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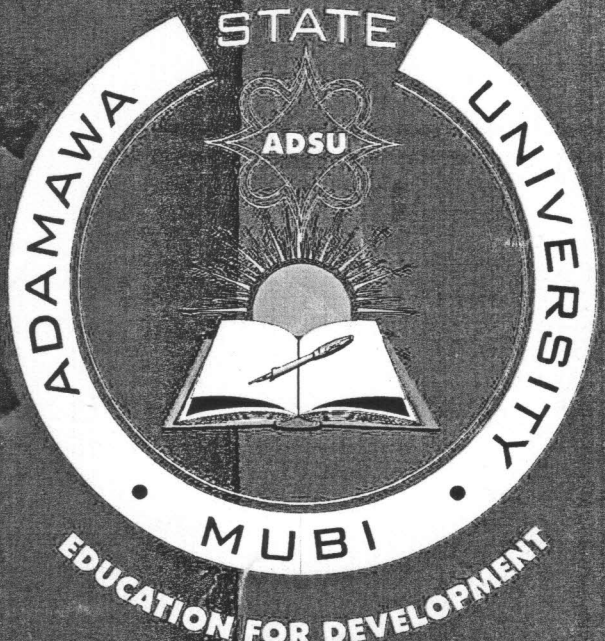
JOURNAL OF ACCOUNTING RESEARCH (AJAR)



VOLUME 4 NUMBER 1 & 2, 2016

Effect of Capital Flight on Gross National Savings: An Empirical Evidence from Nigeria

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Abstract

Capital flight has been one of the perturbing, unresolved and persistent macroeconomic problems plaguing for the past four decades. The problem is more acute in a country like Nigeria where gross national savings have been severely affected. The aim of this study is to investigate the effect of capital flight on gross national savings in Nigeria from 1985 to 2014. In analyzing the impact of capital flight on gross national savings in Nigeria using time series data obtained from CBN statistical bulletin (2014) and international monetary fund, Ordinary Least Square (OLS), units root test, Johansen Co-integration Test and Vector Error Correction Model (VECM) were used to analyse the data. Essentially, the result indicates that capital flight has negative and significant impact on gross national savings in Nigeria. This is as a result of the high level of capital flights or low level of savings undertaken over the years in the economy. The basic variable involved in the two model is the exchange rate which is significant in gross national savings but insignificant in capital flight. The paper concludes that policies to encourage national savings by both private and public sector be put in place for better reduction in capital flight in Nigeria.This paper recommends further floating of the exchange rate and transparency in its management by government.

Keywords: Capital flight, economic growth, gross national savings product, openness of the economy.

Introduction

The empirical investigation into the implications of capital flight for economic growth has received increasing attention from several researchers (Ajayi, 1995, Ayadi, 2008,

and Beja, 2007). In recent years, considerable interest has risen in the expanse to which capital flight has a detrimental impact on economic development (United Nation Development Program, UNDP, 2011). According to Ajayi (1995), the sluggish economic growth and persistent balance of payment deficits in most developing economies have been attributed to capital flight. In addition, the UNDP (2011) argues that the magnitude of capital flight is a major obstacle to the mobilization of domestic resources for development. This implies that capital flight exasperate resource constraints and contributes to undermining long-term economic growth (Beja, 2007). Therefore, the magnitude of capital flight from developing nations is assuming a serious dimension that poses a huge threat to sustainable development, especially in Africa (Ayadi, 2008). Capital flight has become a topic of discussion in recent times in the Nigerian financial environment such that three national dailies (The Daily Vanguard, The Sun and The Guardian) publicly ran editorials on it between April 11th and 20th 2010.

Cuddington (1986) describes capital flight as short-term speculative outflows out of a country. Capital flight in Nigeria manifest themselves in many ways, among which is the country's loss of an estimated total of $95 million (₦655.46 million at $1/₦145.00) as payments to counterparties outside the country over the last twenty years (between 1986 – 2006) as a result of lack of indigenous technology (see The Guardian editorial of 8th of February, 2007).

The need to empirically investigate the relationship that exists between capital flight and gross national savings cannot be overemphasised. Various studies have always concluded *a priori* that capital flight brings about the lack of investible funds in the economy and pushes the country to seek external resources to meet developmental needs (Ajayi, 2000). The implications arising from this would bring about a decision that would enable resident savings to be profitably invested in the economy rather than having to seek alternative investment outlets outside. This area has not been fully addressed by previous studies in Nigeria, though some studies have been done on other countries (Ajayi, 1995, Ayadi, 2008, and Beja, 2007). Most of this study based on capital flight and economic growth. It is believed that this study bridges this gap by incorporating element of domestic investments as well as gross national savings in analyzing the effect of capital flight on the Nigerian economy.

