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Original Research Article

An Examination of the Impact of Capital Flight on Economic Growth in Nigeria

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Abstract: The study examined the impact of capital flight on economic growth in Nigeria applying annual data sourced from Central Bank of Nigeria Statistical Bulletin from 1986 to 2020 and using an Error Correction Model (ECM). The results of the cointegration test demonstrated that the variables have a long-term relationship. The findings show that most of the constituents of Capital flight (first, second and third lags of foreign direct investment and portfolio Investment) have negatively impacted Nigeria's economic growth. In contrast, external debt and current account balances positively impact on economic growth in Nigeria. This, therefore, confirmed that changes in capital flight impact economic growth in Nigeria. The study recommends that the government and stakeholders create an attractive, conducive, and enabling environment suitable for ease of doing business that will attract and retain foreign investors in the country. More importantly, the Government should ensure proper use of the funds borrowed, by channelling it to the productive sector of the economy and will also increase Government revenues.

Keywords: Capital flight, current account balances, direct investment, economic growth, error correction model and portfolio investment.
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INTRODUCTION

Typically, there are several variables international investors consider before deciding to invest in an economy. Investors could check the size of a country's external reserves, depth of its financial system, rate of economic growth, stability of the exchange rate, and government investment policies as measures of confidence in the economy. They are also attracted by possible arbitrage opportunities. Over the years, the Nigerian Government has explored several measures to boost the investment component of the National Income Identity in a bid to improve economic growth in the country. A review of the data on capital importation in Nigeria[1] showed that fluctuations in capital flows coincided with changes in interest rates of domestic government securities, changes in oil prices and changes in interest rates of advanced economies. These observations have been supported by some empirical studies such as IMF (2016[2]) and Banerjee et al (2016[3]). In the past five years, Nigeria

[1]Central Bank of Nigeria Statistics Database

[2]IMF (2016) showed that pull factors for capital flows into Nigeria such as rising interest rates, high yields on long-term and one-year bonds (ten years or more) Nigerian Federal Government Securities, expected strong economic growth and higher oil prices.

[3]Banerjee (2016) found that a tight US monetary policy leads to a decline in both inflow and outflow of capital in emerging markets economies.

experienced two recessions, before being confronted with the COVID-19 Pandemic, the combination of which resulted in a sharp slowdown in economic growth. During this period, there was huge volatility in capital flows, with Foreign Portfolio Investments (FPIs) being the largest contributor outside the period of recession. However, during the periods of recession, asides from a decline in capital inflows, 'Other Investment (OI)' contributed the highest to capital flows, followed by FPIs while 'Foreign Direct Investment (FDI)' had the lowest contribution to capital inflows. The benefits of foreign capital flows to developing countries like Nigeria include boosting external reserves, maintaining stability of the local currency, contributing to infrastructure development and its positive impact on growth. This study is thus motivated by these important benefits to seek solutions to capital outflows or capital flight to ensure that the Nigerian economy maximizes the identified benefits.

Several studies distinguish between capital outflow and capital flight in terms of factors causing the exit of capital and in terms of legality (Ajayi, 1997; Gusarova, 2009; Ajilore, 2010; Ajayi, 2012; Otene & Edeme, 2012; Okonkwo *et al.,* 2020; Orji *et al.,* 2020). This study would contribute to existing literature by using a broader definition of capital flight to examine its impact on economic growth in Nigeria. The definition of capital flight in this study encompasses situations when capital flows out of a country due to economic or political instabilities or perceived internal risks or external opportunities and include the legally recorded outflows in the country's national accounts as well as illegal outflows that are not recorded in the national accounts. This is because capital withdrawals from Nigeria, whether legal or illegal, have been shown to impact the economy negatively (Ajilore, 2010; Okonkwo *et al.,* 2020; Orji *et al.,* 2020). Also, the period covered in the study from 2000-2020 captured defining moments in the history of Nigeria including two recessions, the Global Financial Crisis, and the COVID-19 Pandemic, which negatively affected investor confidence. This study differs from previous studies in Nigeria by the measurement of capital flight adopted. The most widely used measurement of capital flight in the literature is the residual methodology developed by the World Bank (1985), which considers the difference between recorded source of funds and the recorded uses of funds (Gusarova, 2009). The relevant variables usually estimated include current account balance, change in external debt stock, net addition to the stock of foreign reserves and net foreign investment. However, the foreign investment variable deployed by several studies in the literature is focused on FDIs. This paper would thus consider FPIs and OIs in addition to FDIs as the measure of foreign investment, as they are the major sources of capital inflows to Nigeria. This study adopts an Error Correction Model (ECM) cointegration technique which allows for determination of speed of adjustment and short run dynamics of the coefficients.

