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Illicit Capital Flights and the Nigerian Economic Outputs Nexus: The Lucas Paradox Approach

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Abstract: *The current study examined the asymmetric effect of illicit capital flights on the growth of the Nigerian economy from 1999 to 2021. The illicit capital inflows proxies considered are: Repatriated Looted funds, Foreign Education and Medical Services Expenditure, and External debt servicing. Meanwhile, the economic output proxy considered is real gross/ domestic product-RGDP. The study controlled for political stability as well. Data for the study were gotten from both the World Bank annual reports and the Central Bank of Nigeria (CBN) bulletins. The Robust Least Square-RLS technique was adopted. The study reaffirmed that, repatriated looted funds improved RGDP significantly. However, political stability improves RGDP minimally. Again, both Foreign Education and Medical Services Expenditure, and External debt servicing reduces RGDP significantly. Consequently, the study concludes that, illicit capital flight is the reason behind the improved state of the Nigerian economy and that with strong institutional policies in place; the Nigerian economy will record high level of development. Hence, recommends that, to reduce the rising capital flight incidence, conscious efforts must be made to address the current macroeconomic volatilities in the Nigerian economy. Again, only those with good track record should be given political positions. Lastly, repatriated looted funds as well as borrowed funds should be used for productive purposes. Lastly, the Nigerian government should invest more on the educational and health care sector. This will help reduce the excuses made by public office holders.*

Keywords: Illicit Capital Flights, Nigerian Economic Outputs, Lucas Paradox Approach

1. INTRODCUTION

One of the most debatable economic issue facing developing economies like Africa lies on the illicit capital flights. This because, even with the rate at which citizenry faces social and economic deprivations (shortage or lack of access to basic social amenities), most of the political class still smuggle public funds offshores. This underscores that, illicit capital flights is not just a major obstacle to development of a country but also an economic issue which reduces the global competitiveness of a country. Worthy to note is that, various ways through which public office holders smuggle money overseas include: currency smuggling, imports and export over invoicing, electronic fund transfers from private banking services, kickbacks in foreign contracts fees, drug trafficking, tax evasion, and trade (exchange) rate controls

The above exposition reveals that illicit capital flights have demeaning consequence on the economy in that, it does not only reduce the productive capacity of a country, it also reduce the investment base of such country. Another issue is that, it can also discourage foreign investors from investing in such country. This in turn, may make such country to face debt overhang. As reported by Bredino, Fiderikumo, and Adesuji (2018) submitted that**,** about $10 billion annual loss to capital flight and that, Nigeria is a major victim of illicit capital flight in African. Other African countries exposed to high public revenue lost to illicit capital flights are Egypt, Morocco, Algeria, and South Africa. However, if these funds are repatriated, economy would not only be relieved but also increase the revenue base of such country. Again, the World Bank Doing Business (2020) suggests, that to invest in the country is high. The chief amongst the issues which contributed to this is the increasing rate at which funds leaves the shores of the Nigerian economy. As such, more investors to invest in the country, there is need for the Nigerian government to correct its infrastructural development. This can be achieved if strong institutional qualities are put in place. It is in this light that, the Nigerian government makes proactive steps to repatriate all stolen funds by public office holders. Another major step which the Nigerian government took is to establish the treasury single account. Looted Funds, Foreign Education and Medical Services Expenditure, and External debt servicing

Even with the various policy measures enacted by the African government, Nigerian government to be specific, the rate at which most Nigerian public office holders smuggle money overseas is still very alarming (MacCarthy, Ahulu, & Thor, 2022). A case in point is the Abacha and Ibori looth (Opakunbi & Babajide, 2022). Another recent approach used by most of these public office holders to smuggle funds overseas is the disguise of public funds for medical treatment and training overseas. Again, even till date, there seems to be no universally accepted measures of illicit capital flights even till date considering the fact that, it may though seems to be legal but in reality it is not. Most of these conflicting approaches includes: the residual method; the trade transaction falsification method; the Dooley method; and the hot money method. The challenge of these approaches is that, they failed to capture. This formed the major one of the major issues which the current study seeks to address. Lastly, with the current demeaning/improvised state of the Nigerian economy, it calls for policy makers in the Nigerian context to analyze the effects of illicit capital flows on the growth of the Nigerian economy using the Lucas Paradox theory. In this wise, the study raised: to what degree has Looted Funds, Foreign Education and Medical Services Expenditure, and External debt servicing hampered the real gross domestic product of Nigeria from 1999 to 2021.

