Capital flight and poverty in Nigeria

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Abstract

This paper examined effect of capital flight on poverty in Nigeria. Capital flight is generally seen as having adverse and enormous effect poverty. Capital flight suggests a cross movement of capital from one country to another. It has both legal and illegal manifestations. The Study adopted a quantitative method of data collections and used ex-post facto research design in estimating the causal relationship between capital flight and poverty. The autoregressive distributed lag (ARDL) method was used as an estimation technique. Dependency theory was utilized to guide the direction of study. The paper concluded that capital flight has a positive but not statistically significant impact on poverty as measured by misery index in Nigeria. The paper recommends that Federal Government encourages technological acquisition digital system and a specialized department to monitor capital flight of foreign investors at the same time encouraging the local content through industrialization as that will no doubt helps in wealth creation and generate employment which will result in reducing the level of poverty in Nigeria.

Keywords: Capital Flight, Poverty and Nigeria.

Introduction

One of the causes of underdevelopment in peripheral formations is the massive outflows of capital towards the core formations (Cario-i-Cespedes & Palacios-Civico, 2022; Ndikumana, 2017). This phenomenon, known as capital flight, deprives peripheral countries of much-needed resources for investment in infrastructure and social services. As a result, these countries struggle to achieve sustainable development and reduce poverty levels. Multinational corporations (MNCs) from the core countries are seen as responding to investment opportunities, while investors from peripheral formations are said to be escaping the high risks they perceive at home (Ajayi, 1997; Davies & Markusen, 2021.). This unequal distribution of capital exacerbates economic disparities between core and peripheral countries, perpetuating a cycle of underdevelopment. Thus, according to Schneider (2003), the outflow of resident capital, is motivated by economic and political uncertainties in the home countries. Economic resources lost through capital flight inhibit the increase of production activities or the overall development of the residents (Basorudin *et al.,* 2021; Epstein, 2005). This phenomenon ultimately hinders economic growth and perpetuates poverty in the home countries. It is estimated that the African continent, which is a peripheral formation, has lost over one trillion dollars through capital flight since the 1970s (Ndikumana, 2017).

This capital lost through "capital flight" is structured to far exceed the capital received in the form of official development assistance (Ndikumana, 2017). Capital flight is detrimental to the economic development of countries, as it deprives them of much-needed resources for growth and poverty reduction. Addressing the root causes of capital flight, such as corruption and weak governance structures, is crucial in order to promote sustainable development. This implies that resources are vital to sustaining economic growth and development (Olatunji & Oloye, 2015). Investment in a country is closely related to economic growth in that country. Nonetheless, capital absconds from countries with marginal capital organization and poor government investment policies. It is believed that if this capital had been retained and invested, African countries would have progressed more quickly towards a reduction in poverty (Akani, 2013; Akani, 2015). Capital flight can occur through the declaring of non-foreign debts, illegal electronic fund transfers from private banking services, currency smuggling, over invoicing of imports, under-invoicing of exports, payment of expatriates, and payment of

imported equipment and technology, among others (Schneider, 2003). Capital flight can also be caused by factors like speculation, an unfriendly investment climate facing local and foreign investors, inflation, a repressive financial system, etc. (Saheed & Ayodeji, 2012).

The adverse effects of capital flight on the development of a country are enormous and severe. It hinders potential growth and development, thereby resulting in a fall in investment. Similarly, funds taken outside the country cannot be taxed, resulting in a loss of revenue for the government (Olatunji & Oloye, 2015). Capital flight is seen as a major factor contributing to the mounting foreign debt and hindering developmental efforts in peripheral formations. In the same vein, the outflow of capital may increase the foreign finance problems of heavily indebted poor countries if potential creditors like the World Bank, the IMF, and other contributors are less motivated to give assistance as a result of the outflow of capital. The study, therefore, examined the role of capital flight on wide spread of poverty in Nigeria, discusses the concept of Capital and poverty, the role of capital in encouraging the spread of poverty in Nigeria. To address these issues, the study is divided into four sections: the first section introduces the paper, the second section discusses capital flight on poverty in Nigeria, the third section discuss the role of capital flight on poverty in Nigeria using ordinary least square (OLS), the last section concludes the paper and provide prognosis.