According to the IMF (2016), growing capital flows to Nigeria depends on reducing structural barriers to growth, improving the business climate, and strengthening governance. Other areas that could be improved include improving data on capital flows, promoting sound exchange rates, fiscal, and monetary policies to improve macroeconomic fundamentals and enhancing the mechanisms for checkmating illicit capital flows. The outcome of this study is expected to help stimulate policy discussions around improving capital inflow to Nigeria and mitigating capital flight (both legal and illegal outflows) from Nigeria. The remainder of the paper is structured as follows: A review of the literature is presented in Section 2, and the data and technique employed in the study are described in Section 3; while Section 4 presents the estimation of the model and analyzes the results. Section 5 summarizes and concludes the study.

LITERATURE REVIEW

Empirical review

Several papers have been written on impact of capital flight on growth in many developing countries with different conclusions for example, Uzoma and Godday (2019) used annual data from 1990 to 2017 to assess the impact of capital flight on economic growth in Nigeria (OLS). The T-Test result revealed a significant correlation between the growth proxy, the gross domestic product, and the proxies for capital flight. However, Paul et al. (2015) also looked at how capital flight affected Nigeria's economic growth using an autoregressive distributed lagged model (ARDL). The ARDL results showed that capital flight significantly and negatively affects economic growth. According to pooled mean group (PMG) analysis by Gautier et al. (2020) using annual data for ECCAS, ECOWAS, and SADC from 1984-2015, the impact of capital flight on economic growth is highly significant and negative in SADC and neither positive nor negative in ECCAS and ECOWAS depending on whether the interaction between capital flight and private investment is taken into account. Adedayo and Ayodele (2016) examined how capital flight affected Nigeria's economy. The Augmented Dickey-Fuller Unit Root Test, Co-integration Test, and Ordinary Least Square (OLS) tests were also used in the study. The result reveal that the variables had a favourable effect. This suggests that as capital flight increases into the economy, the exchange rate also rises, positively

impacting the Nigerian economy over the study period. According to the report, the government should foster an atmosphere that is favorable to investment in Nigeria in order to boost foreign investment and reduce outflows of money by creating outlets for it. The monetary authority should also ensure that local investment capability is built.

Ndikumana *et al.* (2014) investigated the magnitude of capital flight for 39 African nations from 1970 to 2010. The study undertakes a thorough econometrics analysis of the drivers of capital flight from African nations and found capital flight in African countries to be a problem. It has started from the turn of the century in a period marked by a resource boom and a resurgence of growth in the continent. The paper further found a substantial variation across oil-rich countries, Nigeria, Angola, and Algeria. In 2010, accumulated capital flight exceeded GDP for eighteen out of the 39 nations. Capital flight was also found to be more significant in large compared to external debt, official development aid, and foreign direct investment. Capital flight and economic growth in Nigeria: new evidence from the ARDL approach from 1981–2017 was another topic of investigation for Orji et al. in 2020. The outcome showed that capital flight considerably lowers economic growth over the long and short terms. Other factors in the study, such as domestic investment, the availability of money, and loans to the private sector, demonstrated a considerable impact on economic growth. In order to promote growth and development, it is advised that proactive policy measures be taken to stop capital flight and to make the economy appealing and competitive for domestic investment.

