so large as to more than offset the drug-payment outflows. Is this large-scale, international offsetting fortuitous? This paper argues not; the two are sociologically linked -- a linkage that has been overlooked, a linkage which necessarily finds its roots both in the United States and abroad.

Not proposing to explore and prove every aspect of capital flight as it relates to the drug culture, this paper concentrates on the sociological aspects -- that is, the less-quantifiable aspects. This approach is in contrast to the existing literature, which is limited to identifying the highly measurable, profit-maximizing motives of capital holders.

Capital flight cannot be understood outside of the broader sociological setting of the juxtaposition of two vastly different

economies. The acute juxtaposition of poor countries with fast-paced, developed countries causes investment infrastructure to be oriented towards investment in the developed world and causes capital holders to psychologically focus on the developed world. The implications of this juxtaposition are that both the root causes and the effects of capital flight are much broader than realized so that such a pervasive problem can only be offset by concerted measures orchestrated on several fronts. Significantly, even such a seemingly tangentially related phenomenon as the growing U.S. drug culture is tightly intertwined with capital flight.

II. Capital Flight

A. Brief Description

Very generally, capital flight is the tendency for liquid assets in lesser developed country (LDC) economies to flow to fast-paced, developed economies. Although capital flight literature is in an early stage, virtually all the literature agrees that an enormous amount of capital flows into the developed world from LDCs. (for example, Lessard and Williamson 1987; Maddison 1970: 228)¹ That the problem is serious is accepted despite large gaps both in measuring its size and in describing its cause. Measurements vary widely, are largely irreconcilable, and inaccurate. (Anthony and Hallett 1992) What the literature has identified is a continual flow

of money that surges greatly during political or economic troubles of a particular country. (Lessard and Williamson 1987: 97) For example, from 1976 to 1981, Argentina, Venezuela, and Mexico experienced massive bouts of capital flight while undergoing economic problems. (Lessard and Williamson 1987: 38-43)² Normally these countries always experience a lesser amount of capital flight.

Identifying the immediate cause of capital flight seems more settled than establishing its exact size. The root cause centers around LDCs expropriating domestically held capital, largely through taxation; the holders of domestic capital effectively avoid expropriations by transfer to the developed world. (Tornell and Velasco 1992) (Pastor 1990: 7) LDCs rarely tax foreign income of their citizens. Thus, these capital holders find great financial rewards in moving capital abroad. Significantly, the expropriations avoided are often indirect as well, the expropriations which result from inflation and exchange rate fluctuations. The perspective of this paper is to assume the literature's description of the size of capital flight and the profit maximizing motives driving it. Then this paper builds on the literature by explaining both why capital is transferred with such ease and why capital holders are so quick to use this capital flight

means of maximizing profits.

B. The Cause -- Juxtaposition

1. What is

This paper traces the modern tide of capital flight to one common source or cause -- the vast difference in vitality between two juxtaposed economies. The difference between LDCs and fast-paced, developed economies is far greater now than ever before in history. (Brenner 1966: 161 (quoting Simon Kuznets)) Not only is the difference greater, but also the juxtaposition is acute because of the nature of the modern world economy.

Economies of the world are now closely linked, the transportation of goods in world trade is highly developed. World travel is highly developed. Communication, also. But most importantly, international capital markets are highly developed. The effect of this acute juxtaposition of two vastly different worlds is first psychological and then financial. It is human nature that everyone's eyes and thoughts are drawn to the success stories, the fast-paced, developed economies, so that a psychological effect is had. From this psychological effect, the financial effect flows. People put both their confidence and their money in that which they admire -- fast-paced, developed economies.

2. Psychol

The most obvious effect of such an acute juxtaposition is psychological. The excitement especially present around financial centers and high-tech development projects of fast-paced, developed economies at times seems almost tangible. Corporations are growing rapidly, developing new products, conquering new territories, expanding market share, and acquiring rivals or other businesses. Morale is high. The future seems limitless. Science fiction writers are spoken of as prophets rather than as story tellers.

