Foreign capital inflows and growth nexux in Nigeria

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Abstract

This research examined the effect of foreign capital inflows on economic performance in Nigeria between 1981 and 2020,. It used the Least Squares econometric technique to analyze data from the World Bank's time series database. The data were checked for stationarity using the Augmented Dickey Fuller technique before being submitted to further empirical testing using a system-wise Johansen Cointegration Test, an ECM, and the Granger Causality Test. The analysis discovered a negative and negligible link between FDI and GDP. The association between REM and NOA and GDP is favorable but negligible. While GDP and GCF have a positive and substantial link. The study discovered that foreign capital inflow factors such as FDI, REM, and NOA had a negligible short-run effect on economic development in Nigeria. However, if the influx is steady throughout time, they have a major effect in the long run. Additionally, the study discovered that gross capital formation has a substantial effect on economic growth in both the short and long run. As a result, the study recommended that the government encourage savings by increasing deposit interest rates in order to increase the availability of funds for domestic investment and that the government create an enabling environment for investment to thrive by providing basic amenities such as electricity, good roads, and health care, among others.

Keywords: *Capital inflow, Economic growth, Foreign Remittances, Net Official Assistance, Gross Capital Formation.*

Introduction

Investment is one of the major factors that affects Economic growth in any given economy. There is always a gap between the level of resources required for investment to propel the minimum required economic growth in an economy and the actual resources that are invested, particularly in developing countries. The resources available for investment can be sourced domestically or internationally. However, the domestic resources are generated from savings which are most times grossly inadequate for the required investment to propel growth. Thus, the need to source for foreign capital to compliment the domestic capital that is available and as such it has played vital roles in the process of economic development of many developing countries.Foreign capital inflow comes through various sources either in the form of Foreign Direct Investment (FDI), Foreign Portfolio Investment (FPI), foreign grants and aides, foreign loans and Foreign Remittances.

Within Sub Saharan African countries, foreign inflows come primarily through foreign aid, either directly from developed country governments or through different types of grants supplied by developed country governments and non-governmental organizations. Additionally, private capital inflows to Africa have surged in recent years. While foreign direct investment has begun to play a greater role in recent years, remittances remain the primary source of private foreign inflow to Sub Saharan Africa and African countries in general.For instance, one-quarter of the total inflow in Ghana in 2007 was remittance and some other countries like Kenya, Ethiopia and Nigeria had the same experience (Kanu, 2015).

However, some economists are of the view that the economic downturn in Nigeria was as a result of the foreign capital inflows into the country and other developing countries and therefore the economy does not require foreign capital inflow to cause growth. But others (the neo-liberals) were of the mind-set that the economic downturn was not as a result of foreign capital inflow but was due largely to corruption, fraudulent use of public funds, insecurity on the part of lenders and borrowers, amongst others. Thus, the neo-liberals advocated for foreign capital inflow that may bridge the gap between the expected investments and the actual amount invested (Duasa 2007).

Therefore, considering the crucial place ofinternational capital in a nation's development process, it becomes expedient to investigate the flow of international capital into Nigeria and its effect on economic performance of the country. Also, while appreciating the studies by different scholars {Uwakaeme (2015), Ekwe and Inyiama (2014), Edu, Inaya and Bassey (2015), Kanu (2015), Olatunji and Shahid (2015), Okafor, Ugochukwu and Chijindu (2016) and others}, it was discoveredthat no study captured Foreign Direct Investment (FDI), Net Official Assistance (NOA) and Remittances (REM) as the parameters in measuring capital inflow as well as gross capital formation (GCF) as one of the parameters that may affect foreign capital inflow. Thus, this study expands the parameters in measuring foreign capital inflow to include FDI, NOA and Remittances and GCF.

This study is guided by the following hypotheses in the null form.

i. FDI does not significantly impact the expansion of the Nigerian economy.
ii. Foreign Remittances does not significantly impact the expansion of the Nigerian economy.
iii. Net Official Assistance does not significantly impact the expansion of the Nigerian economy.

iv. Gross Capital Formation does not significantly impact the expansion of the Nigerian economy.