When the political climate is favorable, the monetary authority may also think about implementing an expansionary monetary policy to increase the money supply. Olawale and Ifedayo's (2015) studies, which support this, demonstrated that capital flight had a detrimental effect on the Nigerian economy. In the year under review, GDP was correlated with capital flight, external debt, current account balance, foreign reserve, and foreign direct investment. Other research employing the ICOR technique, like Geda and Yimer (2017) in Ethiopia and Zobeiri, Akbarpour Roshan and Shahrazi (2016) in Iran, indicated a negative relative relationship between capital flight and economic growth. Similar to this, Fofack and Ndikumana (2010) and Ndiaye (2014) employed the generalized method of moment and discovered capital flight has a negative impact on economic growth in SSA. While it was discovered by Adesoye, Maku, and Atanda (2012), Collier, Hoeffler, and Pattillo (2004), and Owusu (2016) that capital flight stimulates Nigeria's economy. Similarly, Weeks (2015) demonstrated that capital flight has a favorable impact on economic growth using a sample of oil-producing nations. Based on the literature review, it is evident that most studies on capital flight results showed a mixed result. Based on this paper's knowledge, few studies adequately addressed how capital flight affects macroeconomic indicators. Therefore, unlike those papers above, this paper examined the effect of capital flight on the Nigerian economy from 1986 to 2020 to confirm their respective claim. Secondly, only a few studies used the Error Correction Model to investigate the impact of capital flight on economic growth in the Nigerian economy. To this end, our study would also use the ECM to examine the impact of capital flight on economic growth in Nigeria from 1986 to 2020. Lastly, the research result will help policymakers know the effect of capital flight on the country's economy and the policy instruments to prevent the escalation of capital flight in the country.

Theoretical review

The theoretical framework of this paper introduced four major concepts of capital flight, the investment diversion, tax depressing, austerity and debt driven thesis. In view of the negative impact capital flight has on economic development, this study settles for investment diversion theory and is considered fit to analysing the Impact of Capital Flight on Economic Growth in Nigeria.

The investment diversion theory: Kindleberger 1966 introduced the idea of the investment diversion. According to the idea, rearranging the production facilities results in increased direct investment in some regional countries and decreased direct investment in others. Because the domestic government has no control over wealth stored overseas and cannot tax it, this could result in a possible revenue loss due to capital flight. Therefore, it is believed that the investment diversion theory is appropriate for analyzing how capital flight affects economic growth in Nigeria.As some corrupt, bureaucrats, and unscrupulous leaders and individuals habitually drain off fund the country’s fund that is meant for the country themselves and developed countries where there is the existence of better (Ayaji, 1992).

The Tax depressing thesis: The potential revenue loss resulting from capital flight was explained by the tax depressing argument, which stated that as the domestic government has no control over wealth stored abroad, it is impossible to tax i. Therefore, this reduces the revenue generating ability of the government. Furthermore, the drop in government

revenue makes it difficult for political and economic engineering to promote growth and development.

The austerity thesis: According to this opinion, poor people are frequently extremely indebted as a result of capital flight out of a nation. They suffer more because they are put in jeopardy by the brutal government tactics taken to pay off debt owed to foreign banks (Prophet, 1990).

The debt driven thesis: According to the hypothesis, citizens of a nation are motivated to transfer borrowed funds to other nations for resource development as a result of the nation's significant external debt. Assuming that high foreign debt is a result of exchange rate impacts that push out domestic capital for debt repayment, this reduces the incentive to save and invest in the domestic economy.

Capital flight has been identified as one of the major causes of low economic growth due to the sudden departure of huge amount of assets or money to another country which is disadvantageous and causes several undesirable consequences for the affected country. Major assets may be devalued, which might have a cascading impact if other people start to withdraw their capital out of fear Corporate Finance Institute, weakening the government and economy as well as the purchasing power of the people in the affected country (2021).

METHODOLOGY

In this section, we discuss the model specification, measurement, definition of variables, and data.

Sources of Data

Annual times series data on Real Gross Domestic Product (RGDP), Portfolio Investment (PI), Foreign Direct Investment (FDI), External Debt (ED), and Current account Balance (CAB) National Bureau of Statistics (NBS), Central Bank of Nigeria (CBN) and the World Bank Development Indicator (WDI) data based.

Model Specification

The model for this study is derived following Ajilore (2010) which demonstrates the the theoretical link between capital flight proxied by; Current Account Balances (CAB), Foreign Direct Investment (FDI), Portfolio Investment (PI), and External Debt (ED) and economic growth.
The functional form of the model can be specified as follows:

Real Gross Domestic Product =ƒ (Current Account Balance, Foreign Direct Investment, Portfolio Investment, External Debt).

$$RGDP_t = f(CAB_t\ FDI_t, PI_t, ED_t) \quad \ldots\ldots\ldots\ldots\ldots \quad (3.1)$$

The mathematical form for the first model can be expressed as:

$$RGDP_t = \beta_0 + \beta_1 CAB_t + \beta_2 FDI_t + \beta_3 PI_t + \beta_4 ED_t \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (3.2)$$

The equations above are exact or deterministic. To allow for the inexact relationship among the variables, the stochastic error term "μ_t" is added to the three equations, giving the econometric form of the models as:

$$\text{RGDP}_t = \beta_{i,t} + \beta_{1,t}\, CAB_t + \beta_{2,t} FDI_t + \beta_{3,t} PI_t + \beta_{4,t}\text{ED}_t) + \mu_t \quad \ldots\ldots\ldots\ldots\ldots\ldots (3.3)$$

Where, RGDP_t = is Real Gross Domestic Product
CAB = Current Account Balance,
FDI = Foreign Direct Investment
PI = Portfolio Investment
ED = External Debt
t, denote number time,
β_t coefficient of the variables
μ_t= stochastic error term.

