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Analysis of capital formation and foreign aid nexus in Nigeria

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Abstract

Purpose – The issue of foreign aid has continued to gain renewed economic cum political attention in the early years of the twenty-first century. At a summit, popularly known as the Millennium Summit, which took place in 2000, there was an agreement by the international community concerning some goals known as the Millennium Development Goals which were targeted to be reached by the year 2015 but have now been replaced by the Sustainable Development Goals. Against this background, it becomes pertinent to ascertain the contributions and impact of foreign aid in the form of Overseas Development Assistance (ODA) on capital formation in Nigeria. This is an area of foreign aid studies that has been ignored by many researchers. Most studies are seen delving into analyzing the aid-growth nexus without evaluating the transmission link through which foreign aid transmits to affect economic growth. There is paucity of studies on the aid-capital nexus. The paper aims to discuss these issues.
Design/methodology/approach – The empirical method used was autoregressive distributed lag (ARDL) model.
Findings – The empirical results from the ARDL model estimations show that foreign aid, which is proxied by ODA, has a positive and significant impact on capital formation in Nigeria for the years under analysis. The result of the Granger causality test shows that a bi-directional granger causality exists between foreign aid and gross fixed capital formation (GFCF).
Originality/value – Empirical results from the ARDL model estimations show that foreign aid, which is proxied by ODA, has a positive and significant impact on capital formation in Nigeria for the years under analysis. The result of the Granger causality test shows that a bi-directional Granger causality exists between foreign aid and GFCF. It is therefore recommended that government should make serious efforts toward the implementation and effective utilization of foreign aid. Appropriate policy measures that would monitor the maximum and effective utilization of foreign aid are also required.

Keywords Foreign direct investment (FDI), Exports, Foreign aid, Imports, Capital formation
Paper type Research paper

1. Introduction

Many developing countries, especially in Africa, have been confronted by low levels of savings and investment. Some studies, however, have supported the view that the savings, investment and capital formation in a country can be improved by the inflow of foreign aid (Mekasha and Tarp, 2013; Alessandra *et al.*, 2017). Foreign aid has been adjudged by some researchers as a necessary tool for closing the savings and investment gap in an economy, ensuring the halting of poverty, boosting capital formation, supporting economic growth and improving the living standards of people especially in developing countries (Hussain *et al.*, 2017; Sothan, 2018). These benefits are essentially the basic needs of African countries. Interestingly, Africa has been one of the greatest recipients of foreign aid in the global community. The report put forward by OECD in 2009 shows some interesting statistics that in 2008 the total foreign aid from members of Development Committee increased in real terms by 10.2 percent in the tune of $110.8bn. Subsequent annual records show that it further increased to the tune of $130bn in 2010. In 2013, foreign aid further increased by 6.1 percent in real terms which was adjudged as the highest level ever recorded. On the other hand, there was also a rise in bilateral trade in favor of Africa and Sub-Saharan Africa (SSA) by the magnitude of 10.6 and 10 percent, respectively.

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Africa justifiably needs significant foreign inflow to hedge the cascading and deteriorating living standards of the people. Studies have confirmed that during the 1980s, the per capita income of the average Sub-Saharan African fell consistently at an annual rate of 2.2 percent while consumption per capita deteriorated by 14.8 percent. In the same vein, the volume of import rose by an annual rate of 4.3 percent while the volume of export was fixed, which was not healthy for the economy. In the 1990s, the growth rate per capita was also seen to be falling continuously until it reached its negative levels. It is also documented that about 79–80 percent of Sub-Saharan Africa countries were identified as countries that have low human investment capacity and were also categorized as highly indebted (Bakare, 2011). Based on the above analysis, it becomes justifiable to assert that Africa needs assistance beyond the domestic resources as it will be a great move to help them escape the strap of economic decadence (Riddle, 2007). Table I shows the top ten ODA recipients in Africa between 2013 and 2015, with Nigeria taking the sixth position.

Domestically, the situation in Nigeria also calls for concern. For example, Nigeria, which was in the early years of 1970 ranked as one of the 50 richest countries, has deteriorated so terribly to the extent of being categorized as one of the 25 poorest nations of the world. Again, another economic irony exists in Nigeria as it is categorized as the eighth largest exporter of crude oil and yet has a large number of impoverished people as its inhabitants (World Bank, 2017). Subsequent years have shown signs for urgent foreign assistance to countries categorized as developing to which Nigeria belongs. Advanced economies and international organizations have made persuasive pleas for foreign assistance to be massively fused into Nigeria for growth and development. Scholars and experts who make case for aid infusion into the economy of Nigeria argue that it will boost the material well-being of Nigeria and hence translate into economic growth of the country (Ngene, 2012).

Nigeria has over the years received external aid in the form of Overseas Development Assistance (ODA). A historic macroeconomic outlook of Nigeria regarding foreign aid inflow shows that between the periods 1980 and 1986, the official aid inflow into the economy recorded in millions of dollars increased from \$34.4m to \$58.1m. The year 1986 was marked as the turning point for Nigeria through the Structural Adjustment Programme (SAP) leading to the deregulation policy. The aid inflow increased to \$67.62m in 1987, \$118.08m in 1988 and further increased to \$344m in 1989. On average, the ODA received in favor of Nigeria was relatively stable and progressive in the 1980s (Central Bank of Nigeria (CBN, 2014)).

		2013	2014	2015	3-year average	% of all recipients
1	Egypt	5,513	3,538	2,488	*3,846*	7
2	Ethiopia	3,886	3,585	3,234	*3,568*	7
3	Tanzania	3,434	2,649	2,580	*2,888*	5
4	Kenya	3,308	2,661	2,474	*2,814*	5
5	Democratic Republic of the Congo	2,584	2,400	2,599	*2,528*	5
6	Nigeria	2,516	2,479	2,432	*2,475*	5
7	Mozambique	2,313	2,106	1,815	*2,078*	4
8	Morocco	2,009	2,240	1,369	*1,873*	3
9	South Sudan	1,399	1,964	1,675	*1,679*	3
10	Uganda	1,700	1,635	1,628	*1,654*	3
	Other recipients	28,146	29,043	28,742	*28,643*	53
	Total ODA recipients	*56,806*	*54,299*	*51,036*	*54,047*	*100*

Note: Values are in USD million, receipts from all donors, net ODA receipts

Table I.
Top ten ODA recipients in Africa