Literature review

There is hardly a universally accepted definition of "capital flight," and this has brought about controversy over how the term has been used interchangeably between developed and developing countries. Consequently, some schools of thought see capital flight from developed countries as foreign direct investment, while the same activity is referred to as "capital flight" when it is undertaken by residents of developing countries (Ajayi, 1995). Cuddington (1986) "refers to capital flight as short-term capital outflows involving hot money that responds to political or financial crises, burdensome taxes, a prospective tightening of capital controls, or a major domestic currency devaluation as well as actual or developing hyperinflation." Similarly, Copper and Hart (2000) see capital flight as an abnormal flow of funds whose holders seek safe havens from financial uncertainty and taxation or seek to launder proceeds from illegal activities.

Capital flight suggests a cross-border movement of capital from one country to another. It is a kind of illicit movement of financial assets (capital) from one country to another. Scholars like Nyong (2013) and Ayodele (2014) see these capital movements as "capital flight." Mahon (2004) argues that capital flight is a way of preserving and looting savings against the depredations of bad political leaders. Isu (2002) refers to capital flight as not good and terrible for the growth and development of any nation. He further explained that all private capital outflows from developing countries or peripheral formations, whether short-term or long term are categorized as "capital flight." Resources or assets of a country, whether government-owned or privately owned, are not spent in the country or invested back into the economy, but rather are spent abroad or in other countries. As a result, there are bound to be issues and challenges. Capital flight is a large-scale exodus of capital from a nation due to events such as political or economic instability or the imposition of capital controls. Capital flight refers to an exodus of capital from one nation, an entire region, or a group of countries with similar fundamentals.

Types of capital flight

Capital flight has both legal and illegal manifestations. Legal capital flight: According to Olatunji and Oloye (2015), the legal component is generally after tax funds, properly

documented, and remaining in the books of the entity from which it is transferred. There is evidence that such flow broadly enhances economic growth. They further asserted that such free market operations are accepted as largely beneficial to investment, trade, and development, leaving aside the question of the utility of short-term capital controls. The legal component is normally fleeing to safety and can be expected to return to the country of origin when investment conditions are attractive.

From the foregoing, one can understand that the legal aspect of capital flight means the retrieval of invested capital and profit by foreign investors. In this case, the capital outflows must follow the country's laws and properly documented. Legal capital flight, according to Kosarev and Grigoreyev (2000), is the consequence of capital outflow in full accordance with the law. The legal component is that generally, after tax and properly documented, individuals and companies transfer earnings from interest, dividends, and realized capital gains to the country of origin. As a result, from a legal standpoint, capital flight is viewed as a return on investment that benefits both the host country and the country of origin. The legal aspect of capital also significantly contributes to economic development, especially in the host countries, by making capital available for investment, employment opportunities, and industrialization.

Illegal capital flight: the illegal component of capital flight is quite different. According to Olatunji and Oloye (2015), illegal capital flight refers to tax evasion; therefore, it is improperly documented or linked to falsified transactions, and it disappears from any record in the country of origin. The illegal component of capital flight is fleeing to secrecy to be accumulated in a hidden manner, as only private banks can at least rarely return to the country of origin. The greater proportion, probably upwards of 90 percent, constitutes a permanent outward transfer, as most private banks will keep the secrets (Baker, 2005). The little that does return home comes from having acquired a foreign nationality as a firm of partnerships and is neglected as foreign direct investment, intending to move abroad again in the form of interest, principal, and dividends. Getting rich secretly while avoiding pressure to distribute interest is the overriding intent. The motivation is demonstrated to be more important than tax evasion or tax protection from confiscation, convertibility, or inflation risks. Hence, the following continues even after the government has liberalized exchange regimes, moderated tax codes, and promoted free trade to attract foreign direct investment. Illegal capital flight, generally, appears indicative of illicit financial flow. Essentially, illicit financial flows disappear from the records within a country and do not return to the country. Illegal capital transactions occur when traders transfer capital abroad by falsifying trade documents, especially in the peripheral formations.

Methodology

The study adopted an Ex-post facto research design to determine the impact of capital flight on poverty crisis in Nigeria. Ex-post facto research design makes use of empirical estimation methods in the estimation of the causal relationship between capital flight explanatory (capital flight) variable. For a robust analysis, the study adopted both descriptive and analytical methodologies in its analysis and in the estimation of the specified equation. In analyzing the trend performances of the variables captured in the study and examining the degree of relationship among the variables, the descriptive methodology used statistical tools such as simple tables, graphs, percentages, and correlation analysis. The analytical methodology used is Autoregressive distributed lag modelling (ARDL)

Model specification

The theoretical foundation of the model for this study is anchored in Dependency theory.