In the modern world, this enthusiasm is not lost on the population of poorer economies. Radio, and sometimes television, reach almost everyone. They know of the success of the developed world. The U.S. entertainment industry no doubt greatly enhances the successful image of the developed world. But more importantly, those in leadership roles always know of this image. Many have studied or traveled in the developed world and speak its languages.

This focus of attention on fast-paced, developed economies has effects on LDC economies. These effects are real. Corresponding to the enthusiasm for undertakings in a fast-paced, developed economy is a lack of enthusiasm for any undertaking in a LDC economy. Sometimes just the perception that an economy or

industry is weak can be devastating. Certainly, prestige is a real thing. Talented workers do opt for one firm over another, one location over another simply because of prestige.

One common U.S. phenomenon brings an interesting insight to these psychological effects. In the United States, exist areas that do not much participate in neither the prosperity nor the enthusiasm of a fast-paced, developed economy. However, because of geographic location, the juxtaposition is even more acute than with foreign LDC economies. The apparent hopelessness of these areas as seen through high crime, violence, and drug abuse rates is disproportional to the degree of poverty that exists. Not to trivialize U.S. poverty, but in objective measurements the poverty of foreign countries is often greater. Yet the poor of these foreign regions do not seem quite as frustrated as in the United States. To a large extent, the depths of this frustration results from the acute juxtaposition to a prosperous economy and the resultant psychological effects. However, this frustration is also caused by other reasons, cultural reasons and the indignant nature of U.S. unemployment.

3. Capital

The above observations concerning the psychological effects of the juxtaposition may strike one as containing much truth, but such

effects do not explain the existence of large capital flows.

However, these psychological effects set in the world economic structure, as it now exists, produce another effect, very real and often measurable. This other effect is called capital flight.

Capital flight comes about in the following way. As is well known, income and wealth distribution in LDC economies is quite skewed. Those in the favored position are also those most familiar with fast-paced, developed economies. Not only are they under the spell of fast-paced enthusiasm, but also they are familiar with investments in the developed world. Substantial portions of their liquid assets are already held in U.S. dollars or other major currencies.³ Besides, the nature of LDC tax systems and custom encourage investment in fast-paced, developed economies.

(Walter 1990: 18, 185-186) An extensive international finance system is in place making private investment in the developed world both safe and efficient. (Walter 1990: 24-5, 28-9, 56, 186-7)

Telephones allow investors to keep in touch and monitor U.S. investment with ease. Through television and the print media, an investor can keep abreast of happenings in the developed world.

Therefore, considering the sociological setting in which LDC capital holders find themselves -- a psychological mind-set of fascination with the developed world and an investing

infrastructure pointing towards the developed world -- how surprising can capital flight really be? How dependent is the phenomenon on the narrow welfare maximization analysis? If the expropriation threat were curtailed, would not capital tend to flow out of LDCs for the sociological reasons alone?

C. The Effects of Capital Flight

That capital flight is caused to a great degree by sociological reasons is also seen in the effects capital flight has on LDC economies. Obviously, capital accumulation is directly and profoundly affected by capital flight. A well-known economist has summed up the effect: "Simon Kuznets emphasizes major differences [exist] between underdeveloped countries today and the now advanced countries when they began their industrialization: the inequality in the distribution of income is wider today than in the past, but not in a way that favors accumulation of productive capital" (Higgins 1968: 192. Higgins himself comes to a similar conclusion. 505-6) The effect on slow-pattern economies is devastating. This conclusion is generally consistent with that reached by the majority of economists. W. Arthur Lewis, who reached the opposite conclusion, stated:

Our study originates from interest in the proposition

that the upward movement of those already on the escalator [, fast-paced, developed economies,] helps to pull more and more countries into the moving company. This proposition is not obvious, and its opposite -- that it is the enrichment of the rich that impoverishes the poor -- is perhaps even more widely held in one form or another.