Conceptual Review

Economic Growth

Economic growth is critical for any country, developed or emerging. This has prompted each country to strive hard with suitable economic policies to assure continual expansion of the economy, which is a key indicator of a country's economic development. Economic growth has been defined in a variety of ways throughout history. Economic growth is defined in this paper as an economic phenomenon that refers to the increase in the level of output in a given economy. It simply refers to the increase in a country's output of products and services over a specified time period. Thus, if the total quantity or value of products and services produced in a country increases numerically, economic growth occurs or is said to have occurred.

Foreign Capital Inflow

Capital is an important aspect of production that cannot be neglected. As a major component of production, its domestic inadequacy, mostly, in developing countries is a challenge in terms of economic growth. This has made countries to source for capital elsewhere since where it originates from is not significant as long as it will propel rapid economic growth. The capital got from outside the country is what is known as foreign capital (Kanu, 2015).

Therefore, foreign capital inflow could be seen as the influx of funds (capital) from a source or sources outside the country.Basically, foreign capital inflows are divided into two categories; official and private capital inflows. Officialcapital inflow involves all well documented or recorded financial transactions from outside the shores of the country in both the private and public sectors. Whereas, the private inflow has to do with capital or fund that is transferred into a country. Such funds (in some instances) according to Vincent (2011) are smuggled into a country and most times are not accounted for.

Theoretical Literature

This study is hinged on the “two-gap theory” which is succinctly discussed below.

The “Two Gap Model”

Chenery and Stout (1966), introduced the “two-gap” theory to economic growth. The two-gap theory posits thatgaps in savings and foreign exchange exits and that these two gaps are

independent of each other and is constraints to achieving a targeted rate of economic growth particularly in LDCs.

For Chenery and Stout (1966), Foreign aid and investment are the means through which the savings can be filled so as tomeet the set goals in the growth of the economy. However, the growth rate targeted and the capital-output ratio given are used in calculating the sizes of the gap.

A savings gap emerges if the internal (domestic) rate of savings is smaller than the required amount of investment to attain a targeted growth in the economy.The target growth can be attained if the savings gap can be filled with foreign aid and investment.

Similarly, foreign aid and investment are the means through which the foreign exchange gap can be filled so as tomeet the set goals in the growth of the economy. In every economy, there is a specified foreign exchange requirement or earnings so as to attain targeted economic growth. Therefore, foreign exchange gap emerges when the earnings from net export is smaller than the foreign exchange requirements given to attain targeted growth in the economy. When such gap emerges, foreign aid (investment) can be used to fill in the said foreign exchange gap. The gaps (savings and foreign exchange) are been explained in terms ofthe national income accounting identities. NE – NY = Inv – Sav = Mp – Xp = NCI. Where NE = National Expenditure; NY = National Output; Inv = Investment; Sav = Savings;Mp = Import; Xp = Export; NCI = Net Capital Inflow (Investment).

Savings gap is explained by (Inv -Sav) while the foreign exchange gap is explainedas (Xp-Mp) as it is expressed using the identities of the national income accounting. However, in any accounting period, the gaps (savings and foreign exchange) are equal to ex-post but may be different ex-ante in the long-run because the decision makers concerning exports, import, savings and or investment becomes different in the long run.So, during the planning process, the plans of savers, investors, importers and exporters are likely to be different. The ex-ante (predicted or planned) investment is in relationship with the rate of growth in the economy that was targeted.

However, one main criticism of the two-gap theory is that it is only good for a short-run forecasting. Despite this weakness, this study is based on it considering the fact that it explains the savings and trade gaps which deals considerably with economic growth and foreign capital inflow respectively.

Empirical Literature

Studies have shown that economic growth which is the numerical increase in the produced goods and services is determined by some determinants (factors). Baghebo and Apere (2014) concluded in their study that there exists a relationship between FPI and economic growth. This implies that FPI can be a factor that influences economic growthEmploying the necessary econometric tests of Johansen co-integration, unit root, Granger Causality and Error Correction Mechanism (ECM), the study of Baghebo and Apere (2014) suggested that in Nigeria, economic growth adjust slowly to long-run equilibrium changes in the aforementioned positive variable of foreign portfolio investment.

Kizito and Hooi (2019) in their study on "foreign capital inflows and economic growth in Nigeria: any nexus", used the ARDL model to show that foreign portfolio investment has positive and significant impact on economic growth on the one hand, foreign loans had a negative impact on the economy of Nigeria. They also found that FDI foreign aid have insignificant impact on the Nigerian economy between 1980 and 2015.

