Capital flight from highly indebted countries has drawn considerable attention as a factor behind the 1980s debt crisis. Perhaps the best example of the importance policymakers place on policies to stop and reverse capital flight was in the Brady Plan announcement by Treasury Secretary Brady in March 1989: “First and foremost, debtor nations must focus particular attention on the adoption of policies that can better encourage new investment flows, strengthen domestic savings, and promote the return of capital flight.”

Since 1989, capital flight has indeed begun to flow back to those countries that have taken forceful macroeconomic and structural adjustments. One indicator of the repatriation of capital flight is the recent drawdown in private nonbank claims on U.S. banks. Total private nonbank claims of the six largest Latin American countries increased from $7 billion dollars at the beginning of 1980 to a peak of $38 billion by the end of the first quarter of 1990, and have been steadily declining since then (Chart 1). As of the end of September 1992 they had declined by $10 billion to $28 billion. During this same time period private nonbank claims of all foreign countries, excluding these six countries, increased slightly from $59.8 billion in March 1990 to $60.7 billion in March 1992.

*Paper presented by Susan Charrette, International Finance Department, Federal Reserve Bank of New York, at the XXIXth meeting of Technicians of Central Banks of the American Continent, St. Lawrence Gap, Barbados, November 16-20, 1992.*
CHART 1. PRIVATE CLAIMS ON FOREIGN BANKS, 1978-1992

$ Billions

A. Latin America

B. Argentina
$ Billions

IMF

US

C. Mexico


$ Billions

IMF

US

D. Venezuela


Notes: a IMF data includes bank deposits only, while the U.S. data also includes
c Claims by the six largest Latin American countries.
Despite the importance placed on capital flight, econometric work on the determinants of capital flight has been very limited. Most studies have estimated capital flight using residual variables, which may be very imprecise, and have also suffered from relying on very few observations since the measure of capital flight used was only available on an annual basis. The latter factor severely limits the types of statistical analysis that can be employed. This problem has recently been addressed through the use of cross-section data or panel studies that look at the experiences of a group of countries over a period of time.\(^1\) The small sample size for each country, however, has made it impossible to test whether or not the capital flight experience of any country is unique.

This article investigates the causes of capital flight from the three Latin American countries that recently experienced the greatest outflows of capital: Argentina, Mexico, and Venezuela. The method used to measure capital flight is based on the cross-border deposits and U.S. Treasury bill holdings of Latin American private residents in U.S. banks. Until now, this measure has not been employed in the empirical literature on capital flight. The data are available on a quarterly basis, which increases the number of observations on each country.

The results of this study indicate that the two determinants that had a significant role in promoting capital flight from all three countries were the absence of capital controls and high U.S. interest rates. In the case of Argentina and Venezuela, expectations of a depreciation of the domestic currency were also found to have a significant direct role. For Mexico, the domestic inflation rate and the growth rate of GDP were found to be important determinants.

The first section of this article addresses the conceptual issues of capital flight. The next section surveys the methodologies used to estimate capital flight. The third section focuses on the causes of capital flight. A final section contains conclusions of the study.

**CONCEPTUAL ISSUES**

The concept of capital flight implies a difference between the individual

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\(^1\) See, for example, Darryl McLeod and Parantap Basu, "What Causes ‘Capital Flight’ from Developing Countries: Some Cross Section Evidence," Fordham University Memorandum, January 1991 and Lisa Schineller, "Is Capital Flight from Developing Countries Subject to Hysteresis: An Econometric Test," Yale University Memorandum, November 1991.
and social returns of private capital outflows. On the one hand, capital flight is the result of individual investors' rational responses to different risky investment opportunities and, therefore, is merely another term for portfolio diversification. This characterization does not carry any clear negative connotations. On the other hand, when social returns to capital exceed private returns, say, because private perceptions of risk are unusually high, capital flight, by depleting potential investment capital, can reduce the national welfare of a country. In this section these two aspects of capital flight will be examined and reconciled by differentiating between the individual and social returns to capital outflows.