(Lewis 1978: 16) Others have noted the above described effects also although they have not always attributed them to capital flight. For example, one book describes "special problem areas" resulting from "centripetal forces that favor growth of the heartland [, fast-paced, developed economies,] at the expense of the hinterland [, LDC economies]." (Berry, Conkling, and Ray 1987: 408 (emphasis added))

Two main effects are had on capital accumulation, thus impeding important mechanisms of capital accumulation. First, capital invested abroad is not available for local investment. (Walter 1990: 62-3) Not only is the capital itself not available, but also the credit it could produce through the money multiplier effect is not available. In banking, the amount of money deposited in all banks is multiplied by the money multiplier to obtain the amount of money banks have available. If bank reserve requirements are

twenty percent, generally the case, then the money multiplier is five. Therefore, the money removed from an economy shrinks the money supply by five times the original amount. So banking systems are severely crippled by capital flight.⁴ In addition, the money supply becomes unstable. "This instability is, as a matter of fact, much higher than that which is usually observed in the developed countries and would in itself make of monetary programming an enterprise highly difficult to realize with any degree of accuracy over time." (Ground 1984: 45, 77)

Second, capital flight harms capital accumulation by harming the exchange rate mechanisms of the LDC economies. The harm comes about in the following way. In the rush to invest liquid capital abroad, capital accumulated in both the local currency and foreign currencies, usually the U.S. Dollar, must be sent abroad. That accumulated in the local currency must first be converted into the currency of the fast-paced, developed country. The large number of those seeking to invest abroad in this manner places downward pressure on the local currency. Confidence in the local economy is diminished all the more. The desire to invest abroad becomes so great that investors willingly pay a premium to do so: they sell their local currency holdings at even greater discounts. The large size of the discount is evidence of how high they esteem

investment in the developed world. As the local currency falls, imports become more expensive causing inflation that, in turn, places even more downward pressure on the local currency. Inflation further erodes confidence in the local economy.

Two readily observable trends in LDC economies are consistent with the above described effect of capital flight. Firstly, since the local currency has been discounted so much, the preference is to conduct business in U.S. dollars so that dollars often circulate widely in slow-pattern economies. Secondly, the loss in confidence in local currencies is so great that the change in the exchange rate usually far surpasses the inflation rate. (for a review of these statistics, see The World Bank 1992; International Monetary Fund 1992) Those able to invest abroad, those most captivated by the spell of the developed world, necessarily have less confidence in the local economy than those who have no choice but to operate only in the local economy.

Besides harming capital accumulation, capital flight harms the other key elements of economic growth, political stability and technological advancements. The great harm capital flight does to capital accumulation has its effect on confidence -- confidence in political and business leaders, in the nation, in individual undertakings, and in oneself. Political turmoil often erupts in what

may have been a stable political environment. Even the most well prepared and intentioned leader is left helpless. The technological advances at hand are impossible to implement in the face of such great economic and political turmoil.

Of course, other factors beside capital flight contribute to the stagnation of LDC economies. "Appropriate technology" for manufacturing must develop. (Schumacher 1973) For example, the extraction of petroleum from many third world countries does not benefit the local economy much since employment is minimal, skilled personnel are brought in from other countries, and the employment is usually located in sparsely populated areas. (Bairoch 1975: 59-60) Another example is the tendency of the capital holders in the third world to "sterilize [the capital] by hoarding, luxury consumption or low productivity investment outlays." Such use does not contribute to growth. (Rostow 1971: 49) But such factors do contribute to the sociological background of capital flight.

D. What about the Success Stories?

The next logical step in the analysis of this paper remains. Why did not such a formidable obstacle to capital growth as juxtaposition and the resulting capital flight prevent all economies from breaking into the fast-paced, developed pattern? Why has

Japan done so? And later South Korea, Taiwan, and Singapore, etc.? The answer to these questions strongly supports the thesis of this paper since the success of all these economies is quite consistent with the thesis.