Poverty-capital flight equation

The relationship between poverty and capital flight is expressed in a functional form as follows:
$$MIS = f (INDU, GPCI, CAPF, FDI) \qquad\qquad 1$$
This relationship in its linear form can be expressed as:
$$MIS = b_0 + b_1\,INDU + b_2 GPCI + b_3\,CAPF + b_4\,FDI + u_t \qquad\qquad 2$$
The logarithmic form of equation 2 can be written as:
$$MIS = b_0 + b_1\,INDU + b_2 Ln(GPCI) + b_3\,Ln(CAPF) + b_4\,Ln(FDI) + u_t \qquad\qquad 3$$

Where:

MIS = misery index (measured in percentage). This is derived from the unemployment rate plus the inflation rate.

INDU = industrialization index (measured in percentage). This is derived from manufacturing value added divided by GDP.

PCI = GDP per capita income in thousand dollars. This is derived by dividing the gross domestic product (GDP) by the population of a country, usually in a specific year.

CAPF = Capital flight in million dollars.

FDI = Foreign direct investment in million dollars. This represents the capital inflow into the economy. This is the reverse of capital flight.

MIS is expected to have a negative relationship with INDU, GPCI, and FDI and a positive relationship with CAPF.

Estimation technique

The autoregressive distributed lag modeling framework was used to estimate the equations.

1. **Presentation and analysis of econometric results**

The Short run and ARDL Error Correction Results for poverty capital flight equation

Table 1: short run ARDL and error correction results of the poverty capital flight equation

Dependent Variable: D(MIS)

Variable	Coefficient	Standard Error	t-Statistic	Probability
D(INDU)	-268.139	85.7429	-3.1272	0.0061
DLOG(PCI)	16.9512	8.0964	2.0937	0.0516
DLOG(CAPF)	2.0820	1.4181	1.4682	0.1603
DLOG(FDI)	-4.5099	2.4383	-1.8496	0.0818
ECT(-1)	-0.6952	0.0645	-10.77673	0.0000
Adjusted R-squared	0.6193	Durbin-Watson statistic		2.2043
F-statistic	6.5776	Serial Correlation LM test statistic		0.2844 (0.6012)
Probability (F-statistic)	0.000735	Heteroskedasticity test statistic		0.5349 (0.7964)
		Jargue-Bera Normality test		1.2707 (0.5298)

Source: Computation by the Author, 2021, with the aid of E-view-9.

Table 1 shows the short-run ARDL and error correction results of the poverty capital flight. The short-run coefficient result for current INDU is -268.139 with a corresponding probability value of 0.0061. According to this result, there is a negative impact of the current level of industrialization on poverty, and the impact is statistically significant because the corresponding probability value is less than five percent. This means that in the short run, a one percent increase in industrialization will lead to a 268.139 decrease in the poverty level in Nigeria, all other things being equal. The short-run log coefficient (PCI) is 16.9512, with a probability value of 0.0061. According to the result, there is a positive impact of per capita income (PCI) on poverty in the short run, and this result is statistically significant because the corresponding probability value is less than 5 percent. This means that, all other things being equal, a one hundred percent increase in the log (PCI) will lead to a 16.951 percent increase in poverty in Nigeria in the short run. This result indicates the absence of inclusive economic growth in Nigeria, where the increase in per capita income does not affect the poor because of their lack of access to means of production and their lack of opportunity to participate in the processes that generate economic growth through gainful employment opportunities.

The CAPF short run coefficient is 2.0820, with a probability value of 0.1603. According to the result, there is a positive impact of CAPF on MIS, and this result is statistically not significant because the corresponding probability value is greater than 5 percent. This means that a one percent increase in CAPF will lead to about a 0.0208 percent increase in poverty in Nigeria in the short run, all other things being equal. The FDI short run coefficient is - 4.5099, with a probability value of 0. 0818. According to the result, there is a negative impact of FDI on MIS, but this result is not statistically significant because the corresponding probability value is greater than 5 percent. This means that, holding all other things constant, a one percent increase in foreign direct investment will lead to about a 0.0451 percent decrease in poverty in Nigeria in the short run.