Individuals may not adequately take into consideration the social returns associated with a particular portfolio and as a consequence may invest more than the socially optimal share of their portfolio in foreign assets. This view of capital flight as capital flows resulting from a deviation between private and social returns has been suggested, although not emphasized, in the literature. For example, Cumby and Levich comment that "in order to justify a negative connotation for a subset of capital movements, there must be a derogation from the market paradigm, such as a deviation between private and social welfare." Walter labels capital flight the subset of capital outflows deemed to threaten the attainment of some national objective. Even when foreign asset accumulation is privately rational and legal, it is considered capital flight when it violates an implied social contract among domestic agents. Capital flight, therefore, represents an externality that will not necessarily be addressed by private investors' search for an efficient portfolio. This characterization also provides a reconciliation of the two different aspects of capital flight presented above. At the private level, capital flight is indeed a form of portfolio diversification and hence in the best interest of the private investor. At the same time, however, it is a flight from the financial assets of a particular country and may, at the social level, entail extra costs.

The 1980s debt crisis directed attention to the phenomenon of capital flight. Although capital outflows from highly indebted countries occurred throughout the 1970s, capital flight was not considered an important issue since foreign creditors were implicitly financing these outflows. Capital flight did not conflict with national objectives until international credit dried up in 1982.3

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3 For a more rigorous treatment of this characterization of capital flight, see Susan
Apart from conceptual issues, the practical problem of measuring capital flight is also difficult since it involves making a distinction between capital flight and “normal” capital outflows. Normal outflows do not conflict with a national objective and include, for example, flows to finance international trade. Gordon and Levine take the view that these “normal” outflows cannot be reliably disentangled from “abnormal” flows associated with political instability and distortionary policies. One strain of the literature has responded by looking at the total resident outflows and has not attempted to disentangle normal from abnormal flows. Others have made a distinction based on criteria such as legal flows versus illegal flows or capital flows that generate investment income versus those that do not.

The measure that this paper uses differentiates normal from abnormal flows by concentrating on the changes in the private, nonbanking sector’s deposits in U.S. banks. We make a distinction between the public and banking sectors, on the one hand, and the private, nonbanking sector, on the other. It is assumed that most of the normal flows will be carried out either through interbank channels or by the public sector. Further, this delineation does not preclude normal private outflows but does assume that the level of normal deposits by the private, nonbanking sector stays relatively constant over the period under examination.

ESTIMATING CAPITAL FLIGHT

Capital flight, by its very nature, is quite difficult to measure. Recent empirical work has relied on estimates derived from balance of payments data. The most widely used method is the so-called broad measure of capital flight (KF1) based on the residual approach. This method measures resident capital outflows as the difference between the sources and uses of foreign exchange. It is derived from the increase in a country’s recorded external debt, net of repayments, plus new foreign direct investment plus the


This method is used by Manuel Pastor, “Capital Flight from Latin America,”
current account surplus (deficit) minus the change in international reserves. Adjustments are sometimes made to take into account interest earnings on previous capital flight and tourist receipts. This definition is considered to be a broad measure because it considers the foreign acquisitions of both the official and the private sector, and considers both short-term and long-term capital outflows.

The biggest problem with this measure is that it depends on the accuracy of the debt data. Since debt reporting, especially of private debt, improved considerably after the debt crisis in 1982, this measure will tend to overstate capital flight in 1983-84. In the case of Mexico, there was not a legal requirement prior to the debt crisis for the registration of private debt and therefore very little was registered. More recently, this measure could distort capital repatriation if the debt-equity swaps and the debt reductions obtained through the Brady Plan are not properly treated.

The narrow measure of capital flight (KF2) looks at short-term capital outflows of the nonbank private sector plus recorded errors and omissions from the balance of payments statistics. This measure is considered a narrower measure than KF1 because it attempts to measure the foreign acquisitions of the nonbanking private sector only. However, the errors and omissions term may capture flows from the official and the private banking sectors as well as from the nonbanking private sector.

There are several problems with the KF2 definition. First, since errors and omissions is a residual factor, it does not consist only of capital flight. A negative errors and omissions term would also be recorded if imports were being smuggled into the country. Another problem is that short-term capital data consist largely of commercial credit, and hence this measure will tend to increase as imports increase. A further drawback with this measure is that it does not capture capital flows that arise due to trade misinvoicing. Enterprises may either under-report exports or over-report imports.


7 The World Bank reports that private nonguaranteed Mexican debt rose by 83 percent from $8.1 billion in 1982 to $14.8 billion in 1983, while public and publicly guaranteed debt increased by only 30 percent from $51.6 billion to $66.8 billion. For a more detailed discussion of this point, see Ernesto Zedillo, “Case Studies: Mexico” in Lessard and Williamson, eds., Capital Flight.

in order to purchase foreign exchange at preferential rates. This last criticism also applies to the measure KF1.

