



## EFFECT OF CAPITAL FLIGHT ON ECONOMIC GROWTH IN NIGERIA

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### **Abstract**

*This study examined the effect of external reserves on economic growth in Nigeria. The study employed a descriptive and time series research design, which is very important in determining the relationship between time-series variables. Data were on capital flight and economic growth from inception to the 2020 period in the Central Bank of Nigeria Statistical Bulletin. The Descriptive Statistics and Least Squares regression technique were adopted to analyze the variables. The results show that external reserve has a negative and insignificant effect on gross domestic product. It has the expected theoretical sign as debt servicing acts as a drag on economic growth because it diverts the availability of public funds for investments purposes to payments of debt. In light of the study's findings, the study also recommended that reserves be encouraged at this time because they are important for macroeconomic stability and must be addressed in order to improve Nigeria's economic growth.*

**Keywords:** Capital Flight, External reserve, Economic growth

## **INTRODUCTION**

As politicians, corporations, and foreign investors massively move funds out of the country, the Nigerian economy is losing a lot of money. According to a survey of public payments made by the Central Bank of Nigeria (CBN), \$22.1 billion left the country over the course of five weeks, or an average of \$4.5 billion per week. Foreign exchange outflows increased to \$5.35 billion for the week ending November 30, 2014, compared to approximately \$3.083 billion for the week ending July 31, 2014 (CBN Statistical Bulletin 2014). The naira exchange rate, which had been stable prior to the 2015 elections, is said to have fallen as a result of capital flight. Although the Central Bank of Nigeria (CBN) has said that currency speculators who buy and hold currency to sell at a later date at a higher rate in order to make money are to blame for the collapse of the naira, Nigerians themselves are to blame for the movement of funds out of the country by purchasing dollars with their naira and moving them offshore. Nigeria's foreign reserves are said to have been depleted as a result of capital flight, weakening the naira.

At \$5.4 billion in 1999, Nigeria's foreign exchange reserves increased dramatically to \$51.3 billion at the end of 2007 and \$53.0 billion in 2008. However, the reserves fell further from \$38.138 billion at the end of April 2014 to \$33.04 billion in February 2015 due to the 2008 crash in the international price of crude oil and the global financial crisis that followed (World Bank, 2015).

With these brief records, one can then speculate on the actual quantity that traveled from Nigeria's shores to developed nations via legal and illegal routes. Since Nigeria's economy relies more heavily on foreign direct investment (FDI) than on domestic investment, the prevalence of capital flight is even more concerning. Researchers are now looking into the effects of capital flight on the domestic economy as a result of this fact. Even though there is a lot of literature on the ongoing debate about the connection between capital flight and domestic investment, little has been written about doing an analysis of a specific country like Nigeria.

The term "foreign direct investment" (FDI) refers to investments made by individuals or corporations in a nation other than the investor's home nation for the purpose of starting a business or purchasing an asset there. According to John (2016), foreign direct investment is viewed as the transfer of capital and technology from a developed or developing nation to another. According to Farrel (2008), "foreign direct investment" refers to a company's use of technology, capital, management, and entrepreneurial skills to operate in a foreign market and provide goods and services. Nigeria is the third economy in Africa to welcome FDI, following Ethiopia and Egypt. The United States, the United Kingdom, China, the Netherlands, and France are among the nations that invest in Nigeria. According to UNCTAD (2018), political instability, widespread corruption, a lack of transparency, and subpar infrastructure may have contributed to a 21 percent decline in Nigeria's FDI flows in 2017. However, this study tends to re-examine the impact of external reserves on economic growth in Nigeria.