The main objective of this paper is to examine the effects of capital flight on gross national savings in Nigeria, using Nigerian data. Other specific objectives are to:

i. examine the relationship between capital flight and exchange rate in Nigeria.
ii. assess the impact of capital flight on domestic investments.

The paper is organized as follows introduction, literature review,

methodology, results and discussion, and conclusion and recommendations.

Literature Review

Capital flights and its trend among countries are important economic problem that countries have to grapple with in the development process because of the essential role investment and saving play in Nigeria.

Cuddington (1986) describes capital flight as short-term speculative outflows out of a country. This is taken to mean outflow that would involve the acquisition of assets abroad plus net errors and omissions in the Balance of Payments of the country. Cuddington definition is similar with the term hot money flows. He recognizes that the non-bank private sector are involved in capital flight. Dooley (1986) believes that this form of capital in flight often responds faster to expected returns, risks factors and dissimilarities in the macroeconomic factors that affect such flows.

Khan & Ul Haque (1987), described it as gross private short-term capital flows in addition to net errors and omissions in the country's BOP. However, a third definition, by Morgan Guaranty Trust Company (1986), defines it as the reported and unreported acquisition of foreign assets by non-bank private sector and entities of the public sector. Oloyede (2002) and Ajayi (1992) opined one generally acceptable definition, both see it as all private capital outflows from developing nations, be they short or long term, portfolio or equity investments.

Schneider (2003), describes it as that part of outflow of resident capital that is motivated by economic and political uncertainty. This means that such political uncertainty will lead to change of government or governmental policies as denoted by country instability and all variations of minor and major changes in the political circumstance of the country.

Domestic investment is only possible with domestic savings which itself is a function of the level of income. However, the level of investment with growth has proved to be negligible. Uchendu (1993), found that there is a positive but low correlation between investment and savings in Nigeria. The Nigeria financial system records low savings as a result of low income; low income itself is as a result of reduction in investment cumulated to low savings – thereby snowballed to a vicious circle. Given that the available resources are the only sources of investment, then the rate of investment used would be low. However, other sources of investment, such as foreign inflows of capital can be used to supplement domestic investment.

Empirical Review

Henry (1996) examined the causes of capital flight for 3 Caribbean countries using time-series analysis over the period 1971–1987. The result reveals that external debt, real interest rate differentials and unemployment rate are significant causes of capital flight.

Ndikumana & Boyce (1998), using time series data, stipulates that capital flight in Zaire was stimulated by reckless debt management, multilateral depository and financial institutions

that were too lenient in their lending practices, as well as by the misappropriation of export revenues.

Nyoni (2000) employed time series analysis over 1973 to 1992 on Tanzania in analyzing the impact of some socio-economic variables on capital flight. He concludes that lagged capital flight, real growth rates, interest rate and exchange rate differentials have no statistically significant impact on capital flight, while political shock had significant impact on capital flight.

Le & Rishi (2007), used a portfolio choice model of asset allocation and econometric analysis, found that holding other determinants of capital flight constant, corruption does have a positive and significant impact on capital flight.

Adetiloye (2009) analyzed the impact of capital flight on domestic investment in Nigeria using vector error correction mechanism on data between 1970 to 2007. The result revealed that capital flight has negative impact on domestic investment but not statistically significant.

In sum, a lot of factors determine capital flight in various countries. What these factors are in Nigeria we proceed to explore, bearing in mind that capital flight leads to poor growth and economic stagnation, as a result of the savings and investment gap created by lost capital.

Based on the above empirical reviews especially, emphasis on Nyoni (1992) that employed time series analysis using ordinary least square regression method over 1973 to 1992 on Tanzania in analyzing the impact of some socio-economic variables on capital flight; this current study is a replica in Nigeria with a major focus on domestic investment, to examine the effect of capital flight on gross national savings in Nigeria using Vector Error Correction Model (VECM). Thus, this study fills the existing research gap.

Methodology

The study employed a modified version of the Nyoni (1992) model cited in the literature as the variables that affect domestic investment the most in Nigeria.