The answer is that the reasons for capital flight, especially the sociological reasons, were largely absent. We know quite a bit about the Japanese economy, so let us concentrate on it. Its success is so great and began so early that much has been written about it. Japan accumulated much capital during its transition to a fast-paced, developed economy. Unlike many other success stories, such as Australia, where the source of capital accumulation was from abroad, Japan's source was from within. (Minami 1986: 201) Why did not the small, initial, tentative Japanese capital accumulation flee abroad? The juxtaposition present now did not exist. Two facts explain the juxtaposition's absence. First, Japan had isolated itself from the rest of the world especially from the West. It had little contact with the West and had never been a colony of the West. So it was not linked to an international banking network, nor did its wealth holders possess western business contacts or even much knowledge of the West.⁵ Second, the gap between Japan in its LDC days, roughly before 1920, and the then existing fast-paced, developed economies was not near as

great as such gaps are now. (Minami 1986: 423-4) So the pull on capital was not so strong. Its political stability is well documented. In more recent times, it began with the Meijing Era in 1868 and continued to the present. In addition, economists have found that Japan implemented at first small technological advances in the silk industry and agriculture and eventually built up to the large industrial advances of recent decades. (Minami 1986; Higgins 1968: 622-5) Finally, it possessed other characteristics that the development literature considers important to success such as a stable population, relatively dense in regions.

On the other hand, South Korea has not the history of political stability and isolation from its neighbors. However, during the Korean war its people and political system pulled together to meet the outside threat. Thus, it quickly obtained political stability. But most importantly it was at center stage of world affairs. During the height of the cold war, its competition with North Korea became a sort of competition between champions of two political systems. The free world, especially the United States, acted as a sort of mentor for the Korean economy. Much foreign capital flowed into South Korea,⁶ and the war-time government was able to keep tight control of the economy including the control of capital outflows. So the capital accumulation characteristic was to a large part thrust

upon it. Technological advances were quickly implemented under these conditions. The population characteristics were present as well. The bulk of the population is densely located in one small region. Taiwan's is a similar story.

Although having many of the elements of the above success stories, the success of several other small Asian countries is attributable to a different circumstance. Such nations, Singapore and Hong Kong for example, have made themselves tax and banking havens. As havens, they have achieved a certain amount of capital accumulation. In the area of finance, they have far reaching bank secrecy laws. So they benefit from the capital flight phenomenon. Much of the money fleeing LDC economies, evading taxes, or being laundered, flows through their banks on its way to the West. (Walter 1990: 28, 156-7, 186-8) A certain amount of this money stays in the haven countries, at least enough to be the basis of entry into the fast-paced, developed world.

Can their success be emulated? No, since their success can only be achieved by a few; by definition, not everyone can be a haven. Even the success of Japan cannot be emulated under present world conditions, however. Japan's method of isolating itself is incompatible with the extensive international trade and communications network of the present world. The economic

difficulties of Cuba over the last thirty years is one story of how difficult it is for even the most determined government to control unilaterally capital flight through regulation and force. The recent collapse of many successful Asian financial markets and simultaneous strength of U.S. markets is further evidence of the power of the capital flight phenomenon. In retrospect, with the collapse of the Soviet Union, the West has perhaps less incentive to mentor these outposts of the free market.

E. The Linkage With The Drug Culture

The intertwining of capital flight with the drug culture begins abroad. Capital flight predates the drug culture so that to secretly invest profits in the developed world is to be expected; if taxes can be evaded through capital flight, all the more can confiscation of drug proceeds be evaded. And the juxtaposition pressures also driving capital flight apply just as much to drug money as to other types of capital. Therefore, as a general proposition, a prosperous drug export industry will not lead to development no matter how profitable. The export of drugs will not lead to development any more than does the export of other basic commodities where capital flight is also present. Even more so with drugs, since political instability is bound to accompany such an industry. On the other hand, the sheer size of drug profits or some other factors

may temper or except this general proposition in a particular case.