An alternative measure of capital flight that does not rely on balance of payment statistics is one based on the change in cross-border deposits; such deposits are reported by the recipient banks, not by the depositors. There are several sources of data on cross-border bank deposits. The two most comprehensive series are provided by the Bank for International Settlements (BIS) and the International Monetary Fund (IMF). The BIS provides a geographical breakdown of data on the bank liabilities of all BIS member countries but unfortunately does not distinguish between liabilities to the private and official sectors. The IMF provides a series on the bank liabilities of 33 banking centers that distinguishes between bank and nonbank holdings, but the data on nonbank holdings also do not distinguish between the private and the official sectors. Another drawback of the IMF data series is the September 1981 starting date, which does not cover a major portion of the buildup in foreign assets that preceded the debt crisis.

To measure cross-border bank deposits, we rely on U.S. Treasury data on the liabilities of U.S. banks and brokerage houses to the private, nonbanking sector of foreign countries. Although this data series covers capital flight only to the United States, it is superior to both the BIS or IMF data series in terms of its focus on the private, nonbanking sector. In addition, it is a broader measure since it includes the custody liabilities to foreigners of banks, brokers, and dealers including foreign holdings of U.S. Treasury Bills. Data are also provided on net foreign transactions in long-term domestic securities, including U.S. Treasury notes and bonds, U.S. government agency bonds, corporate bonds, and stocks.

The change in the cross-border liabilities of U.S. banks will not capture all of capital flight because funds are held in countries other than the U.S. and in assets other than bank and custody liabilities. Another source of inaccuracy is that the nationality of the ultimate depositor is not always known or correctly reported. This measure has some characteristics, how-

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9 See Sunil Gulati, "A Note on Trade Mis invoicing" in Lessard and Williamson, eds., Capital Flight.
12 The data on foreign transactions in long-term securities is an aggregate of private and official transactions. Therefore, U.S. Treasury notes and bonds are not included in KF3. Although there are very few incidences of official holdings of U.S. government agency and corporate bonds and stocks, this generality does not apply to long-term U.S. government securities.
ever, that are preferable to the measures based on balance of payments statistics previously mentioned. First, since it is not a residual variable, there is much less uncertainty as to what is actually being measured. As long as cross-border deposits are highly correlated with total capital flight, this variable will be more appropriate to use as a dependent variable in regression analysis. Second, unlike the two previous measures, this measure focuses on the private nonbanks, the participants most likely to generate capital flight.

Chart 2 contains a comparison of the three measures of capital flight for Argentina, Mexico, and Venezuela from 1979 to 1991. Looking first at Argentina, the measure based on the change in claims on U.S. banks (KF3) greatly underestimates capital flight in 1980 through 1982 relative to either the broad measure, based on the difference between the sources and uses of foreign exchange (KF1), or the narrow measure, based on short-term capital outflows and recorded errors and omissions (KF2). KF3 resembles the other two series more closely for the period 1983 through 1988 when there was only moderate capital flight from Argentina, but again underestimates capital flight as measured by the other two series in 1989.

Looking next at Mexico, the first point to note is that, with the exception of the years 1981 and 1982, KF2 and KF3 move quite closely together. This is a surprising result given that the two measures are based on entirely

CHART 2. MEASURES OF CAPITAL FLIGHT

$ Billions

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</tr>
</thead>
<tbody>
<tr>
<td>KF1</td>
<td>KF2</td>
<td>KF3</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

A. Argentina
NOTE: KF1 = Change in Debt + Direct Investment + Current Account Balance – Change in Reserves. KF2 = Short-term Capital Flows + Errors and Omissions. KF3 = Change in Claims on U.S. Banks.

different types of data. Although KF3 exhibits less volatility than KF1, in
general they move in the same direction.

Finally, the data for Venezuela show that although in terms of magnitude
KF3 does not closely follow KF2, the two series are highly correlated from
1980 until 1986. Since the purpose of this study is to explain the variations
in capital flight rather than determine the exact magnitude, the high correla-
tion is a sufficient criterion for using this measure as a dependent variable
in regression analysis. Both KF1 and KF2 indicate that capital continued to
flow out of the country in 1990, which contradicts the buildup in foreign
reserves that occurred in those years.