The dynamic specification of the model is:

$$\Delta(\text{RGDP}_t) = \alpha_0 + \Sigma\theta_{1i}\Delta CAB_{t-1} + \Sigma\theta_{2i}\Delta FDI_{t-i} + \Sigma\theta_{3i}\Delta\text{PI}_{t-1} + \Sigma\theta_{4i}\Delta ED_{t-1} + \delta ecm_{t-1} + \varepsilon_{t-1} \quad (3.4)$$

Where:
ecm_{t-1} = the error correction mechanism lagged for one period
δ = the coefficients for measuring speed of adjustment
ε_t= stochastic error term.
θ_1-θ_5= coefficients of the variables

Procedure for Data Analysis

Pre-Estimation Test

In this section, the pre-estimation tests, summary statistics, and unit root tests are outlined and discussed.

Summary Statistics

In this section, we present a brief descriptive summary and compute measures of central tendencies (mean, median, and mode) as well as the skewness and kurtosis.

Test of Stationary (Pre-Estimation Test)

Two popular unit root tests, the Augmented Dickey-Fuller (ADF) and the Phillip - Perron (PP) unit root tests were employed to test for the stationarity of the data.

Serial Correlation

The error term is serially correlated when error terms from various (often neighboring) periods (or cross-section data) are correlated. When errors from one period continue into subsequent

ones, this is known as serial correlation in time-series studies. The Breusch-Godfrey (LM) test is employed to test for serial correlation and is found superior to the conventional Durbin-Watson (DW) test due to numerous assumptions and problems associated with their.,

Heteroscedasticity

The term "heteroskedasticity" (also known as "heteroscedasticity") refers to the non-constant nature of a variable's standard errors when observed over a given period of time. With heteroskedasticity, the tell-tale sign upon visual inspection of the residual errors is that they will tend to fan out over time. Symbolically.

$E(\mu_i^2) = \sigma^2 \quad i= 1,2,...,n$ ……(3.7)

Cumulative sum of recursive residuals (CUSUM) and cumulative sum of squares of recursive residuals (CUSUMSQ) Tests

The Cumulative Sum of Recursive Residuals (CUSUM) and Cumulative Sum of Squares of Recursive Residuals (CUSUMSQ) stability tests is adopted to test for the stability of the chosen ECM.

RESULTS & DISCUSSIONS

Stationarity test

Using the Augmented Dickey-Fuller Test, we test for the stationarity of the data set, interpreting with the Schwarz information and Akaike information criterions. Our results showed that current account balances, foreign direct investment, portfolio investment, external debt and log of real gross domestic products were stationary at first difference as shown on table 1 below.

Table 1: unit root test result Estimation

	ADF		SCI		ADF		AIC	
Variable	I(0)	P-value	I(1)	P-value	I(0)	P-value	I(1)	P-value
LOGRGDP	-1.041159	0.7282	3.783083	0.0065	-1.041159	0.7282	-3.783083	0.0065
Cab	-1.136191	0.6910	-8.000133	0.0000	-1357638	0.5893	-8.000133	0.0000
ED	-1.806706	0.3717	-4.629695	0.0006	-1.806706	0.3717	-4.629695	0.0006
FDI	-2.137604	0.2317	-5.314989	0.0001	-2.541513	0.1140	-5.314989	0.0001
PI	-1.734144	0.4056	-3.648433	0.0119	-0.127945	0.9362	-3.648433	0.0119

Researchers' computation using EViews version 10, *** 1%, ** 5% and * 10% level of significance.