## **LITERATURE REVIEW**

The process of maximizing a nation's external resources to meet its economic needs is known as foreign reserves management. The management of foreign reserves is the sole responsibility of the Central Bank in Nigeria. Monetary gold, a reserve position at the International Monetary Fund (IMF), the holding of special drawing rights (SDRs), and foreign exchange, which are convertible currencies of other nations, are all components of foreign reserves (CBN, 1997). According to Aluko (2007), the Nigerian economy has recently benefited significantly from external reserves. It has increased the amount of money in

circulation, which has had a positive effect on economic activity because more money could be invested in productive endeavors. In turn, employment was created, output increased, and consumption increased. The people's standard of living significantly improved as a result of their multiplier effects on the economy and effective financial resource management. In addition, there was an increase in the manufacturing sector's contribution to GDP, which had been decreasing. Obaseki (2007) made the observation in a related study that the applications of external reserves cannot be overstated. The majority of external obligations must be settled in foreign currency. As a result, reserves grow in importance as a means of financing external imbalances. Intervention in the foreign exchange market, protection against unanticipated volatility, and preservation of natural wealth for future generations are additional uses for external reserves.

The government, according to Benigno and Fornaro (2012), induces a real exchange rate depreciation and a reallocation of production toward the tradable sector, which boosts growth, by accumulating foreign reserves. Central banks must switch from holding their external reserves in the conventional gold reserve assets to a basket of foreign currencies and securities in order to implement currency diversification. The majority of nations' monetary authorities are influenced by historical, economic, and political fundamentals when determining the basket of foreign currencies to hold. Although Central Banks' investment in foreign currencies and securities is a general economic objective of currency composition of reserves to maximize returns on financial resources, the monetary authorities frequently minimize profitability and focus on their liquidity requirements, particularly when they are experiencing balance of payments disequilibrium (Nwafor, 2017). At the time the Central Bank of Nigeria (CBN) was established, legislation made it relatively difficult to diversify the reserve assets away from gold (10%) and pounds sterling (90%) until the CBN Act was changed in 1962, the dollar assets did not even count as part of the official reserve holdings. Thusly, in the 1960s, outside of the country, most real resources were held in pounds consequently adjusting to the plan of authentic Trade Framework (Nwafor 2017).

From 1959 to 1970, assets in US dollars made up 12.5 percent of the external reserve, while the pound sterling averaged 78.4 percent. The country's foreign reserves are currently held by the central bank in major currencies like: the Euro, the US dollar, the Japanese yen, the British pound, the Swiss Franc, and the currencies of other trading partners. However, due to the fact that Nigeria's crude oil exports are invoiced in the US dollar and the majority of its obligations, such as external debt service, foreign exchange intervention, and other service obligations, are also denominated in the US dollar, over 90% of Nigeria's foreign reserves are denominated in the US dollar (Nda, 2006).

### **EMPIRICAL REVIEW**

In the year 2020, Orji, Ogbuabor, Kama, and Anthony-Orji looked into how capital flight affected Nigeria's economic growth. In doing the examination, information from CBN factual release was utilized for the period 1981 to 2017. The study used the Autoregressive Distributed Lag (ARDL) bounds test method. According to the study, both short-term and long-term economic growth are significantly hampered by capital flight. Money supply, credit to the private sector, and domestic investment are additional variables that have been found to have a significant impact on economic growth. From 1981 to 2015, Anetor (2019) investigated the macroeconomic factors that led to capital flight from Sub-Saharan African (SSA) nations. The autoregressive distributed lag (ARDL) model was used in conjunction with secondary data from the World Bank Development Indicators (WDI) to identify the macroeconomic factors that influence capital flight from the SSA region. The study's findings demonstrated a significant negative relationship between economic expansion and capital