CAUSES OF CAPITAL FLIGHT AND REPATRIATION

In this section the causes of capital flight are empirically tested. The foun-
dation of the empirical model is a portfolio-adjustment model in which the
domestic investor holds his/her wealth in either domestic money, domestic
government bonds, or external financial assets. The share of wealth held in
foreign assets therefore depends on the expected rates of return on both
domestic and foreign investment opportunities. In order to calculate the
growth rate of the share of wealth held in foreign assets, total wealth is
assumed to grow at the same rate as domestic GDP.13

The implicit cost of holding wealth in domestic money as opposed to
real goods is the domestic inflation rate. Since an increase in inflation caus-
es money to be a poor store of value, the expected relationship between
holding wealth in foreign assets and the domestic inflation rate is positive.
Given the role of money as a means of transaction, money demand also
depends on real domestic output. Output is proxied in this study by indus-
trial production, in the case of Mexico, and petroleum production, in the
case of Venezuela. The expected relationship between foreign asset hold-
ings and the growth rate of output is negative.

The return to holding domestic bonds is the real domestic interest rate.
For both Argentina and Venezuela, the only interest rate available was an
average domestic deposit rate. For Mexico, the real rate of return on 3-
month Certificados de la Tesorería (CETES), the Mexican equivalent of
Treasury Bills, was used. Likewise the return to holding foreign bonds is
the foreign real interest rate; the 3-month U.S. Treasury Bill rate is used. In

13 For ease of calculation, the average real GDP growth rate for the period is used.
From 1978 to 1991, Argentina contracted at an annual average rate of -0.2 percent
while both Mexico and Venezuela grew at an average rate of 2.22 percent and 1.15
percent respectively.
order to compare the return on foreign bonds to returns on domestic assets, it is necessary to take into account expected exchange rate changes. These expectations are proxied in two different ways.

First, the black market premium over the official exchange rate is included as an explanatory variable. It is expected that the black market premium will be greatest when capital controls are in effect and residents expect a depreciation of the domestic currency. Capital controls were employed in all three countries during the period under examination. In Argentina, capital controls were in effect from 1981 through 1989. In Mexico, there was a fixed exchange rate regime and free convertibility of the Mexican peso until August 1982, when a controlled market was introduced. Exchange controls were in effect from this time until November 1991, when the controlled market was eliminated and free convertibility was restored. In Venezuela, a reduction in oil export earnings prompted the adoption of a multiple exchange rate system in February 1983. This system was simplified in November 1988 and eventually replaced in March 1989, when Venezuela returned to a unified exchange rate system and virtually all exchange controls were eliminated.

Although it would have been possible to include the black market premium only during periods in which there were capital controls, this was not done for two reasons. During periods in which capital controls are either not in effect or very weak, the black market premium over the official rate should be very close to zero, hence it is technically equivalent to only including the black market premium during periods of capital controls. Also, it is difficult to determine when capital controls were actually in effect. Under a dual exchange rate regime in which there is a free and a controlled market, if the government intervenes to keep the free market rate close to the fixed official rate, then this is equivalent to a fixed exchange rate regime with no capital controls. Since it is very difficult to differentiate the periods in which the government is intervening in the foreign exchange market from those periods in which there are no expectations of a depreciation, the black market premium was included for all periods and a dummy variable was used for the entire regime during which capital controls were used.

The second variable used to proxy for expectations of a devaluation was the interest rate differential. The theoretical rationale for this proxy is interest rate parity, which maintains that in the absence of capital controls differences in interest rates across countries reflect expectations of a depreciation and a risk premium. This variable therefore differs from the black market premium in that it also incorporates a risk premium. It is necessary to omit from the regressions one of the interest rates if the interest rate differential is included or the model specification would be perfectly correlated. The domestic interest rate was therefore omitted.
The empirical results are presented in Tables 1, 2, 3. The sample period used was June 1978 to December 1991. The methodology used to arrive at the results presented was to regress the percent change in Mexican private non-bank claims on U.S. banks,\textsuperscript{14} net of a constant growth rate of wealth, on a constant, a trend variable, a dummy variable for capital controls, and the one-period lag of the dependent variable, the domestic inflation rate, the rate of growth of domestic production, the foreign interest rate, and the two proxies for expectations of a devaluation based on interest rate parity and the premium in the black market. Contemporaneous variables were not used, with the exception of the foreign interest rate, in order to avoid problems of simultaneity.

