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DISAGGREGATED FOREIGN CAPITAL INFLOWS AND ECONOMIC GROWTH IN A DEVELOPING ECONOMY: EMPIRICAL EVIDENCE FROM NIGERIA

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ABSTRACT

This study estimates the impact of Foreign Capital Inflows on economic growth in Nigeria from 1986Q1 – 2014Q4. For empirical analysis, the paper adopts the Auto-Regressive Distributed Lag- Unrestricted Error Correction Model (ARDL-UECM). Empirical evidence from the ARDL-bounds Co-integration Test shows there is co-integration between Economic Growth (proxied by Growth rate of Real Gross Domestic Product) and Foreign Capital Inflows (disaggregated into Foreign Direct Investment, Foreign Portfolio Investment and Workers' Remittances) in Nigeria. The results also show that apart from remittances, other components of Foreign Capital Inflows have significant impact on Economic Growth in Nigeria. The study therefore recommends that Government should, alongside other economic activities, provide an enabling economic environment for more Foreign Capital Inflows. Also the financial sector should be improved so that workers' remittances can be efficiently tracked through the banking channels and also put to productive use. This is how to minimize the negative impact of workers' remittance inflows into Nigeria.

Contribution/Originality: This study contributes to existing literature as one of the recent empirical papers that focus on the disaggregated impact of Foreign Capital Inflows on economic growth in Nigeria using the framework of the Auto-Regressive Distributed Lag- Unrestricted Error Correction Model (ARDL-UECM).

1. INTRODUCTION

Economists have long recognized capital as one of the core elements in economic development. Thus, capital deficient countries have always resorted heavily to foreign capital as a means of supplementing domestic resources to achieve economic targets. It has also been argued in the literature that international capital flows have the potential to bring a variety of benefits to recipient countries, which include augmenting domestic savings, reducing cost of capital through better allocation of risks, transferring technology and managerial expertise, stimulating employment opportunities as well as promoting economic growth. Other economists also opine that the flows of capital into low income countries are desirable because they augment domestic resources, help in providing resources to close savings – investment gap in the recipient countries and enhance the activities of entrepreneurs (Rajan, 2006; Chorn and Siek, 2017; Mowlaei, 2018).

Since independence, Nigeria like other developing economies, has been trading with the rest of the world being an open economy. This has deeply encouraged movement of human, material and financial resources across the borders of different nations, including Nigeria. Like other developing countries, Nigeria has adopted policies over the years to encourage foreign capital inflows. According to World Bank Report (2011) foreign capital inflow (including foreign direct investment and foreign portfolio investment only) Nigeria was reported at ₦7. 7 billion in 2011. Nigeria has constantly ranked among the largest recipient of foreign capital in Africa, particularly, foreign direct investment, with about $120 billion as proceed of foreign investments in the last decade (Udoidem and Udofot, 2014). Growth in cross-border securities investments mushroomed in the 1980s as portfolio investment became increasingly attractive and lending by international banks declined. In the early 1990s, the switch from bank lending to portfolio investment drove up securities prices. Foreign capital surged into certain developing countries, rising rapidly as a share of Gross Domestic Product. In addition, Nigeria is one of the largest recipient of remittances in Sub-Saharan Africa (Hernandez-Coss and Bun, 2007).

Then, here comes the pertinent question, "Does foreign capital play a helpful or non-helpful role economic growth in Nigeria economy?" Existing global guidelines supporting the inflow of capital suggest that first, capital should flow from rich countries to poor countries. This is because the marginal product of a unit of capital is much higher in poor countries that are typically labor abundant and capital poor according to the neo classical model. Second, it is expected that foreign capital should be attracted by more productive poor countries since they have the ability to use it better. And third, because of the collateral benefits of foreign capital such as encouraging technology transfers. As a result of this, foreign capital has been associated with increase in productivity, creation of jobs and more employment opportunities, reduction in unemployment and at large, more economic growth. On the other hand, it has also been argued that foreign capital inflows can lead to reducing the competitiveness of the economy through overvaluation of the exchange rate. Also by reducing manufacturing exports and undermining its traditional role as a stepping stone to growth (Fambon, 2013).

Against this background, this paper seeks to investigate the impact of disaggregated foreign capital inflows on economic growth in Nigeria. The subsequent sections are organized as follows; section 2 reviews some related literature, while the methodology is presented in section 3. In the same vein, section 4 looks at the results and analysis, while the paper concludes with section 5.

2. BRIEF REVIEW OF LITERATURE

Some studies have been conducted to investigate the relationship between foreign capital inflows and different macroeconomic variables. However, the empirical link between foreign capital inflow and economic growth has been a subject of intense debate in modern development literature. For example, Waheed (2004) in an attempt to integrate the major empirical studies on the macroeconomic impact of foreign capital on the economies of the developing countries, found that the growth experience of many capital-deficient developing countries has not been very satisfactory, and a result, they accumulated a large external debt and are now facing serious debt servicing problems. Ghose (2004) investigated capital inflows and investment in 37 developing countries over the period, 1983-1997. The study employed regression analysis and found that the emergence or growth of surplus saving in many developing countries could thus be seen as a consequence of exogenous capital inflows and their effects are not unambiguously positive for developing countries. In a different study, Nkoro and Uko (2012) examined the dynamic interactions among aid, remittance, FDI and external debt and growth of the Nigerian economy using the concept of co-integration, variance decomposition, and impulse response analysis and block exogeneity tests. The results of the co-integration test revealed that a causal relationship exists between foreign capital inflows and economic growth in Nigeria. Similarly, Iloh (2012) examined the relationship between Foreign Capital Inflows and investment in Nigeria during 1980 – 2008, using OLS method and exogenous variables include; degree of openness to financial trade, human capital, financial sector development, level of income and level of government interference.