Cointegration Test

Table 2: Bounds test (cointegration)

Null hypothesis: There is no long-term relationship			
F-statistics	5.417041		
Critical Value Bound			
Level of significance	Lower Bounds	Upper Bound	Decision
10%	2.2	3.09	*Cointegrated*
5%	2.56	3.49	*Cointegrated*
2.5%	2.88	3.87	*Cointegrated*
1%	3.29	4.37	*Cointegrated*

Researchers' computation using EViews version 10

Table 2 shows that the null hypothesis of no long-run relationship is rejected based on the value of F-statistics 5.417041 which falls outside the upper and lower bounds values, we thus deduce that capital flight has a long run relationship with economic growth in Nigeria.

Error Correction Model (ECM)

Table 3: Result of the ECM long run and short run

Dependent variable RGDP				
Cointegration form				
Variable	Coefficient	Std. Error	t-Statistic	P-value
D(DRGDP(-1))	-0.849719	0.152606	-5.568048	0.0008
D(DRGDP(-2))	-0.682501	0.181394	-3.762529	0.0071
D(DRGDP(-3))	-1.943607	0.342564	-5.673706	0.0008
D(DFDI)	0.013388	0.002480	5.397398	0.0010
D(DFDI(-1))	-0.013744	0.004056	-3.388563	0.0116
D(DFDI(-2))	-0.010171	0.003438	-2.958167	0.0212
D(DED)	-0.154899	0.025302	-6.121924	0.0005

Dependent variable RGDP				
Cointegration form				
D(DED(-1))	0.142495	0.023043	6.183980	0.0005
D(DED(-2))	0.040461	0.015114	2.676951	0.0317
D(DCAB)	0.000220	0.000169	1.303300	0.2337
D(DCAB(-1))	0.000408	0.000130	3.144690	0.0163
D(DCAB(-2))	0.000446	0.000112	3.968515	0.0054
D(DPI)	-0.001261	0.000350	-3.604692	0.0087
D(DPI(-1))	0.001259	0.000362	3.479167	0.0103
D(DPI(-2))	-0.001133	0.000563	-2.012140	0.0841
D(DPI(-3))	-0.001265	0.000401	-3.158370	0.0160
CointEq(-1)*	-0.302948	0.040585	-7.464458	0.0001

R-squared	0.923496	Mean dependent var	7.918966
Adjusted R-squared	0.821492	S.D. dependent var	1146.237
S.E. of regression	484.2878	Akaike info criterion	15.49326
Sum squared resid	2814416.	Schwarz criterion	16.29478
Log likelihood	-207.6523	Hannan-Quinn criter.	15.74429
Durbin-Watson stat	2.640464		
F-statistic		5.417	
Prob(F-Stat)		0.0024	

Researchers' computation using EViews version 10, *** 1%, ** 5% and * 10% level of significance.

The result shows that the adjusted R^2 = 0.82 percent, implying that changes in the independent variables account for 82percent of the changes in the dependent variable. The model is statistically significant at the 5% level, according to the F-test, and there is no serial autocorrelation, according to the DW. The model is convergent with fast adjustment speed, with an error correction coefficient of (-0.302948). This suggests that deviations from equilibrium can be adjusted in the short-term. We also note from the Error Correction model that in the first and second lagged periods, the real gross domestic product (DRGDP) declined by -0.0137 and -0.010 percent, respectively, as a unit or percentage of foreign direct investment (DFDI) flows out, and vice versa. At a 5 percent level of significance, the finding demonstrates that foreign direct investment is statistically significant. As expected, portfolio investment (DPI) is adversely associated with real gross domestic product (DRGDP) over time, as illustrated by the results. In the second and third periods, portfolio investment (DPI) falls by a unit or percentage, while real gross domestic product falls by -0.0011 percent and -0.0012 percent, respectively, and vice versa. The findings on foreign direct investment and portfolio investment are consistent with Orji *et al.,* (2020). Furthermore, using the p-value, the result shows that Portfolio investment is statistically significant at a 10 percent level of significance. External debt (DED) has a positive and significant association with real gross domestic product (DRGDP). With a unit increase in external debt in the first and second periods, real gross domestic product rises by 0.142 and 0.04 percent, respectively, and vice versa. This result, however, contrasts Uzoma (2019). The p-value is statistically significant at 5 percent, as seen in the results. As a result, it's possible that the Nigerian government has been borrowing money from abroad to fund its operations. Finally, as indicated in the table, the coefficient of current account balances (DCAB) demonstrates positive and significant connections with gross domestic output In general, capital flight has a significant impact on the Nigerian economy; high capital flight decreases economic growth while lower flight brings about lesser negative impact on the economy.

