DOES CAPITAL FLIGHT MOVE NIGERIA TO THE WORLD'S POVERTY HEADQUARTERS? AN IMPLICATION FOR SUSTAINABLE DEVELOPMENT

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Abstract

The aim of this study is to examine the relationship between capital flight and poverty levels in which past studies have not fully explored in Nigeria. Data were collected from the Central Bank of Nigeria Statistical Bulletin from 1981 to 2017. The objective of the study was examined within the framework of Johansen cointegration test, Dynamic Ordinary Least Square and Granger causality. Consequently, the findings that emanated from this study could be summarized as follows: all the variables of interest are integration of order one and possess long run convergence. Direct foreign investment and household consumption per capita have a significant negative relationship. External debt service payments, exchange rate and openness of the economy have a negative relationship with household consumption per capita. Though, this relationship is not significant at 10 percent level of significance. Moreover, external debt service payments and poverty levels do not have a causal relationship. No feedback effect exists among openness of the economy, external debt service payments, direct foreign investment and poverty levels. But there is a uni-directional causal relationship which flows from direct foreign investment to external debt service payments in the country and poverty levels Granger cause foreign reserves in Nigeria but not vice versa. Based on the findings that emerged in this study if the Nigeria wants to achieve the

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sustainable development goal of poverty reduction comes 2030, policy makers in the country should ensure that direct foreign investment should be invested in the domestic economy. The country should as a matter of urgency recourse to the usage of domestic debts instead of external debts. Also, there should be an aggressive campaign and policy against importation of materials that can be manufactured domestically in order to solve exchange rate volatility and depletion of foreign reserves that trade deficit could cause the country.

Keywords: Capital Flight: External Debt Service Payment, Foreign Reserve, Direct Foreign Investment
Jel Classification: F21, F43, I32.

1. INTRODUCTION

In the last few decades, the issue surrounding capital flight has been critical in African countries generally but Nigeria in particular. This has drawn the attention of scholars in elucidating the devastating effects of outflows of capital on the general welfare of the masses in the country from where it takes its flight. Developing countries in Africa are generally capital scarce due to low income and savings. However, it is paradoxical that capital from such countries flows into developed economies where capital is surplus. In Nigeria, capital is highly needed for investment projects that will generate employment opportunities and reduce poverty in the country. In the same vein, Nigeria is bewildered with infrastructural deficits, insecurity of life and properties that need to be addressed in order to create an enabling environment for businesses to thrive in the country. Capital is very crucial for investment that will provide an enabling environment for businesses to generate employment opportunities, addressing infrastructural deficits, insecurity challenges, improving the socio-economic conditions of the citizens in the long run.

Meanwhile, capital flight is a critical issue in Nigeria because the country lost $107 billion between 1970 and 2001 and $35.9 billion between 1975 and 1991 through capital flight (Adetiloye, 2011; Ojo, 1992). In the last few decades, the rate of almost $10 billion annual loss has been arrogated to capital flight in Nigeria (Adaramola & Obalade, 2013). The huge capital flight in Nigeria has been attributed to various factors ranging from perpetual budget deficit, financial sector constraints, volatility of exchange rate, risk perception of investors, corrupt practices of political leaders, insecurity, dwindling terms of trade and the host of others. Capital flight could be legal or otherwise. The legal capital flight is regarded as all forms of documented capital that flows from a country of origin to the rest of the world. Such capital could be repatriated (Baker, 2000). Whereas the reverse is the case of the illegal capital flight.

Despite the fact that Nigeria is endowed with both natural and human resources which are supposed to transform the country into the habitation of prosperity yet the country has the highest number of poor people in the globe which makes the country to become the world`s poverty headquarters (Adebayo, 2018). It is instructive to state that low investment and saving in Nigeria is aftermath effect of