Ismaila and Imoughele (2015) using a co-integration approach analysed the determinants that may influence economic growth in Nigeria. Their study found that, in Nigeria, FDI, Government expenditure and gross fixed capital formation are some of the factors that influence the growth of the economy under a stable inflationary rate.

Chigbu, Ubah and Chigbu (2015) carried out an analysis using an ordinary least square regression so as to determine the influence capital inflow may have on economic growth in developing economies using a period of twenty-six years. They found out that foreign capital inflows have significant impact on economic growth in the three countries (Nigeria, Ghana and South Africa) they used for the analysis. They stated that in Nigeria and Ghana, foreign direct investment, foreign direct portfolio and foreign borrowing have positive and significant impact on economic growth while remittances have significant impact on the three countries. Nevertheless, their study revealed that foreign aid has a negative relationship with economic growth in Nigeria.

Kanu (2015) also disaggregated foreign capital inflows into Foreign Direct Investment and other financial inflows indicators and lagged foreign direct investment by one year using a sample of 3 countries which were Nigeria, Ghana and South Africa. Kanu (2015) using the multiple regression analysis revealed in his findings that foreign capital inflow and other financial inflow indicators have no significant long run relationship with economic growth in

Nigeria and South Africa, but that the long run relationship is significant for Ghana. He concluded that growth relates negatively with foreign direct investment and other inflows in the long run but their impact on economic growth is felt in the short run.

In the short run, Olatunji and Shahid (2015) discovered a substantial association between FDI and economic growth in Nigeria. Over the period 1970–2010, the study established an empirical association between FDI and economic growth in Nigeria using cointegration analysis. According to the Engle Granger cointegration tests, there is no long-run link between Foreign Direct Investment and economic growth in Nigeria. However, FDI and economic growth have a short-run dynamic relationship. Finally, the study stated that in order to establish a long-term relationship between FDI and economic growth in Nigeria, the business environment must be improved, including the supply of critical infrastructure and political stability.

Baghebo and Apere (2014) reviewed and analyzed the evolution of portfolio investment with the goal of determining the extent to which portfolio investment has been used to boost the Nigerian economy's growth. According to the study's policy analysis, the international portfolio has seen the adoption of numerous policy measures over the years. Among these initiatives are capital market liberalization and the abolition of restrictions on foreign investors' participation in the market. From the empirical evidence, it was clear that foreign portfolio variables contributed significantly to the expansion of the economy in Nigeria.

Akinlo (2004) investigated the impact of FDI on economic growth in Nigeria for the period 1970-2001. His study concluded that FDI has no significant influence on economic growth. This was in line with Ajide and Adeniyi (2010) conclusion that carried out a similar study. However, this was not in line with the findings of Ilomona (2010) and that of Ogunmuyiwa, Onabanjo and Ogunleye (2011) that conducted a similar study as they concluded that a positive relationship exists between FDI and economic growth in Nigeria while Badeji and Abayomi (2011) concluded that the relationship that exists among the two variables (foreign aid and economic growth) was negative and not positive as stated by Ilomona (2010) and others.
Chigbu et al. (2015) in their study tried to analyse the impact of foreign capital inflows in developing economies and it revealed that foreign capital inflows have a significant impact on economic growth. However, they made it clear that the degree of impact differs in the different economies as some are more significant than others. Similarly, the impact of various variables

(proxies) such as foreign direct investment, foreign borrowing, etc on economic growth has varying degrees. Some tend to impact more than others.

Okafor et al. (2016) in their study expressed how foreign aid, other capital inflows and savings are related to economic growth. They concluded that the variables relate positively and significantly with growth. They further stipulated those economic policies of government such as liberal trade and financial policies if conducive also help to improve the overall growth performance of an economy particularly in a fast-growing economy. But that trade liberal policies are more important in slow growing economies.

Similarly, Shuaib and Dania (2015) in their study capital information: impact on the economic development in Nigeria using time series data from 1960 to 2013 found that gross capital formation has significant impact on economic growth in Nigeria.

From the literature reviewed, one is tempted to deduce that foreign capital inflow may have influence (impact or relationship) on economic growth, using different parameters such as FDI, FPI, foreign aid and loans. Also, stable macroeconomic policies, good financial and trade policies may also have some influence on the growth of the economy.