The error correction coefficient, otherwise known as the speed of adjustment, is -0.6952, with a corresponding probability value of 0.0000. This is a correct sign, and it is also statistically significant at a 5 percent level of significance. This means that about 69.52 percent of the disequilibrium in the short run is corrected in the long run. This is a rather good speed of adjustment from short-run disequilibrium to long-run equilibrium. The correctness of the sign and the statistical significance of the error correction coefficient are confirmations of the existence of the long-run relationship between the dependent and independent variables as reported by the cointegration/bounds test result in table 1.

The calculated value of the F-statistic is 6.5776, with a corresponding probability value of 0.000735. This is statistically significant judging from the probability value at the 5 percent level of significance. This means that all the independent variables (D (INDU), D (PCI), D (CAPF), and D (FDI)) jointly have an impact on the dependent variable, D (MIS). The adjusted R-squared is 0.6193. This means that about 61.93 percent of the total variation in MIS can be explained by variations in the independent variables (D (INDU), D (PCI), D (CAPF), and D (FDI). The Durbin-Watson (D-W) statistic is 2.2043, which is above 2 and, by rule of thumb, shows no presence of autocorrelation in the estimated model. The serial correlation LM test, otherwise called the Breuch-Godfrey test, reports an F-statistic of 0.2844 with a corresponding value of 0.6012. This means that there is no multicollinearity in the estimated model. The heteroscedasticity test or Breuch-Pagan-Godfrey test result of 0.5349 with a corresponding probability of 0.7964 shows the presence of homoscedasticity (equal spread or variance) in the estimated model. The Jarque-Bera statistic of 1.2707 with a corresponding probability value of 0.5298 means that the variables of the model are normally distributed.

The stability test using the cumulative sum (CUSUM) in figure 1 also reveals that the variables in the poverty-capital flight equation remained consistent throughout the study period. The swing of trends within the CUSUM limit at the 5 percent significant level bound demonstrates this. This, on the other hand, implies that the parameters of the poverty-capital flight equation do not experience any structural instability during the study period, implying that all of the equation's coefficients are stable. These diagnostic tests show that the estimated model is robust, which means that the results of the poverty capital flight equation can be used for policy making and for making long run decision.
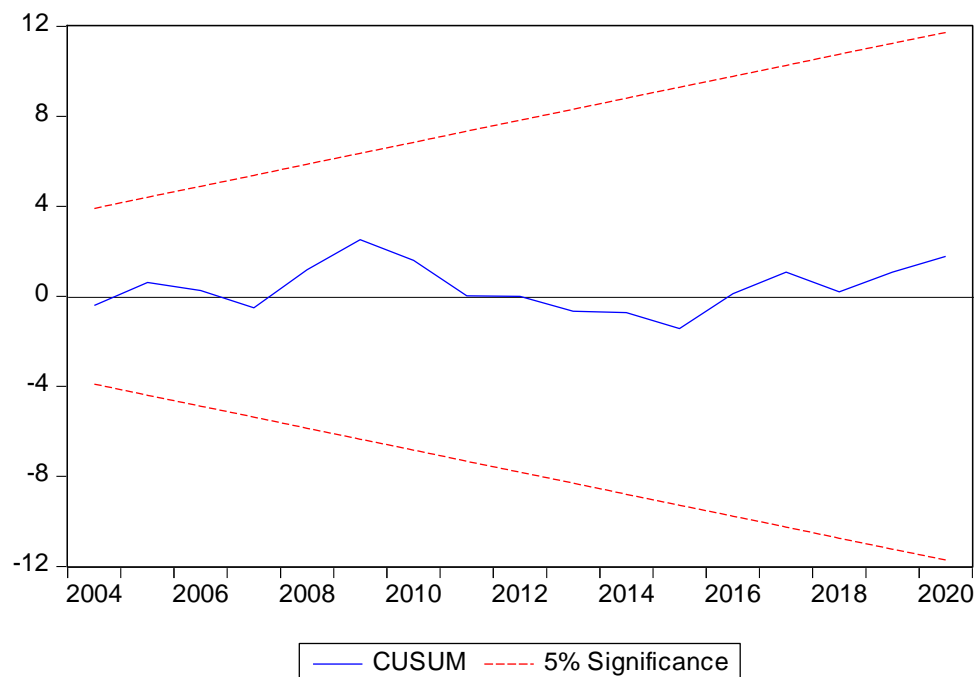

FIG 1: The stability test using the cumulative sum (CUSUM) of the poverty capital flight equation.