capital flight (Raheem & Adeniji, 2015; Ndiaye, 2014). The multiplier effects of inadequate capital in Nigeria could be traced to rise in the level of unemployment, declining in the educational standard, fiscal deficit, inadequate infrastructural facilities and resources misallocation (Uguru, 2016). In the past empirical studies in Nigeria, the focal points of debate were about the nexus between capital flight and economic growth. See Egbuwalo and Abere (2018), Lawal et al. (2017), King (2015), Usman and Arene (2014), Ayogu and Abgor (2014), Umoru (2013), De Boyrie (2011), Kolapo and Oke (2012), and Ajayi (2012). In the recent times, poverty levels have been worrisome in Nigeria and there is a little empirical evidence to substantiate these current levels of poverty as a result of capital flight. See Onyele and Nwokocha (2016), Peter and Ebi (2017). In order to fill the existing gap identified in the literature, this study provides an empirical answer to the question whether capital flight from 1981 to 2017 led Nigerians in the current pool of abject poverty.

In addition to the introduction, the rest of this work is organized as follows; section two presents the review of empirical study. Section three presents methodology, discussion of results, summary and policy implication of the study.

2. EMPIRICAL REVIEW

This section presents the submission of the past studies regarding the nexus between capital flight and economic growth with a view to seeing the perceptions of various scholars regarding the subject matter of this study.

In China, Gunter (2017) examined the relationship between corruption, family effects on capital flight and economic growth between 1984 and 2014 with the application of both the Cuddington's balance of payments and residual measures. The author submitted that the impact of capital control was little or none in the long run on the volume of capital particularly the capital flight route in Hong Kong. However, the major drivers of capital flight from mainland China were reported to be corruption, migration facilitation process and transaction costs. In another study, Yalta and Yalta (2012) employed a panel causality approach in investigating how financial development and liberalization could affect capital flight in twenty-one emerging countries from 1980 to 2004. It was discovered from the study that the lagged values of capital flight were self-reinforcing in the study. Meanwhile, financial liberalization policies showed little or no impact on capital flight reduction. In this same vein, Efobi and Asongu (2016) examined a panel of 29 African countries with a view to analyzing how terrorism and capital flight are related from 1987 to 2008. The study utilized the Generalized Method Moment (GMM) alongside Forward Orthogonal Deviations (FOD) and Quantile regression (QR). The results from the study showed that domestic, transnational unclear and total terrorism are the consistent factors that give rise to capital flight. Also, the result of QR indicated that transnational terrorism has a direct relationship with capital flight at about 0,90[th]

quintile. But capital flight in low quintiles of the capital flight distribution was affected by terrorism dynamics.

In another perspective, Carp (2014) analyzed the aftermath effect of economic and financial crisis, financial globalization on rise in capital flow volatility and the multiplier effect on economic growth and development in Central and Eastern European Countries (CEECs). The author submitted that capital flight could be mitigated through a careful movement towards financial liberalization. Anaya, Hachula, and Offermanns (2017) employed a structural global VAR model to examine how US unconventional monetary policy shock affects financial and economic conditions of emerging market economies and also, whether or not international capital flight flows constituted a major channel of shock transmission. The authors asserted that portfolio flows from the US to emerging economies was increased largely due to an expansionary policy. As a result of this, the receiving emerging economies recorded a persistence movement in real and financial variables. Similarly, Brada *et al*. (2011) applied a panel OLS to analyze factors that caused capital flight in seven countries of the Commonwealth of the Independent States, namely Armenia, Azerbaijian, Belarus, Kazakhstan, Moldova, the Russian Federation, and Ukraine between the period of 1995 and 2005. It was discovered from the study that the major factors causing capital flight in those countries were political factors because investors were protected through the rule of law and limits on predation in democratic regime. Therefore, capital flight and political risk have a direct relationship in the countries under study. While investigating the relationship between capital flows and political environment in China between 1992 and 2007, Lan, Wu and Zhang (2010) utilized ARDL bounds testing to posit that political instability and change in economic policies were the paramount factors leading to capital flight in the domestic economy under consideration.