Gaps in Literature

While appreciating the studies by different scholars such as, Ekwe and Inyiama (2014), Edu, Inaya and Bassey (2015), Kanu (2015), Olatunji and Shahid (2015), Okafor, Ugochukwu and Chijindu (2016), among others, it was discoveredthat no study captured the issues under investigation. For instance, Vincent (2011) investigated the relationship that exists between economic growth and foreign capital inflow, using Foreign Direct Investment, Foreign Portfolio Investment and Official Development Assistance only as the components of foreign capital inflow. Therefore, this study expanded the parameters in measuring foreign capital inflow to include Foreign Direct Investment (FDI), Net Official Assistance (NOA) and Remittances (REM) as well as Gross Capital Formation (GCF) as one of the parameters that may affect Foreign Capital Inflows so as to ascertain their impact on economic growth in Nigeria from 1981 to 2020.

Research Design

This study adopted the Quasi-Experimental research design. The work examined the nexus between foreign capital inflows and economic growth in Nigeria for the period 1981-2020 using the Error Correction Model. The quasi-experimental research design was adopted to avoid the issue of random selection of variables used in the study.

Model Specification

To capture the nexus between foreign capital inflows and economic growth in Nigeria, this study adopted the modified Solow growth model. The model suggests that output growth is determined by labour productivity and capital availability. That is,

$$Y = f(K, L) \quad . \quad . \quad . \qquad (3.1)$$

Where, *Y* representsNational Output or product, *K* represents Capital and *L* representsLabour.

Equation 3.1 was modified by substituting remittance forlabour and taking various component of capital; therefore, the functional model is given as:

$$RGDP = f(REM, NOA, FDI, GCF, INTR) \quad . \quad . \quad . \qquad (3.2)$$

Where: RGDP = real gross domestic product; REM = remittance as a proxy for labour; NOA = net official assistance proxy for foreign capital; FDI = foreign direct investment proxy for foreign capital; GCF = gross capital formation proxy for domestic capital and INTR = Real interest rate.

All independent variables are assumed to have a positive association with the dependent variable theoretically.

The corresponding econometric model was specified after taking the logarithmic transformation of the variables as:

$$rgdp = \beta_0 + \beta_1 rem + \beta_2 noa + \beta_3 fdi + \beta_4 gcf + \beta \ \ intr + u_t \quad . \quad . \quad . \qquad (3.3)$$

Where: all the variables remain as previously defined; lowercase indicates log transformation of the corresponding variable. u_t= stochastic term.

The ECM model is derived from the model in equation (3.2) and is stated as:

$$\Delta(rgdp)_t = \gamma_0 + \gamma_1\Delta(rem)_t + \gamma_2\Delta(noa)_t + \gamma_3\Delta(fdi)_t + \gamma_4\Delta(gcf)_t + \gamma_5\Delta(intr)_t + \delta(ECM)_{t-1} + \varepsilon_t \quad . \quad . \quad . \quad (3.4)$$

Where: ECM = residual from the estimated regression in equation (3.3)

The coefficients on the change, Δ terms that is, γ_i represent short-run impacts and δ the speed of adjustment to long-run equilibrium.

Data Collection and Sources

Annual time series data for Economic Growth (as measured by Real Gross Domestic Product), Foreign Direct Investment, Foreign Remittances inflow, Net Official Assistance, and Gross Capital Formation were gathered in Nigeria from 1981 to 2020. The World Bank Databank was used to extract all data.

Estimation Technique, Procedure and Justification

The study used the least squares estimation technique. This technique was adopted due to its Best Linear Unbiased Estimation (BLUE) properties. The estimation however started with the unit root test as a result of the assumptions of the technique that implied stationarity of the variables. The estimation continued to cointegration test and finally error correction model (ECM) estimation.The first order condition for fitting an ECM is that all the variables must be stationary of the same order and the second order and sufficient condition is that the variables are cointegrated, therefore, the need to test for unit root and cointegration.

Stationarity Tests

Time series data often exhibit unit roots. Estimating time series with unit root often time leads to spurious regression phenomenon, a situation where variables that are not related would appear to be significantly related. As a result, it has become a component of time series analysis to look for unit roots. The Augmented Dickey-Fuller unit root test was used in this investigation, and the results are provided in Table 4.1. Analyses were done using the logarithmic transformation of all the variables in order to scale them down and allow for the measurement of elasticity.