Long run coefficients of poverty capital flight equation

Table 2: Long run ARDL poverty capital flight equation

Dependent variable: MIS

Variable	Coefficient	Std. Error	t-Statistic	Probability
INDU	-385.681	139.9226	-2.756391	0.0135
LOG(PCI)	24.3820	11.3895	2.1408	0.0471
LOG(CAPF)	4.1696	2.8485	1.4638	0.1615
LOG(FDI)	-13.8231	4.9816	-2.7749	0.013
Constant	212.1838	133.7675	1.5862	0.1311

Table 2 shows the long-run equation for the poverty capital flight equation using the autoregressive distributed lag method. INDU's long run coefficient is -385.681, with a probability value of 0. 00135. According to the result, there is a negative impact of industrialization (INDU) on poverty (MIS), and this result is also statistically significant because the corresponding probability value is less than 5 percent. This means that a one percent increase in INDU will lead to a 385.681 percent decrease in poverty in Nigeria in the long run. The long-run coefficient of log (PCI) is 24.3820, with a corresponding probability value of 0.0471. According to the result, there is a positive impact of per capita income (PCI) on poverty, and this result is statistically significant because the corresponding probability

value is less than 5 percent. This means that a 100 percent increase in log (PCI) will lead to about a 24.3820 percent increase in poverty in Nigeria in the long run. This result indicates the absence of inclusive economic growth in Nigeria, where the increase in per capita income does not affect the poor because of their lack of access to means of production and their lack of opportunity to participate in the processes that generate economic growth through gainful employment opportunities.

CAPF's long-run coefficient is 4.1696, with a probability value of 0.1615. According to the result, there is a positive impact of CAPF on MIS, and this result is statistically not significant because the corresponding probability value is greater than 5 percent. This means that a one percent increase in CAPF will lead to about a 0.4169 percent increase in poverty in Nigeria in the long run. The long run coefficient of FDI is − 13.1818 with a corresponding probability value of 0.0130. According to the result, there is a negative impact of FDI on MIS, and this result is statistically significant because the corresponding probability value is less than 5 percent. This means that a one percent increase in foreign direct investment will lead to about a 0.1318 percent decrease in poverty in Nigeria. The results' constant is 212.1838, with a corresponding probability value of 0.1311. This means that holding all other things constant, Nigeria's poverty level will increase by 2.1218 percent on average.

Conclusion

The results obtained from the estimated poverty-capital flight equation as displayed in tables 1 and 2 and analyzed in sections 5.2.6 and 5.2.7 show that capital flight does have a positive but not statistically significant impact on poverty, as measured by the misery index, in Nigeria. Since the probability value of the estimated coefficient of GAPF (capital flight) as shown in tables 5.14 and 5.15 for short run and long run estimation is greater than 5 percent level of significance, the study, therefore, accepts the null hypothesis that there is no significant relationship between capital flight and poverty in Nigeria at 5 percent level of significance and rejects the alternative hypothesis that there is a significant relationship between capital flight and poverty in Nigeria. The non-significant impact of capital flight on poverty in Nigeria does not mean that capital flight is not a causal factor in poverty incidence; rather, it means that the positive impact of capital flight on poverty is not that substantial, but given the existence of a long-run relationship between capital flight and poverty in Nigeria, the capital flight activities of MNCs can accentuate the poverty situation in Nigeria in the long run if they are not curbed. This is in conformity with dependency theory, which postulates that the peripheral countries were forcefully integrated into the capitalist world where the core dominates the peripheral countries through capitalist tendencies and unbalanced trade in international business. They further argued that because of the unequal exchange in terms of trade, For them, poverty in Nigeria is linked to unequal trade terms that have disadvantaged peripheral countries in the global market. This implies that the international trade in which MNCs are the main actors places them as agents of the core countries and that there is an unequal exchange between high-wage, high-product, and low-wage, low-profit products. Capital flight and poverty are, therefore, the opposite sides of the same phenomenon, each being the result of the other.

While admitting to this argument, Bassey (2017) observed that Nigeria's development is hindered as a result of multiple disorders; for instance, while the importance of capital in economic development cannot be overemphasized, the facts remain that the needed capital cannot be raised through the export of agricultural surplus as highlighted by the theory of comparative advantage. He also observed that the current market economy favors the already well-off and disadvantages the peripheral countries. This is because of the structural countries. This inequality has no doubt widened the gap between core and peripheral countries in terms

of the availability of scarce resources needed for industrialization, which will eventually lead to economic transformation and provide employment opportunities, especially to many unemployed youths. By implication, the peripheral countries will not have industries to transform their economies and fight poverty.

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