This paper contributes to economic literature as it is seems to be the first of its kind to actualize disaggregate illicit capital flows into Looted Funds, Foreign Education and Medical Services Expenditure, and External debt servicing. This is critical to policy makers in their policy making on how to detect, track and address illicit capital flows being one of the greatest cankerworm which eaten deep into the financial structure of the Nigerian economy.

For ease of reference, this paper is organized into five (5) major sections. The first and second section presents the introductions and the literature review while section three and four dealt with the methodology and the result estimations and discussions. Meanwhile, section five accounted for the conclusions, recommendations, and policy implications and suggestions for further studies.

2. LITERATURE REVIEW

The term "illicit capital flights" has no universally recognized definition. Liew, Mansor, and Puah (2016) conceptualized illicit capital flows as a transfer of capital/investments offshores to get a better return or prospect while leaving the host country improvised. This signals that, funds which would have been used to better the country are smuggled overseas to better those countries. More so, it is the illegal movement of either public funds or financial assets to different countries by public office holders with a view to avoid been caught up by the law. Nelson, Krokeme, Markjarkson, and Timipere (2018) asserts that, capital flight is the calculation of claims on income which does not appear in a country's balance of payments instead it will settle down in an individual's pocket. That is, directing attention towards the missing money that has left the country without having being officially recorded as leaving. Such action usually impedes economic growth, worsening the possibility of domestic and foreign investments and also dampens the investment prospects of the country.

One of the major arguments raised by these public office holders is that, these funds smuggled abroad or legally transferred abroad are due to economic and political instability, import controls, currency devaluation, and quest for education or medical services. Hence, the challenge here is that, such funds which would have been used to better the economy are smuggled abroad or legally transferred abroad thereby leaving the host countries under-developed. The case of Nigeria is so common in the world in that the once acclaimed giant of Africa is brought to naught due to high level of smuggling by most public office holders (Makwe & Oboro, 2019).

Furthermore, illicit capital outflows, any how it appears, it is highly incriminating, and may involve one decision to avoid been caught up by the law, prosecuted, and confiscated. Such proceeds are not to increase the growth and stability of the economy, instead are for personal gains. This is because most of the funds and asset acquired are not within public reach. Since it is not for productive purposes, it does not lead to economic growth. The term growth here means increase in the productive capacity of a country on yearly basis. It may also involve growth in the productive base of a country (Sodji, 2022).

Outside the fact that illicit capital flights in the form of looted funds, Foreign Education and Medical Services Expenditure hinder growth of a country, it results to brain drain and diversion of funds by public officials for personal pockets (Adedayo & Ayodele, 2016).Worthy to note is that, even when the government borrow funds with the hope to bridge the huge saving-investment gaps, such funds are diverted for personal gains. Consequently, the inability of the government to service such loans may eventually plunge the country to perpetual bondage of poverty (Adedayo & Ayodele, 2016; Egbuwalo, & Abere, 2018).

Theoretically, the study perched its tenth on the Lucas Paradox theory. This theory was named after Lucas, an economist. This theory hold that, instead of capital to flow from up hills (developed countries) to downhill (developing or emerging countries), capital flows from downhill (developing or emerging countries) to up hills (developed countries). This Lucas called the 'Paradox'. The justifiable reason raised by Lucas is that, the reason for this is attributable to poor institutional qualities and not because there are high level of investment return certainty inherent in developed countries.

Furthermore, existing studies are mixed and contradictory. For example, Within the Nigerian context, MacCarthy, et'al (2022) examined the interplay between illicit capital flights and economic growth of Nigeria. The least estimation technique was used. The study covered from 1981 to the 2019 based on the sourced data from the Central Bank of Nigeria. They reported that, illicit capital flights (current account balances) reduce the growth of the Nigerian economy significantly.

MacCarthy, Ahulu, and Thor (2022) examined if illicit capital flows have asymmetric effects on the Ghanaian economy from 1960-2020. The non-linear autoregressive distributive (NARDL) lagged model, Wald test, and cointegration was used to test the asymmetric effects. They evidenced that, illicit capital flows have asymmetric effects on the Ghanaian economy.