Investment is a function of:

$$GNS = f(AVEXRATE, INVT, CF, RGDP, INF) \quad (1)$$

$$GNS = \alpha + \beta_1 AVEXRATE + \beta_2 INVT + \beta_3 CF + \beta_4 RGDP + \beta_5 INF + \mu \quad (2)$$

$$GNS = \alpha + \beta_1 AVEXRATE + \beta_2 INVT + \beta_3 CF + \beta_4 RGDP + \beta_5 INF + \varepsilon_t \quad (3)$$

Gross national savings *is* a function of average exchange rates, gross national savings, yearly capital flight figure, real gross domestic product and stock exchange market index respectively. The original variables determining gross national savings in Nigeria can now be taken to include the investment done on the capital market as it has assumed a proportion that is hard to ignore.

Capital flight regression is thus modelled as follows

$$CAPF\ (WB) = f(\alpha 0\ \beta 1Xi\ \beta 2X2\ \beta 3\ X3 \ldots \beta nXn) \quad (1)$$

The regression notations is substituted to read

$$CAPF\ (WB) = \alpha_0 + \beta_1 Avexrate + \beta_2 Kaopen + \beta_3 Invest + \beta_4 Ird + \beta_5 Gns + \beta_6 Reserv + \mu \quad (2)$$

The logged version of the model is as follow

$$LogCAPF = \alpha_0 + \beta_1 LogAvexrate + \beta_2 LogKaopen + \beta_3 LogIrd + \beta_4 LogInvt + \beta_5 LogGns + \beta_6 LogReserves + \mu \quad (3)$$

The log model represent elasticity of dependent variable that is what is elasticity of change in capital flight with respect to percentage change in a particular independent variable. One advantages of making used of log model is to make all our variables to be on the same scale in percentage term without being worried about unit. Essentially, our coefficient can easily be compared with each other.

Where *CAPF (WB)* is total capital flight by World Bank estimates, *Avexrate* is the average nominal exchange rate, *Invest* is the investment per year, *Intdiff* is the interest rate differential, *Gns* is the gross national savings, *Reserv* is foreign reserves, μ is error term. The *Log* represents the log transformation of the variables.

The model below tests the long run relationship and the equilibrium of the variables. This follows Ayadi (2008).

$$\Delta CAPF\ (WB) = \alpha_0 + \beta_1 \Delta avexrate_{t-1} + \beta_2 \Delta kaopen_{t-1} + \beta_3 \Delta inves_{t-1} + \beta_4 \Delta ird_{t-1} + \beta_5 \Delta Gns_{t-1} + \beta_6 \Delta reserv_{t-1} + \gamma \Delta ECM_{t-1} + \varepsilon_t \quad (4)$$

and the error correction mechanism is as below:

$$\Delta ECM_{t-1} = \Delta CAPF - \beta_1 \Delta avexrate_{t-1} - \beta_2 \Delta kaopen_{t-1} - \beta_3 \Delta inves_{t-1} - \beta_4 \Delta ird_{t-1} - \beta_5 \Delta Gns_{t-1} - \beta_6 \Delta reserv_{t-1} - \varepsilon_t \quad (5)$$

Variable	Avexrate	Kaopen	Intdiff	invt	Reserv	Gns
Expected Sign	+	+	-/+	-	-	-

The *a priori* signs show that higher coefficients of exchange rate and Kaopen would encourage capital flight, while higher financial savings and external reserves would discourage capital flight. The variables of interest differential and investment could go up or down depending on macroeconomic situation of the country.

Results and Discussions

According to the estimation result in table 1 below, it is discovered that a unit increase in average exchange rate will lead to 0.384 increase in savings. This conforms to apriori or theoretical postulations.

Table 1. Regression Results on Gross National Savings

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.958115	0.992901	2.979263	0.0065
AVER	0.384877	0.090389	4.258000	0.0003
INVT	0.187291	0.137782	1.359331	0.1867
CF	-0.025018	0.023326	-1.072502	0.2942
GDPC	0.349608	0.172175	2.030539	0.0505
INFLA	0.022450	0.057032	0.393640	0.6973

R-squared	0.798902	Mean dependent var	7.628926
Adjusted R-squared	0.757006	S.D. dependent var	0.979073
S.E. of regression	0.482629	Akaike info criterion	1.557717
Sum squared resid	5.590327	Schwarz criterion	1.837957
Log likelihood	-17.36576	Hannan-Quinn criter.	1.647368
F-statistic	19.06891	Durbin-Watson stat	1.878271
Prob(F-statistic)	0.000000		