Consequently, Cheung and Qian (2010) analyzed the determinants of capital flight in China with quarterly data from 1999 (Q1) to 2008 (Q2). The authors attributed capital flight to distortions in the political structure of the country because safer political environment attract and boost the confidence of investor to invest in the domestic economy. Kunieda, Okada, and Shibata (2014) investigated the linkage between government corruption, capital account liberalization, capital flight and economic growth within the framework of panel data of 109 economies. It was discovered from the study that corruption led to capital flight with negative impact on economic growth of the countries under study. Liew *et al*. (2016) adopted the ADF and PP unit root tests, KPSS stationary test, bounds test and the ARDL techniques to estimate the macroeconomic elements of capital flight in Malaysia. The authors argued that capital flight, FDI, the stock market and external debt had an inverse relationship. Meanwhile, reverse was the case of political risk and capital flight. In another study, Choong *et al.* (2010) assessed how debts and economic growth are related in Malaysia between 1970 and 2006. It was discovered from the study that rise in external debt level had a better impact on the performance of countries with better financial systems because private capital inflows exceeded

capital outflows in those countries. However, fall in the external debt facilitated investors to invest resulting from a better economic performance of the country. Pyun and An (2016) applied a panel data analysis to investigate the nexus between financial integration, capital flight and economic growth in 58 countries between 2001 and 2013. The findings from the study asserted that global financial crisis and integration of the world economies with the US economy brought about the responses of capital flight. Also, co-movements in business cycle, local fundamental factors, investment channels were principal factors orchestrating capital flight. Liew *et al.* (2016) adopted World Bank residual approach to investigate capital flight in Malaysia between 1975 and 2013. The authors proved that political risk and outflow of capital had a significant direct linkage in the country.

In addition, Brada, Kutan, and Vuksic (2013) researched the variables that caused capital flight from 10 Central and Eastern countries between 1996 and 2009. It was submitted in the study that the following; interest rates, investors sentiment, and the ease associated with movement of funds across borders among others were responsible for the capital flight in the transition economies. Also, expansion in domestic credits and financial liberalization led to capital flight in the countries. Kueh *et al.* (2010) employed Granger causality test and error correction model to examine the determinants of direct investment abroad of Singapore between 1975 and 2007. The results from the study showed that exchange rate caused outward FDI inflows in the country. Cheung, Steinkamp, and Westermann (2016) investigated the link between interest rate disparity and illicit capital flow behavior in China benchmarking 2007 as the year of determinant. It was discovered from the study that the response of capital flight in the post 2007 was weak in the country. The reason for this behavior was largely due to capital control policy, trade frictions and exchange rate variability. Uguru (2016) employed ordinary least squares (OLS) technique to investigate the relationship between capital flight and tax revenue in Nigeria. The results from the study submitted that capital flight and tax revenue had an inverse relationship in the country. In another perspective, Onyele and Nwokocha (2016) examined how capital flight and poverty are related in Nigeria between 1986 and 2014 within the framework of Johansen co-integration test and error correction model. It was discovered from the study that capital flight and poverty possess a long run equilibrium in the long run in Nigeria. In the same vein, capital flight and poverty had a direct relationship in the country. Peter and Ebi (2017) examined the relationship between remittances, capital flight and poverty in Nigeria between 1970 and 2010 with the aid of econometric technique. The study concluded that remittances and per capita consumption had a direct relationship. Meanwhile reverse was the case between capital flight and per capita consumption in the country.

Moreover, Uremadu et al., (2016) posited that capital flight caused a significant detriment to financial savings while investigating the nexus between capital flight and financial savings in Nigeria. Obidike et al. (2015) utilized Autoregressive Distributed Lagged model (ARDL) to analysis the link capital flight and development of the Nigerian economy. The authors argued that capital flight had

significantly retarded the development of the country's economic development. While assessing the dynamics of capital flight effect and real exchange rate in Nigeria from 1981 to 2009, Onoja (2015) provided the evidence of no significant relationship between capital flight and real exchange rate in the country. Raheem and Adeniyi (2015) used system generalized method of moments (Sys-GMM) to estimate the relationship between capital inflow, official development assistance (ODA), remittances, debt, capital flight and economic growth in thirty three African economies between 1970 and 2010. The authors asserted that the major hindrances to economic growth were capital flight and debt. Olawale and Ifedayo (2015) corroborated that economic growth, external debt, foreign reserve, capital flight, FDI and current account balance had a long run convergence while examining the linkage between capital flight and economic growth in Nigeria between 1980 and 2012.