**TABLE 1. ARGENTINA**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. error</th>
<th>T-stat.</th>
<th>2-tail sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>T</td>
<td>-0.0008</td>
<td>0.0005</td>
<td>-1.7505</td>
<td>0.0864</td>
</tr>
<tr>
<td>PREM(-1)</td>
<td>0.2418</td>
<td>0.0591</td>
<td>4.0887</td>
<td>0.0002</td>
</tr>
<tr>
<td>RS(-1)</td>
<td>0.8021</td>
<td>0.5755</td>
<td>1.3938</td>
<td>0.1698</td>
</tr>
<tr>
<td>RS</td>
<td>1.1868</td>
<td>0.5859</td>
<td>2.0254</td>
<td>0.0484</td>
</tr>
<tr>
<td>CC</td>
<td>-0.0774</td>
<td>0.0430</td>
<td>-1.7987</td>
<td>0.0784</td>
</tr>
</tbody>
</table>

| R-squared  | 0.4029      | Mean of dependent var | 0.0505 |
| Adjusted R-squared | 0.3532 | S.D. of dependent var | 0.1041 |
| S.E. of regression | 0.0837 | Sum of squared resid | 0.3365 |
| Log likelihood | 58.868 | F-statistic | 8.0980 |
| Durbin-Watson stat | 1.6954 | Prob(F-statistic) | 0.0000 |

**Note:** Dependent Variable is KF
SMPL range: 1978.3-1991.3
Number of observations: 53

There are several similarities in the models fitted to the three very different economies. The two variables that are significant in all three regressions are the U.S. interest rate and the dummy variable for capital controls. In Argentina and Mexico, both the contemporaneous and the lagged U.S. interest rates are significant, while in Venezuela only the lagged U.S. interest rate has a significant effect on the growth rate of the share of wealth held in U.S. banks. Argentina has the largest elasticity with respect to a change in the U.S. interest rate. A one hundred basis point increase in the U.S. interest rate leads to a 1.2 percent growth in claims on U.S. banks during the same quarter, and a further 0.9 percent the following quarter. At the

\textsuperscript{14} Including holdings on short-term Treasury securities.
TABLE 2. MEXICO

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. error</th>
<th>T-stat.</th>
<th>2-tail sig.</th>
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<tbody>
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<td>C</td>
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<td>0.0129</td>
<td>2.2929</td>
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<tr>
<td>KF(-1)</td>
<td>0.1996</td>
<td>0.1055</td>
<td>1.8924</td>
<td>0.0647</td>
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<tr>
<td>INF(-1)</td>
<td>0.1741</td>
<td>0.0872</td>
<td>1.9966</td>
<td>0.0518</td>
</tr>
<tr>
<td>GRTH(-1)</td>
<td>0.4107</td>
<td>0.2148</td>
<td>1.9121</td>
<td>0.0621</td>
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<tr>
<td>RS(-1)</td>
<td>0.7022</td>
<td>0.2740</td>
<td>2.5626</td>
<td>0.0137</td>
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<tr>
<td>RS</td>
<td>0.5399</td>
<td>0.2621</td>
<td>2.0604</td>
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<tr>
<td>CC</td>
<td>-0.0985</td>
<td>0.0159</td>
<td>-6.1928</td>
<td>0.0000</td>
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</tbody>
</table>

R-squared                              0.6760  Mean of dependent var 0.0190
Adjusted R-squared                     0.6337  S.D. of dependent var 0.0626
S.E. of regression                     0.0379  Sum of squared resid 0.0661
Log likelihood                         102.02  F-statistic          15.996
Durbin-Watson stat                     1.8911  Prob(F-statistic)    0.0000

NOTE: Dependent Variable is KF
SMPL range: 1978.4-1991.4
Number of observations: 53

TABLE 3. VENEZUELA

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. error</th>
<th>T-stat.</th>
<th>2-tail sig.</th>
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</thead>
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<tr>
<td>C</td>
<td>0.0615</td>
<td>0.0244</td>
<td>2.5223</td>
<td>0.0150</td>
</tr>
<tr>
<td>RS(-1)</td>
<td>0.0239</td>
<td>0.0052</td>
<td>4.5937</td>
<td>0.0000</td>
</tr>
<tr>
<td>IDIF(-1)</td>
<td>-0.6851</td>
<td>0.2185</td>
<td>-3.1356</td>
<td>0.0029</td>
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<tr>
<td>CC</td>
<td>-0.1174</td>
<td>0.0324</td>
<td>-3.6263</td>
<td>0.0007</td>
</tr>
</tbody>
</table>