Effects of this vast inflow of easy capital-flight cash are bound to be had in the United States. Do any of these effects pertain to the U.S. drug culture? Certainly, but these effects are not so much perceived by a narrow quantitative analysis. Once again, the leitmotif of this paper -- to understand capital flight means to go beyond the narrowness of measurable, countable factors and look at broader sociological factors. To begin, the easy economic prosperity brought about by this huge influx of cash is bound to create a false confidence. Political and business leaders will falsely think their performance is adequate, that they are in control. Such unearned confidence and complacency is detrimental to personal development. Nothing is obtained without a struggle. The poorly developed personalities will turn to escapes -- such as drugs.

Similarly, human experiences teaches of man's need to be occupied, to perform work, to be creative. The disappearance of U.S. manufacturing, the centering of the U.S. economy around finance, and the accompanying alienation of so much of the population leave this need unfulfilled -- but the loss to be deadened by drugs. This refocusing of our economy on the financial (a refocusing caused by many factors not just capital flight) refocuses

man's outlook away from the merits of constructive, creative work and onto the hope of making a one time "killing" whether from a lottery, a stock tip, or law suit. Thus, we create a culture of instant gratification. Drug use fits in well to such a culture.

III. Conclusion

A reading of development literature points to the almost universally held view that capital accumulation is a necessity to development. Especially in recent years, the literature has defined the capital flight danger to capital accumulation. With this background as premise, this paper asks whether sociological conditions play a role in capital flight in recent times. Not disputing the welfare-maximizing, mathematically based models which explain the actions of LDC capital holders, the sociological considerations place such models in context. By looking beyond measurable factors, we soon see that even such a seemingly unrelated phenomenon as the U.S. drug culture is closely tied to the capital flight phenomenon.

The sociological considerations explain why legal controls aimed at capital flight are not that effective. The financial practices of LDC capital holders are not to be altered by using prohibitions to narrow their financial choices. Especially since the psychological attractiveness of investing in the developed world

pushes capital holders to circumvent prohibitions.

This argument that sociological considerations explain much capital flight is bolstered by a brief look at economies which increased their income and so "succeeded." The capital holders of such successful economies always had the same narrow welfare-maximizing incentives to invest abroad to a certain degree. However, they did not exist in the same sociological setting. That is, they did not always have access to the mechanisms of foreign investment; nor were they always under the mesmerizing influence of the developed world.

All this indicates that unilateral attempts to stop capital flight will meet with little success, a conclusion not necessarily reached by looking only at the narrow profit-maximizing motives behind the capital flight phenomenon.

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ENDNOTES

- 1 . Even before the modern international finance network existed, capital flight existed but took place through political mechanisms of colonialism. (Maddison 1970: 223-4)

- 2 . Bouts of capital flight have also been discerned in Central America: in Costa Rica, El Salvador, and Guatemala from 1978 - 81; in Honduras from 1979 - 82; and in Nicaragua from 1977 - 80. (Bulmer-Thomas 1987: 237-8)

- 3 . "The U.S. dollar appears to be the predominantly vehicle currency, and federal reserve data and the size of reported interbank international currency transactions indicate that a significant proportion of U.S. currency in circulation is actually held outside the United States." (Lessard and Williamson 1987: 111-2)

- 4 . No statistical correlation seems to exist between the amount of capital flight the size of a nation's money supply, money multiplier, or related concept of income velocity of money. This lack of correlation can be explained in several ways outside the scope of this paper.

- 5 . Economic statistics from the time show no evidence of capital flight. They do show, however, that Japan had accumulated enough capital even early on to invest in its own colonies. (Minami 1986: 201)

- 6 . Evidence of the control of capital flight can be seen in the strength of the South Korean exchange rate especially after 1964. International Monetary Fund (1979) 262-3. Most notable, however, are the U.S. government investments in Korea.