flight in both the long and short term. Between 1990 and 2017, Makwe and Oboro (2019) looked at how capital flight affected Nigeria's economic growth. Cointegration analysis was used to analyze the data for both the short run and the long run, and ADF tests were used to test for the time series' stationarity. Time series data covering these study periods were used. The ordinary least square (OLS) econometrics approach was utilized by the researchers for the purpose of data analysis. The results of the T-test showed that the proxies of capital flight and the gross domestic product, which is a proxy for economic growth, had a strong relationship. The work by Adedayo and Ayodele (2016) provides an empirical analysis of the impact that capital flight has on the economy of Nigeria. Secondary data from the National Bureau of Statistics and the Central Bank of Nigeria's Statistical Bulletin of various issues were used in the study. The sample period from 1980 to 2014 is the subject of the empirical measurement. The adopted variables, which include Gross Domestic Product, Capital Flight, and Exchange Rate, were subjected to a comprehensive analysis using the Ordinary Least Square (OLS), Augmented Dickey-Fuller unit root test, and Co-integration test. The findings demonstrated that the variables have a significant positive influence. This suggests that, during the time period under consideration, the Nigerian economy will benefit from an increase in the exchange rate as a result of an increase in capital flight into the economy. Using data from 1981 to 2015, Lawal, Kazi, Adeoti, Osuma, Akinmulegun, and Ilo (2017) used the Autoregressive Distributed Lag (ARDL) model to examine the impact of capital flight and its determinants on the Nigerian economy. Current account balance, capital flight, foreign direct investments, foreign reserve, inflation rate, external debt, and real gross domestic product were among the variables. The finding suggests that Nigeria's economic expansion is hindered by capital flight. Wujung and Mbella (2016) looked into the connection between capital flight and Cameroon's economic growth from 1970 to 2013. They found evidence supporting a negative significant relationship between capital flight and economic development in Cameroon over the study period using the Fully Modified Least Squares (FMOLS) method. Exports and external debt are two additional variables that have a significant negative impact on economic development. The real interest rate, on the other hand, was found to be positively correlated with economic growth. Between 1980 and 2012, Olawale and Ifedayo (2015) looked at how capital flight affected Nigeria's economic growth. Co-integration, Ordinary Least Square (OLS), and Error Correction Mechanism (ECM) were the primary estimation methods utilized in the study. During the study year, findings showed that capital flight, foreign reserve, external debt, foreign direct investment, and current account balance all cointegrate with GDP in Nigeria. Additionally, it was discovered that the economy was adversely affected by capital flight. Over the course of 30 years, from 1981 to 2010, Olugbenga and Alamu (2013) conducted an in-depth investigation into the effects of capital flight on Nigeria's economic expansion. The dynamic relationship between capital flight and economic expansion was examined using the Johansen co-integration test. The outcomes demonstrate that the variables have a long-term co-integration. In addition, the notion that capital flight has a negative effect on economic expansion is only true in the short term. In addition, it was discovered that capital flight has a positive and significant long-term impact on Nigerian economic growth. The research was carried out in China by Lan, Wu, and Zhang (2010) using the ARDL bounds testing procedure and annual data that spanned the years 1992 to 2007. They discovered that capital flow would be affected by changes in the domestic economy and political environment. These included economic policy shifts and political instability like social unrest.

## **METHODOLOGY**

The study employed a descriptive and time series research design, which is a very important in determining the relationship between time-series variables. The population of the study

consist of all data on capital flight and economic growth from inception to the 2020 period in the Central Bank of Nigeria Statistical Bulletin. Data are quarterly data from 1981 to 2020 from Central Bank of Nigeria Statistical Bulletin.

**Method of Data Analysis**

The Descriptive statistics and Least Squares regression technique were adopted to analyze the relationship between the variables. Preliminary tests to know the normality and stationarity of the data are conducted through Jarque- Bera, Skewness, Kurtosis tests, and the unit root test. The test for the Jarque-Bera, Skewness and Kurtosis tests is to find out whether that the data are normal. This is because it includes macroeconomic variables that determine the economic growth in Nigeria.

**Model Specification**

In order to achieve the broad objective of this study, the model of John (2016) was adapted. In his study of the effect of foreign direct investment on economic growth in Nigeria, the model was specified as:

$$NEG = CF \dots\dots\dots i$$

Where

NEG = Nigeria Economy Growth

CF = Capital Flight

NEG is measured by GDP and CF is measured by EXR,. Further, equation i is expanded below to capture the objectives of the study;

$$GDP = f (EXR) \dots\dots\dots ii$$

The econometric form of the functional model is specified as:

$$GDP = \mu_0 + \mu_1 EXR + \varepsilon t$$

Where

GDP = Gross Domestic Product

EXR = External reserves

$\mu_0$  = Constant

$\mu_1$  = Shift Parameters

$\varepsilon$  = error term

t = time series.