Post estimation

The post-estimation tests that are analysed here to check for mis-specification problems, are the Breusch-Godfrey Serial Correlation LM test, the Heteroskedasticity test, and other diagnostic procedures.

Table 4: Breusch-Godfrey Serial Correlation LM test

Breusch-Godfrey Serial Correlation LM test			
F-statistic	0.536625	Prob. F(2,10)	0.6007
Obs*R-squared	2.035378	Prob. Chi-Square(2)	0.3614

Researchers' computation

From table 4 above, the result of the Breusch-Godfrey serial correlation LM test shows the probability Chi-Square value of 0.3514 is greater than the test statistic value of 0.05 percent, leading

us to reject the null hypothesis and conclude that the model has no serial correlation.

Table 5: heteroskedasticity test

Heteroskedasticity Test: Breusch-Pagan-Godfrey			
F-statistic	0.610931	Prob. F(9,11)	0.7658
Obs*R-squared	6.998621	Prob. Chi-Square(9)	0.6373
Scaled explained SS	4.938198	Prob. Chi-Square(9)	0.8397

Researchers' computation

As presented in table 5 above, the Obs* R-squared is higher than the test statistic value of 0.05 percent, indicating that the residual variance is constant, the homoscedasticity null hypothesis is not rejected, and that there is no evidence of heteroskedasticity in the model.

Table 6: Ramsey RESET Test

Ramsey RESET Test			
	Value	df	Probability
F-statistic	1.566024	(2, 10)	0.2561
Likelihood ratio	5.721881	2	0.0572

Researchers' computation

To check for specification errors, the series is subjected to the Ramsey reset test as shown in table 6 above, given that the p-values are greater than 0.05 percent, the result shows that the model is correctly specified. The CUSUM test was also carried out to examine the stability of the model as shown below. This shows that the model is stable in short run as the blue line falls within the bounds of the two red lines.

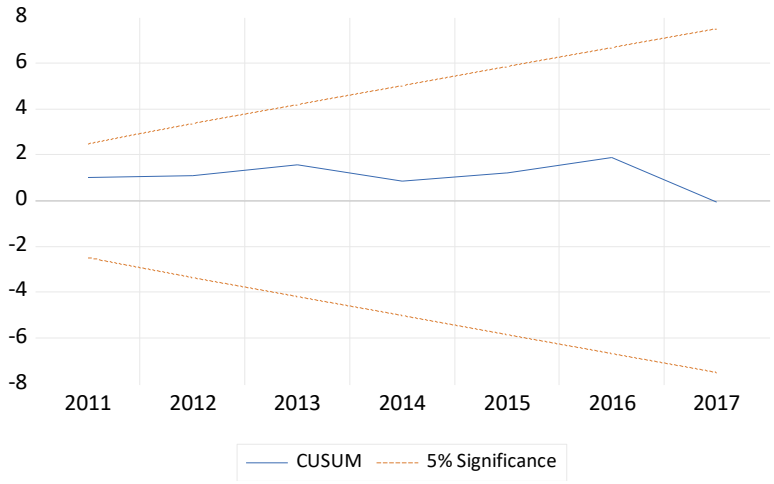

Figure 1: CUSUM test

Researchers' computation using EViews version 10

CONCLUSION

The study examined the impact of capital flight on economic growth in Nigeria using annual data sourced from the Central Bank of Nigeria Statistical Bulletin from 1986 to 2020 and an Error Correction Model (ECM). We confirmed the presence of long-run relationships between the variables for capital flight and economic growth in Nigeria. The findings show that most of these Capital flight variables, (foreign direct investment, portfolio investment and external debt) have significant relationships with economic growth in Nigeria while external debt and current account balances have positive relationship with economic growth in Nigeria, negative relationships were confirmed between foreign direct investment, portfolio investment and economic growth in Nigeria. This further confirmed that changes in capital flight impacts economic growth in Nigeria. Our findings are thus consistent with some studies in the literature.

POLICY RECOMMENDATION

Government and stakeholders should provide an attractive, conducive, and enabling environment to improve the ease of doing businesses to attract and retain both foreign direct and portfolio investors to the country. Since External

Debt (DED), has a positive relationship with growth in Nigeria, the government should ensure proper use of the fund borrowed by channelling it to the productive sector of the economy as that would expand the country's export base and improve the current account balance. This will also increase government revenues thereby bringing about positive changes in reserves, and further attracting more investment into the country.

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