In summary, from the reviewed literature, it could be pinpointed that the studies on the nexus between capital flight and poverty have not been fully explored in Nigeria. Hence, the relevance of this work.

3. METHODOLOGY

This study utilized secondary data from 1981 to 2017 for the variables of interest. These data were extracted from the Central Bank of Nigeria (CBN) Statistical Bulletin.

3.1. MODEL SPECIFICATION

The model for this study is specified functionally as follows:

$$POVT = F (DFI, EXDEBTS, FR, EXCHR, OPEN) \tag{1}$$

Equation (1) could be written in a linear form as follows:

$$POVT_t = \beta_o + \beta_1 LDFI_t + \beta_2 LEXDEBTS_t + \beta_3 LFR_t + \beta_4 EXCHR_t + \beta_5 OPEN_t + \mu_1 \tag{2}$$

Where

POVT is poverty levels and it is proxied by household consumption per capita

EXDTS is external debt services.

DFI is direct foreign investment.

FR is foreign reserves.

F is functional notation

L is natural logarithm

t ranges between 1980 to 2017.

μ = error term.

Aprori Expectation

It is expected that $\beta_1, \beta_2, \beta_{4<0,} \beta_3,$ and $\beta_5 > 0$

3.2.   RESULTS AND DISCUSSION

Table 1. Descriptive Statistics of Annual Data Series (1981-2017)

Descriptive Statistics	LPOVT	LFR	LDFI	LEXDTS	OPEN	EXCHR
Mean	9.460106	12.16424	22.49150	10.79387	32.23865	82.62978
Median	9.861818	11.44867	22.86259	10.75280	34.18000	92.69335
Maximum	13.02816	18.12646	26.27514	15.32974	53.28000	300.0000
Minimum	5.551020	8.608806	17.50439	6.996041	9.140000	0.610025
Std. Deviation	2.424606	2.410142	2.901784	1.935030	12.73767	79.96470
Skewness	-0.094964	0.884441	-0.271612	0.016915	-0.344282	0.685098
Kurtosis	1.630187	3.158477	1.618439	2.887320	2.132128	2.764942
Jargue-Bera	2.948377	4.862505	3.305704	0.021339	1.892121	2.979566
Probability	0.228964	0.087927	0.191503	0.989387	0.388268	0.225422
Sum	350.0239	450.0768	809.6941	399.3733	1192.830	3057.302
Sum. Sq. Deviation	211.6337	209.1162	294.7123	134.7963	5840.936	230196.7
Observation	37	37	37	37	37	37

Source: Authors` Computation (2019)

The above table shows the various descriptive statistics of the set of data used in this study. Evaluation of these statistics becomes imperative because they show the normal distribution properties of the dataset utilized in this study. From the table, it could be deduced that the values of mean and median of the variables of interest such as poverty levels, direct foreign investment, foreign reserves, external debt service payments and openness of the economy are almost the same except those of exchange rate that show a slight divergence. This implies that the dataset in this study is nearly symmetrical. In the case of perfect symmetry, the values of the mean and median must be identical (Karmel and Polasek, 1980). Similarly, looking at the Kurtosis values of the dataset used to capture the variables of interest, it could be established that the dataset is fairly distributed because these values are not too far from 3. Therefore, these data could be further used for econometric analysis because the assumption of normal distribution of data has been fulfilled.