Table 4.1: ADF UnitRoot-Test Results

Var.	ADFStatistic Lev.	1st Diff.	Model	5% C Val.	~I(d)
LOG(RGDP)	-1.9612	-5.2556**	Trend	-3.5485	I(1)
LOG(REM)	-3.0207**	-2.3424**	Trend	-1.9517	I(1)
LOG(NOA)	-3.4868	-5.7288**	Trend	-3.5578	I(1)
LOG(FDI)	-3.9661**	-10.8632**	Trend	-3.5485	I(1)
LOG(GCF)	-0.2079	-3.1920**	Drift	-2.9571	I(1)
ECT	-3.3985**	-	Drift	-2.9511	I(0)

Source: Author's_computation_usingEviews

The results indicate that LOG(REM) and LOG(FDI) where stationary around a deterministic trend but became stationary after differencing once. LOG(RGDP), LOG(NOA) and LOG(GCF) all became stationary after differencing once. This indicates that all the variables are integrated of order one {I(1)}, thus satisfying the first order condition for cointegration. The long-run regression was therefore estimated, the residual {Error Correction Mechanism (ECM)} term was retrieved and subjected to the Engel-Granter residual test for cointegration. The residual test results showed a long-run convergence among the variables, since the ECT with no lags was stationary at level. The Johansen's cointegration test results presented in Table 4.2 corroborated this result by indicating two cointegration equations. The implication is that there is a long-run convergence among the variables and if RGDP wanders away from its long-run path due to short-run fluctuations, there is the tendency for it to return and the speed at which this adjustment takes place is captured in the Error Correction Model by the ECM term. The regressed coefficients of the ECM regression are presented in Table 4.3

Cointegration Test

Table 4.2: Johansen Test for Cointegration (Trace Statistics)

Null Hypothesis	Trace Stat.	5% Crit. Value
$r = 0$	88.8356*	69.8189
$r \leq 1$	52.8105*	47.8561
$r \leq 2$	22.6070	29.7971
$r \leq 3$	8.4540	15.4947
$r \leq 4$	1.1431	3.8415

Source: Author's_Computation using Eviews

ECM Result

Table 4.3: ECM Results
Depend. Var: D(LOG(GDP))

Var.	Coeff.	Std. Err.	t-Stat.	Prob.
C	0.044185	0.042487	1.039967	0.3073
D(LOG(REM))	0.033924	0.074935	0.452715	0.6542
D(LOG(FDI))	-0.056653	0.080821	-0.700969	0.4891
D(LOG(NOA))	0.104407	0.095802	1.089823	0.2851
D(LOG(GCF))	0.451966	0.184038	2.455835	0.0205
D(INTR)	-0.551674	0.122213	-4.514037	0.0008
ECM(-1)	-0.032293	0.005918	-5.456546	0.0001

R^2 = 0.612845, Adj. R^2 = 0.528212, Prob.(F-stat.) = 0.019865, DW Stat. = 1.992688
Source: Author's_Computation_usingEview

All the variables showed positive sign as expected excepting LOG (FDI) that was negative as it is shown in table 4.3. LOG(FDI) therefore negates a priori expectation. Specifically, the results indicate the short-run growth elasticity of REM, FDI, NOA, GCF and INTR to be 0.03, -0.06, 0.10, 0.45 and -0.55 respectively. This is to say that a percentage increase in REM holding other factors constant calls forth 0.03 percentage increase in real GDP; a percentage increase in FDI, decreases Real GDP by 0.06 per cent; a percentage increase in NOA increases Real GDP by 0.1 per cent; a percentage increase in GCF increases real GDP by 0.45 per cent and a percentage increase in INTR decreases real GDP by 0.55 per cent. However, it was GCF and INTR that were statistically significant at the 5% level.

The study concluded that FDI, REM and NOA have no significant impact on economic growth in Nigeria and therefore, upheld the hypotheses that Foreign Direct Investment, Foreign remittances and Net Official Assistance have no significant impact on economic growth in Nigeria and rejected the hypothesis that Gross Capital Formation has no significant impact on economic growth in Nigeria.