R-squared                              0.3552  Mean of dependent var 0.0339
Adjusted R-squared                     0.3157  S.D. of dependent var 0.1224
S.E. of regression                     0.1013  Sum of squared resid 0.5028
Log likelihood                         48.230  F-statistic          8.9984
Durbin-Watson stat                     2.1825  Prob(F-statistic)    0.0001

NOTE: Dependent Variable is KF
SMPL range: 1978.3-1991.3
Number of observations: 53

KF = growth rate of share of wealth held in U.S. banks
C = constant
T = time trend
CC = capital control dummy
RS = U.S. interest rate
PREM = black market exchange rate premium
INF = domestic inflation rate
IDIF = interest rate differential
June 1991 level of $5.6 billion held in U.S. banks by Argentines, this would lead to a total increase of $114.6 million.

The results from the Mexico regression show that a one hundred basis point increase in the U.S. interest rate, holding everything else constant, leads on average to a 0.5 percent contemporaneous increase in Mexican deposits in U.S. banks, and a 0.7 percent increase the following quarter. At the December 1991 level of $9.5 billion held in U.S. banks, a one hundred basis point increase in the U.S. Treasury Bill rate would lead to a $118 million increase in Mexican claims on U.S. banks over the following six months. In Venezuela, a 100 basis point increase in the U.S. interest rate leads to a 0.02 percent increase in claims held in U.S. banks. At the December 1991 level of $7.5 billion held in the U.S., this would lead to an increase of $15 million.

The impact of the U.S. interest rate can be interpreted in two different ways. The direct effect of an increase in U.S. interest rates is the increased return on deposits held in U.S. banks. An indirect effect, however, is an increase in the debt service of debtor countries that leads to an increase in government expenditure and possibly increased domestic inflation.

The other variable common to all three models is a dummy variable that takes on a value of one for periods in which capital controls were in effect. For Argentina, this period runs from the first quarter of 1981 to the fourth quarter of 1989 (see Table 1). Capital controls were used in Mexico from the third quarter of 1982 to the fourth quarter of 1991 (see Table 2), and in Venezuela from the first quarter of 1983 through the first quarter of 1989 (see Table 3). Although this dummy variable is useful as an indicator of the effect of capital controls, it does not differentiate between periods in which strong as opposed to weak controls were in effect.

The magnitude of the effect capital controls had on the share of wealth held in U.S. banks is roughly similar for all three countries. The coefficient on this variable ranges from $-0.08$ for Argentina to $-0.10$ for Mexico and $-0.12$ for Venezuela. These results can be interpreted as indicating that capital controls were somewhat effective in stemming capital outflows. An alternative interpretation is that investors who sought to place their funds abroad correctly anticipated the upcoming capital controls and were able to remove their funds prior to the implementation of the controls.

Despite the similarities that are apparent in the three models, there are also several different results. The model fits the data best for Mexico. Besides the significant variables already described above, the lagged dependent variable, domestic inflation rate, and the domestic growth rate of

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15 The independent variables explain 63 percent of the variance of the dependent variable after adjusting for the number of explanatory variables.
GDP are all significant. The lagged growth rate of the domestic economy did not enter with the expected negative sign based on the portfolio adjustment model and the transaction demand for money.

The model fit equally well for Argentina and Venezuela. In addition to the U.S. interest rate and capital control dummy variable, a proxy for exchange rate depreciation was significant in each of the two regressions. For Argentina, the black market premium over the official exchange rate was the most significant variable in the model. An expectation of a 10 percent depreciation of the domestic currency caused a 2.4 percent increase in claims on U.S. banks. The interest rate differential was originally included in both the Argentina and Venezuela model but was found to be significant only in the Venezuela model. This variable did not, however, have the expected sign.

**CONCLUSIONS**

This article investigates the causes of capital flight from Argentina, Mexico, and Venezuela in the late 1970s and throughout the 1980s. It finds that the high U.S. interest rates and the absence of capital controls were important determinants of capital flight in all three countries. Expectations of a depreciation of the domestic currency also played a significant role in Argentina and Venezuela, but do not appear to have played a significant direct role in explaining capital flight from Mexico. The domestic inflation rate and the growth rate of GDP do appear to have had a significant role in determining capital flight from Mexico.

The results of this study do not, however, imply that capital flight can be fully explained by fundamental determinants such as rates of return adjusted for risk. The low explanatory power of the models, particularly in the case of Argentina and Venezuela, imply that capital flight is an episodic event that creates deviations from fundamental patterns, and therefore that capital flight is inherently unpredictable.