Table 2. *Unit Root Test*

Variables	ADF Test				
	Level	Probability	1st Diff	Probability	Remark
LPOVT	-2.948404***	0.9117	-2.948404***	0.0000	I(1)
LFR	-2.957110***	0.9994	-2.951125***	0.0001	I(1)
LDFI	-2.960411***	0.6600	-2.951125***	0.0000	I(1)
LEXDTS	-2.967767***	0.1534	-2.981038***	0.0527	I(1)
OPEN	-2.945842***	0.2092	-2.948404***	0.0000	I(1)
EXCHR	-2.945842***	0.9999	-2.948404***	0.0130	I(1)
Variables	PP Test				
	Level	Probability	1st Diff	Probability	
LPOVT	-2.945842***	0.9498	-2.948404***	0.0000	I(1)
LFR	-2.945842***	0.9996	-2.948404***	0.0000	I(1)
LDFI	-2.948404***	0.7890	-2.951125***	0.0001	I(1)
LEXDTS	-2.945842***	0.2309	-2.948404***	0.0000	I(1)
OPEN	-2.945842***	0.2092	-2.948404***	0.0000	I(1)
EXCHR	-2.945842***	0.9999	-2.948404***	0.0130	I(1)

*Source: Authors` Computation (2019)   ** %5 level () P-Value*

Stationarity problem is usually linked with time series data which its aftermath effect could bring about a spurious result in a study. An attempt to eliminate the problem of spurious result in this study brought about the verification of the stationarity properties of the data used in this work. Consequently, in testing the unit root of the data, the study employed the estimated standard Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) tests in which the estimated results were presented in the above table. The results therefore established that all the variables of interest are stationary after first differencing. In other words, these variables possess unit root.

Table 3. *Johansen Cointegration Test (Trace Statistics) and (Maximum Eigenvalue)*

Null Hypothesis	Eigenvalue	Trace Statistics	P-value	Maximum Eigenvalue	P-value
r=0	0.525066	62.16909	0.1749	25.31568	0.3640
r≤1	0.459298	36.85341	0.3545	20.90618	0.2819
r≤2	0.292864	15.94723	0.7160	11.78210	0.5693
r≤3	0.115156	4.165128	0.8898	4.159701	0.8421
r≤4	0.000160	0.005428	0.9406	0.005428	0.9406

Source: Authors` computation (2019)

The results of the unit root test confirmed that all the variables of interest are integration of order 1. By this implication, these variables might have a short run divergence as a result of the unit roots present in these variables. However, the variables could have a long run equilibrium relationship. Against this backdrop, this study employed the Johansen and Juselius (1990) cointegration test to verify if these variables possess a long run convergence or not. The estimated results presented in the table above show that the Trace statistics and Maximum eigenvalue statistics model at a lag interval of 1 to 1 confirmed the presence of at most four cointegrating vectors in the systems. The implication of this is that all the variables of interest do have a long run equilibrium relationship with one another, despite the fact that they might likely show some adjustment to short run disequilibrium. In order to estimate the long run relationship among these variables, this study utilized Dynamic Ordinary Least Square (DOLS).

Table 4. *The Impact of Capital Flight Variables on Poverty Levels in Nigeria*

Dependent Variable: LPOVT
Method: DOLS

Variable	Coefficient	t-statistics	P-value
LFR	-0.270620	2.355424	0.0252
LDFI	-0.548713	3.475542	0.0016
LEXDTS	-0.000861	0.007917	0.9937
OPEN	-0.002667	0.192769	0.8484
EXCHR	-0.002026	0.377289	0.7086
R-Squared	0.925778		
Adjusted R-Squared	0.913408		

Source: Authors` Computation (2019)

From the above table, it could be deduced that direct foreign investment and household consumption per capita have a significant negative relationship. A unit change in direct foreign investment leads to 0.54% decrease in household consumption per capita in Nigeria. This implies that capital taken out of Nigeria from 1981 to 2017 for investment in other countries of world contributed a significant impact to the current levels of abject poverty in the country. Similarly, foreign reserves and household consumption per capita have a significant inverse relationship. A unit change in foreign reserves brings about 0.27% reduction in the household consumption per capita. This implies that the country's foreign reserves are not strong enough to contribute to poverty reduction in the country. External debt service payments, exchange rate and openness of the economy have a negative

relationship with household consumption. Though, this relationship is not significant at 10 percent level of significance. Consequently, it could be inferred that capital flight has been one of the economic variables that has led Nigeria into the current world's headquarters of poverty because the country has lost its huge sum of capital to the rest of the world through direct investment abroad, external debt servicing and foreign reserves depletion as a results of trade deficit and exchange rate volatility. The finding in this study is tandem with the submissions of Onyele and Nwokocha (2016), Peter and Ebi (2017) in spite of the fact that different methodology was adopted.