**ANALYSIS OF RESULT**

Table 1. Descriptive Statistics

	GDP	EXR
Mean	34690.67	17959.32
Maximum	71387.83	53000.36
Minimum	13779.26	224.4
Std. Dev.	20237.78	17479.61
Skewness	0.673787	0.622229
Kurtosis	1.880848	1.787424
Jarque-Bera	4.986242	4.905902
Probability	0.082652	0.086039
Observations	39	39

Source: Researcher’s compilation (2022).

GDP had a mean of \$34690.67 billion, a standard deviation of 20237.78 billion, and maximum and minimum values of 71387.83 billion and 13779.26 billion, respectively. The large standard deviation suggests significant GDP variations over time, and the variable appears positively skewed (0.673). The Jacque-bera statistics' p-value of 0.083 indicates that the series is normally distributed and that outliers are unlikely to occur. With a standard deviation of 17479.61, the EXR mean was 17959.32bn. Positively skewed (0.62), the maximum and minimum values were 53000.36 and 224.4000, respectively. The Jacque-bera statistics' p-value of 0.086 indicates that the series is normally distributed and that outliers are unlikely to occur.

### Test of Hypothesis

H<sub>01</sub>: There is no significant relationship between external reserve and the growth of the Nigerian economy

**Table 2: Co-integrating Regression**

Variable	(CCR)	(DOLS)	(FMOLS)
c	5537.481	5164.172	5756.477
	-3084.7	-3066.93	-3194.69
EXR	{0.0821}	{0.10955}	{0.0810}
	-1.037	-1.33157	-1.0188
R2			
Adjusted	-2.815	0.977	0.922
	-15.394	0.956	0.91

Source: Researchers compilation (2022).

In small sample sizes, these methods can produce accurate estimates and provide a check for results' robustness. There are many reasons why CCR, DOLS, and FMOLS are superior to OLS; let me list the most important ones: 1) The t-statistic obtained without stationary or I(0) terms is only approximately normal, despite the extremely consistent OLS estimates. OLS estimates may suffer from serial correlation and heteroskedasticity because the omitted dynamics are captured by the residual, so inference using the normal tables will not be valid—even asymptotically—despite the fact that OLS is super-consistent in the presence of "a large finite sample bias." (2) As a result, the OLS estimates' "t" statistics are useless. (3) DOLS and FMOLS deal with endogeneity by adding leads and lags (DOLS). White heteroskedastic standard errors are also utilized. FMOLS uses a nonparametric method to accomplish the same thing.

The outcomes for the impact of EXR on Gross domestic product is negative and immaterial across every one of the assessments; FMOLS (-1.0188, p=0.2978), CCR (-1.037, p=0.320), and DOLS (-1.332, p=0.3762). The expected theoretical sign for the variable EXR is that debt servicing slows economic expansion because it diverts public funds intended for investments to debt payments. The direction of the relationship is in line with the debt overhang hypothesis, which states that debt servicing can lead to a situation in which debt obstructs economic growth, particularly in developing economies.

Across all estimations, the effect of EDS on RGDP is negative and insignificant; FMOLS (-1.0188, p=0.2978), CCR (-1.0360, p=0.320), and DOLS (-1.332, p=0.3762). The expected theoretical sign for the variable EXR is that debt servicing slows economic expansion because it diverts public funds intended for investments to debt payments. As a result, the

null hypothesis that there is no significant connection between Nigeria's expanding economy and its external reserve is accepted.

### CONCLUSION AND RECOMMENDATION

Across all estimations, the effects of EDS on RGDP are negative and insignificant. The expected theoretical sign for the variable EDS is that debt servicing slows economic expansion because it diverts public funds intended for investments to debt payments. In light of the study's findings, the study also recommended that reserves be encouraged at this time because they are important for macroeconomic stability and must be addressed in order to improve Nigeria's economic growth.

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