Source: Eviews output computed by the author, 2015

The rate of exchange is an inducement for savings in the domestic economy. The relationship between the rate of exchange and investment is positive and significant with probability of 0.003. investments is positive which conforms to apriori expectations that the available savings propel growth of domestic investment in the economy in the financial system. Essentially, the relationship is positive but is not statistically significant. The result of this study is similar to earlier research by Bogunjoko (1998), private and public investment nexus, growth and policy reforms in Nigeria using error correction method, he found that though financial savings increased, but is statistically not significant because this did not translate to investments in Nigeria. The capital flight (CF) is negative but not statistically significant, it indicates that a unit reduction CF will lead to 0.025 decrease in savings. The non significance is as a result of the high level of capital flight or low level of investments undertaken over the years in the economy. It also indicates that less domestic savings were made in the economy. As regards the impact of inflation as explanatory variable on savings, the sign based on the apriori expectation is correct since it could be negative or positive but is not statistically significant because inflation in Nigeria is not justified on the ground of improved living standard but as a result of deficient domestic production or investment which is lower than the market demand and as such, it has to import most of her goods. Gross domestic product per capita (GDPC) indicates that GDPC directly affect investment and does not has statistically significant effect on

investment. The non significant of GDPC was an indication that the investment growth in Nigeria is not brought by increased in the GDPC but determined by the oil sector which is not sufficient to bring the needed saving level in Nigeria.

The essence of cointegration test in table 4 and 5, is to find a long term relationship between the variables in the regression after ensuring that the variables are of the same order to avoid spurious regression (i.e the variables have been subjected to units root testing.)

Units Root Test and Co-Integration Test

Table 2. Represents the ADF Units root test at level I(0) at 5 percent confidence level.

Variables	Order	Included in Test Equation	ADF Test Statistic	Mackinnon Critical Value
LogCAF	I(0)	Trend & Intercept	-2.0738	-3.5806
LogINV	I(0)	Non	-0.6506	-1.9533
LogIRD	I(0)	Trend & Intercept	-2.2507	-3.5875
LogAVEX	I(0)	Intercept	-2.1646	-2.9718
LogGNS	I(0)	Trend & Intercept	-2.0588	-3.5875
LogINF	I(0)	Intercept	-2.7337	-2.9718

Source: Eviews output computed by the author, 2015

Table 3. Represents the ADF Units root test at integration of order one I(1) at 5 percent confidence level.

Variables	Order	Included in Test Equation	ADF Test Statistic	Mackinnon Critical Value
LogCAPF	I(1)	Trend & Intercept	-4.0638	-3.5806
LogINV	I(1)	Non	-2.6506	-1.9533
LogIRD	I(1)	Trend & Intercept	-3.9507	-3.1875
LogAVEX	I(1)	Intercept	-4.1646	-2.0218
LogGNS	I(1)	Trend & Intercept	-3.7588	-2.2875
LogINF	I(1)	Intercept	-2.4312	-1.2110

Source: Eviews output computed by the author, 2015

Table 4. Johansen Multivariate Cointegration Results

Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.932888	238.4419	125.6154	0.0000
At most 1 *	0.884372	162.8031	95.75366	0.0000
At most 2 *	0.812522	102.3966	69.81889	0.0000
At most 3 *	0.625523	55.52203	47.85613	0.0081
At most 4	0.377387	28.01970	29.79707	0.0791
At most 5	0.278087	14.75248	15.49471	0.0645
At most 6 *	0.182107	5.628648	3.841466	0.0177

Trace test indicates 4 cointegrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

Source: Eviews output computed by the author, 2015

Table 5 Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.932888	75.63878	46.23142	0.0000
At most 1 *	0.884372	60.40647	40.07757	0.0001
At most 2 *	0.812522	46.87462	33.87687	0.0008
At most 3	0.625523	27.50232	27.58434	0.0512
At most 4	0.377387	13.26723	21.13162	0.4280
At most 5	0.278087	9.123827	14.26460	0.2760
At most 6 *	0.182107	5.628648	3.841466	0.0177

Max-eigenvalue test indicates 3 cointegrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

Source: Eviews output computed by the author, 2015

The regressions that have been estimated, employed variable that had been tested for stationarity in table 2 and 3, though some have very low coefficient but are nonetheless not plagued with the stationarity problems.

Error Correction Estimate

The result of the model was gotten from the estimation of model specified in the methodology. The empirical result presented in table 6, assumes a year lag in the variables.

