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FOREIGN CAPITAL INFLOWS AND UNEMPLOYMENT IN NIGERIA: A NEW EVIDENCE FROM ARDL-BOUNDS TESTING APPROACH

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ABSTRACT

Using a novel approach, this study disaggregates and estimates the impact of foreign capital inflows on unemployment in Nigeria by adopting the Auto-Regressive Distributed Lag- Unrestricted Error Correction Methodology (ARDL-UECM). The ARDL-bounds test co-integration results show evidence of co-integration between disaggregated Foreign Capital Inflow variables (such as Foreign Direct Investment, Foreign Portfolio Investment and Remittances) and unemployment rate in Nigeria within the period from 1977Q1 – 2013Q4. The empirical results also show that foreign direct investment, foreign private investment and trade openness have negative impact on unemployment rate. On the other hand and interestingly, remittances and real exchange rate show a positive impact. The study therefore recommends the routing of remittances through the banking channels which would help in allocating remittances and other financial flows to productive uses. Again, government should enact investor-friendly policies and build conducive business environment in order to attract more Foreign Capital Inflows which will support job creation for the teeming population and thereby reduce biting unemployment.

Contribution/Originality: This study contributes to the existing literature by adopting the Auto-Regressive Distributed Lag- Unrestricted Error Correction Methodology (ARDL-UECM) in estimating the impact of disaggregated foreign capital inflows on unemployment in Nigeria.

1. INTRODUCTION

Theoretically and empirically, it is a well-established argument that capital inflows play very important but divergent roles in every economy. In line with the proposition of the Classical Economists, governments of different nations have been actively involved in planning and executing economic ideas in order to stimulate inflow of foreign resources. This is with the expectation that such inflows will augment domestic resources and contribute to improved balance of payment, creation of employment opportunities and stimulation of the overall development of the economy. Essentially, it was the economic situation of the early 1980s that sparked off the debate on the desirability of foreign capital inflow into the Country. However, while some scholars express positive views on the relevance of foreign capital inflows, others argue against it Orji *et al.* (2014); Edu *et al.* (2015) and Oluwaseyi *et al.* (2017).

For example, Lucas (1990) argues that not all developing or poor countries exhibit a high marginal productivity of capital. Lack of supporting infrastructure, skills, and policies lower the productive potentials of the recipient economy and hence, limit the positive impact of capital inflows. Thus, the growth experience of many of these countries has not been very satisfactory and, as a result, they accumulated large external debt and are now facing serious debt servicing problems, foreign exchange issues and also walloping in abject poverty, Waheed (2004); Nkoro and Uko (2012). Again, it is also not very clear in the literature if the level of unemployment increases with the inflow of foreign capital or not (Manash, 1999). However, studies by OECD (2011) show that the increase in capital flows since the mid-1980s till the 2000s has contributed to an amplification of the impulse response of unemployment to country-specific shocks and to a fall in the persistence of unemployment in response to the same shocks. Further evidence from the OECD countries show that increased international capital mobility has contributed to higher variance in the unemployment rate.

This confirms that unemployment in countries characterized by larger penetration of international capital is more responsive to idiosyncratic shocks and consequently these countries experience amplified fluctuations in employment. The time it takes for equilibrium to be restored, however, is shorter with international capital mobility (Giovanna, 2007). In Nigeria, capital inflows have been rather unstable in magnitude and trend (Iloh, 2012). The aggregate values of foreign capital inflows to Nigeria and the corresponding unemployment rates are shown in figures 1 and 2 below.

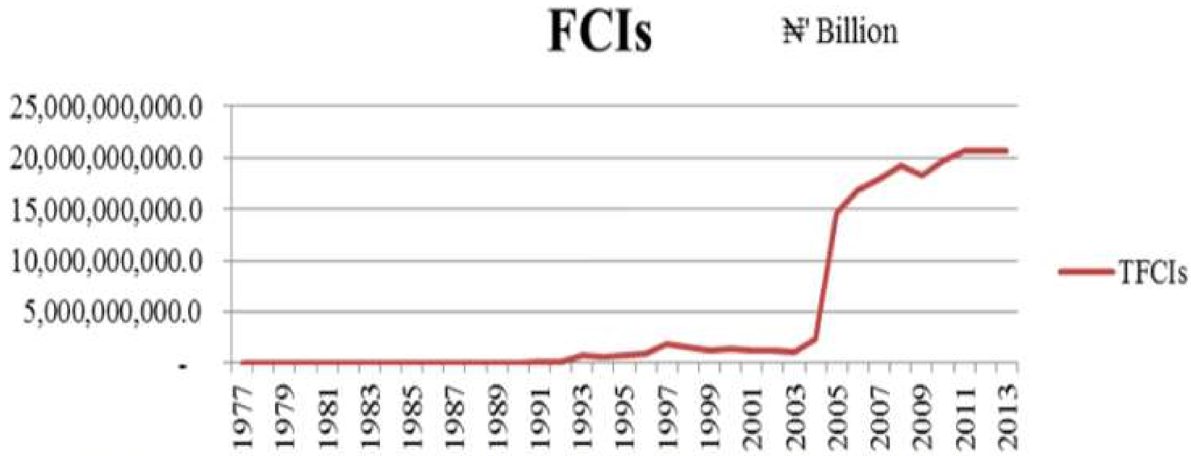

Figure-1. The Trends of Aggregate Foreign Capital Inflows (FCIs) and Unemployment Rate (UNEMP) in Nigeria from 1977 - 2013
Source: World Bank (2015)

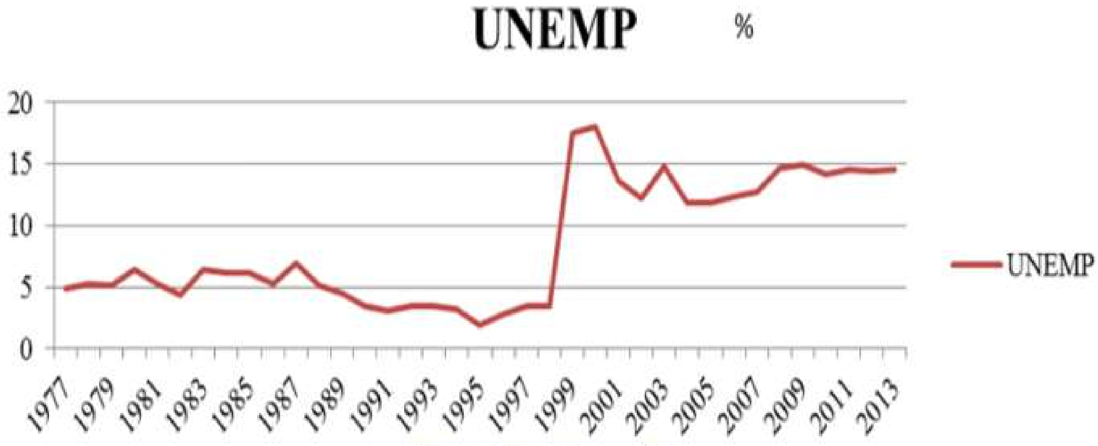

Figure-2. Unemployment Rate

Source: World Bank 2015

A clear comparison of the graphical trends of FCIs' and unemployment rate in Nigeria from 1977 – 2013 shows that as FCIs' increase unemployment rate increases also, which depicts the existence of a positive relationship between FCIs' and unemployment rate in Nigeria. This opposes existing economic theory and the expected advantage of FCIs' on unemployment rate reduction. Hence, an inflow of foreign capital in the presence of