Moreover, the explanatory/ independently variables of the model which comprises of direct foreign investment, external debt servicing, foreign reserves and openness of the economy jointly explained about 92% of the systematic variations in the dependent variable, poverty levels leaving 8% unexplained as result of random chance. This implies that the model is relatively good for the analysis. Meanwhile, after adjusting for the loss in the degree of freedom, the explanatory power reduces to 91%.

Table 4. *Pairwise Granger Causality Test.*

Sample: 1981-2017
Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
LPOVT does not Granger Cause LEXTDS	35	1.52791	0.2334
LEXTDS does not Granger Cause LPOVT		0.86903	0.4296
LDFI does not Granger Cause LEXTDS	34	3.14628	0.0580
LEXTDS does not Granger Cause LDFI		0.51428	0.6033
OPEN does not Granger Cause LEXTDS	35	2.44751	0.1036
LEXTDS does not Granger Cause _OPEN		0.24247	0.7862
LDFI does not Granger Cause LPOVT	34	2.61739	0.0902
LPOVT does not Granger Cause LDFI		0.39418	0.6778
LFR does not Granger Cause LPOVT	35	1.28739	0.2908
LPOVT does not Granger Cause LFR		3.55976	0.0410

Source: Authors' Computation (2019)

This section examined the direction of causality between capital flight variables and poverty levels in Nigeria within the context of Pairwise Granger Causality Test. The estimated results in the above table shows that external debt service payments and poverty levels do not have a causal relationship in Nigeria. However, there is a uni-directional causal relationship which flows from direct foreign investment to external debt service payments in the country. This implies that the part of the country's capital that should have been used for investment abroad

is being lost to foreign debt servicing. Meanwhile, no feedback effect exists among openness of the economy, external debt service payments, direct foreign investment and poverty levels in Nigeria.

Moreover, poverty levels Granger cause foreign reserves in Nigeria but not vice versa. The implication of this is that, the current level of the country's foreign reserves might have been as a result of inability of larger bulk of poor people to engage in viable economic activities that contribute to the nation building.

4. CONCLUSION

This study examined the relationship between capital flight and poverty levels from 1981 to 2017 within the framework of Johansen cointegration test, Dynamic Ordinary Least Square and Granger causality. Consequently, the findings that emanated from this study could be summarized as follows: all the variables of interest are integration of order one and possess long run convergence.

In the same vein, direct foreign investment and household consumption per capita have a significant negative relationship. This implies that foreign direct investment outflows in Nigeria from 1981 to 2017 led to the current levels of abject poverty in the country. Similarly, foreign reserves and household consumption per capita have a significant inverse relationship. This implies that Nigeria's foreign reserves are not strong enough to contribute to poverty reduction in the country. External debt service payments, exchange rate and openness of the economy have a negative relationship with household consumption. Though, this relationship is not significant at 10 percent level of significance. Therefore, it could be concluded that capital flight has led Nigeria into the world's headquarters of poverty because the country has lost its huge sum of capital to the rest of the world through direct investment abroad, external debt servicing and foreign reserves depletion as a result of trade deficit and exchange rate volatility.

Moreover, external debt service payments and poverty levels do not have a causal relationship. No feedback effect exists among openness of the economy, external debt service payments, direct foreign investment and poverty levels. But there is a uni-directional causal relationship which flows from direct foreign investment to external debt service payments in the country and poverty levels Granger cause foreign reserves in Nigeria but not vice versa. Based on the findings that emerged in this study if the Nigeria wants to achieve the sustainable development goal one which centred around poverty reduction comes 2030, policy makers in the country should ensure that direct foreign investment should be invested in the domestic economy. The country should as a matter of urgency desist from perpetual usage of external debts to finance its budget deficit. The country should recourse to the usage of domestic debts instead of external debts. Also, there should be an aggressive campaign and policy against importation of materials that can be

manufactured domestically in order to solve exchange rate volatility and depletion of foreign reserves that trade deficit could cause the country.

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