The implication is that growth is inelastic in both foreign Remittance and Net Official Assistance but it is elastic in Gross Capital Formation. That is, while foreign capital inflows are yet to make meaningful impact on economic growth in Nigeria; domestic investment has impacted significantly on economic growth in Nigeria for the period 1981-2020. These results are attributable to recipients of remittances preferring to consume rather than invest such funds into productive ventures. Also, due to widespread corruption, insufficiency and non-participatory project identification processes, net official assistance may not have impacted on economic growth in Nigeria.

Similarly, in spite of the huge market potential the country enjoys as a result of its large population, FDI has not impacted significantly on economic growth in Nigeria. This may be attributable to foreign investors' unwillingness to invest in green manufacturing but already saturated areas of the oil and gas sectors. Also, the inability of the inflow variables of Foreign Direct investment, Foreign Remittances and Net Official Assistance to impact on economic growth may be attributed to poor economic policies of government. This is supported by Burnside and Dollar (2000). However, Hansen and Tarp (2001) disagrees, as they are of the opinion that the impact is not conditional on "good" policy.

The ECM term was negative as expected and indicated that annually 25 per cent of the deviation from equilibrium path is corrected (Real GDP adjusts to its long-run equilibrium path at the speed of 25% per annum after a short-run disturbance or shock). Further results showed that 24% of variation in Real GDP is explained by the model and the model has no problem of serial correlation as indicated by the R-squared (0.61) and Durbin-Watson statistic (1.992688), respectively. This position is also further supported by the result in Table 4.5. The model is therefore, adequate for policy analysis. The study also tested for the direction of causality to ascertain the instantaneous relationship among the variables and the results are presented in Table 4.4.

However, the finding of this study that Foreign Direct Investment, remittances and Net Official Assistance have no significant impact on economic growth in Nigeria is in line with the findings of Vincent (2011), Kanu (2015) and Edu, Inaya and Bassey (2015) that FDI and other inflow variables have no significant relationship with economic growth in Nigeria. But the finding of this study is not in line with the findings of Okafor et al (2016) for they found that FDI and Foreign Aid (Net Official Assistance) have positive and significant impact on economic growth in Nigeria. Chigbu, Ubah and Chigbu (2015) and Olatunji and Shahid (2015) also concluded in their study that FDI and other inflow variables have reasonably large and positive impact on the performance of the Nigerian economy.

Granger Causality test

Table 4.4: Pairwise Granger Causality Test Results

Lags: 1

NullHypothesis:	Obs	F-Statistic	Prob.
D(LOG(GCF)) ≠D(LOG(NOA))	40	5.81271	0.0222
D(LOG(NOA))≠ D(LOG(GCF))		4.28729	0.0471

Source: Author'sComputation using Eviews10

Table 4.4 showed a two-way causality running from GCF to NOA and from NOA to GCF. However, it was GCF that granger-caused NOA more. That is, in the short-run, gross capital formation helped to predict the movement of net official assistance and net official assistance also helped to explain gross capital formation but gross capital predicted net official assistance more. The implication is that foreign donors observe the domestic situation in terms of returns on investment and if domestic investment is doing well, foreign donors' confidence is built and therefore they would elect to donate, otherwise Nigeria would not attract foreign assistance.

Conclusion and Recommendations

Some conclusions have been drawn from this study's findings. To begin, there is no evidence that foreign capital inflows have a material impact on economic growth in Nigeria in the near run. However, when capital inflows are stable throughout time, they have a considerable effect on economic growth. Second, gross capital formation (domestic investment) affects economic growth in Nigeria both immediately (short run) and over time (long run). Foreign Direct Investment, Remittances, and Net Official Assistance's inability to have an immediate or short-term impact on economic growth can be ascribed to weak economic policies. Therefore, the study recommends the following;

1. Government should make economic policies that will encourage domestic savings by increasing interest rate on bank deposits in Nigeria. This will lead to increased availability of fund for domestic investment which, in turn, will impact significantly on economic growth both in the short and long run.
2. Government should make necessary economic and social policies to create an enabling environment by providing basic amenities such as adequate power generation and distribution, potable water, good network of roads, security, amongst others so as to enable domestic investment to thrive which, in turn, will attract the inflow of foreign capital as foreigners may be encouraged to come in to invest.
3. Government should maximize the utilization of resources from foreign donor agencies. This may attract more foreign capital and if consistent over time will impact on economic growth in the country.

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