Table 6: Result of Error Correction Estimates

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LOGINV)	-2.351885	2.458644	-0.956578	0.3492
D(LOGAVER)	2.026205	2.707132	0.748469	0.4621
D(KAOPEN)	-0.179307	4.979190	-0.036011	0.9716
D(LOGIRD)	5.458405	16.21053	0.336720	0.7395
D(LOGGNS)	-0.576579	1.480924	-0.389337	0.7008
D(LOGRESV)	4.784582	2.456564	1.947672	0.0543
ECM(-1)	-1.320991	0.222290	-5.942649	0.0000
R-squared	0.757312	Mean dependent var		-0.466519
Adjusted R-squared	0.663851	S.D. dependent var		7.685228
S.E. of regression	0.175445	Akaike info criterion		6.293211
Sum squared resid	566.7231	Schwarz criterion		6.623248
Log likelihood	-84.25156	Hannan-Quinn criter.		6.396574
Durbin-Watson stat	2.095491			

Source: Eviews output computed by the author, 2015

The vector error correction method helps to observe the convergence in the long run as earlier revealed by the co-integration test. The error correction term has the expected negative sign and is significant. The general significance of the independent variables is shown by the adjusted R^2 0.68% with other factors accounting for 0.32. The sum of square error is low signifying that the errors are minimized (0.18).

Investment in the domestic economy has low coefficients and was not significant. It shows that a percentange increase in investment will lead to 235% decrease in capital flight out of Nigeria. It indicate a negative relationship in the regression showing that capital flight reduces as domestic investment increases. The results of this study was similar to earlier research by Adetiloye (2009) which analyzed the impact of capital flight and domestic investment in Nigeria using vector error correction mechanism on data between 1970 to 2007. The result revealed that capital flight has negative impact on domestic investment but not statistically significant.

The overall implication of non significant of the results was that outflows of capital indicate that the environment is not suitable for accommodating domestic investment and sustaining it. Since domestic savings is negatively related to capital flight, the root of investment is impaired and there is difficulty in

sourcing capital flight for investment. The effect of the gross domestic product per capita in the investment process indicates that positive relationship exists between the two variables. This shows that Nigerian investment process is not significantly benefitting the GDPC or there is insufficient investment to significantly impact the GDPC. This shows that investment dwindled over the years. The correction term shows that capital flight out of the country is not significantly influenced by the exchange rate. This calls for the need to provide a good and conducive investment environment for both foreign and domestic investors. The external reserve is also significant at 0.05 level. It shows positive relationship between capital flight which means that the higher the reserves the higher the capital flight, this does not conform to apriori expectations. Capital account openness is positive but not statistically significant. This implies that flight of capital in Nigeria is not significantly affected by the openness of capital account of the balance of payments.

Finally, the rate or speed of adjustment is very high (132%) among the capital flight and the variables to realign. The roles of the variables are reduced over the years as capital flight reduces.

Conclusion and Recommendations

The problems of capital flight have always engaged attentions of several analysts and of successive governments in Nigeria because it has denied the country of enormous resources which would have been used to improve economic growth and sustainable development. This paper has attempted to investigate the impact of capital flight on domestic investment in Nigeria. It goes through statistical analysis to discover that capital flight does not significantly affect investment, though the relationship is negative. This shows that there has been little domestic investment done through the years or much capital flight has taken place. The paper recommends the increase in commitment to autonomous domestic investment as well as further floating of the exchange rate and transparency in its management.

In the light of the findings and analysis of this research, the following recommendations are considered necessary for short, medium, and long term implementations:

i. The first point to address is to encourage domestic investment by commitment to investment (e.g public sector borrowing, directed at infrastructural development). This will induce and power domestic investment process in order to encourage and retain capital that would otherwise flee out of the country. This would then encourage domestic savings, which in due course will promote further domestic investment. Since autonomous investments have dwindled sharply and domestic investment is insufficient to match up capital flight, it becomes important to bring the policy-makers to encourage the increase of autonomous investment in the economy.
ii. Concerted steps should be taken to improve security of life and

property in the country. This is because security lapse is a threat to investment as well as businesses which severely constrain output of manufacturing concerns. Where business and investment are threatened, iInvestors will be forced to move their assets abroad thereby causing increase in capital flight.

iii. Encouraging long-term savings in an economy where income is low is a challenge. A short-term measure is the pension funds, which may be used as guarantee for the funding of investments in the economy. The government is currently using this to meet its fiscal deficits. A reliable method of encouraging foreign direct investment is through good environment, which is lacking in the country.

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