Sodji (2022) examined the extent to which illicit capital flows affect the WAEMU economies. The WAEMU economies covered are: Burkina Faso, Ivory Coast, Mali, Guinea Bissau, Niger, and Senegal. The study covered from 1970 to 2019. The dynamic panel regression was adopted. The study recorded that, the more capital are smuggled overseas, the more the selected countries are depressed.

Orji, et'al (2020) studied whether the illicit capital flows is the reason behind the improvised state of Nigeria from 1981 to 2017. The ARDL approach was used. They reported that, the illicit capital flows improvised the Nigerian economy greatly over the periods covered.

Ndikumana and Boyce (2019) examined the interplay illicit capital flights and the growth of Angola, Côte d'Ivoire, and South Africa from 1986-2017. The regression estimation technique was adopted. They reported that, both exports and imports mis-invoicing affected the growth of the targeted countries adversely. These were caused by both institutional and structural factors associated with both the source countries and the global financial system.

Igwemma, Egbulonu and Nneji (2018) examined the impacts of capital flights (Repatriated Looted funds, Political instability, Interest Rate changes, Foreign Medical Services, and Education Expenses, and Domestic Investments) on Nigerian RGDP from 1986-2016. The OLS estimation technique was adopted. They attributed the improvised state of the Nigerian economy to the incessant cases of capital flights.

Using the Artificial Neural Network (ANN) technique, Bredino, Fiderikumo and Adesuji (2018) reported that, rise in the flows of capital outside the shores of the Nigerian economy reduces the growth of the economy significantly from 1980 to 2012. However, Adedayo and Ayodele (2016) revealed otherwise in that they found that, despite the rise in illicit capital flows, the Nigerian economy grows still from 1980 to 2014.

3. METHODOLOGY

The study was factored after the expost-facto research design since the illicit capital flows and economic output parameters are secondary in nature and thus cannot be doctored. The study spanned from 1999 to 2021 (23 years). This is to capture the relative effect to return to civilian rule. Both the descriptive and inferential (regression analysis) were considered using the E-Views 9.0. This statistical package was considered due to its user-friendliness and global time series amenability characteristics. The illicit capital inflows proxies considered are: Looted Funds, Foreign Education, and Medical Services Expenditure, and External debt servicing. Meanwhile, the economic output proxy considered is real gross/ domestic product-RGDP. The study controlled for political stability as well.

Model Specification

The study adapted the Igwemma, et'al (2018) model. Their model expresses RGDP as a function of capital flights ((Repatriated Looted funds, Political instability, Interest Rate changes, Foreign Medical Services, and Education Expenses, and Domestic Investments). However, the study replaced interest rate differential with external debt servicing. Hence, the modified model is stated in equation 1:

$$RGDP = \beta_1 LOFS + \beta_2 EFEM + \beta_3 EXDS + \beta_5 POSA + Ut - Eqn\ 1$$

Where:

RLOF = Repatriated Looted funds
EFEM = Expense on Foreign Education and Medical Services
EXDS = External debt servicing.
RGDP = real gross/ domestic product.
POSA = Political Stability
β_0 = Constant
β_1 to β_5 = Coefficient of the regressors
Ut = Error term

Denotation	Nature of Variable	Measure	Aprioiri Expectations	Source & Year
RGDP	Regressand	Annual Amounts of all finished commodities	Nil	Igwemma et'al (2018)
RLOF	Regressor	Annual looted funds recovered	Positive	Igwemma et'al (2018)
EFEM	Regressor	Annual funds designated for FEM	Negative	Igwemma et'al (2018)
EXDS	Regressor	Cost of borrowed funds	Positive	Orji, et'al (2020)
POSA	Regressor	Political Stability index	Positive	Igwemma, Egbulonu and Nneji (2018)

Source: Researcher's Compilation (2022)

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Table 1 accounted for how each of the study variables were operationalized/measured alongside their expected signs, sources and year.

4. RESULTS ESTIMATIONS AND DISCUSSIONS

Pre-estimation Tests

The pre-estimation tests considered are the descriptive statistics and correlation analysis. The result are presented in table 2 and 3:

Table 2: Descriptive Statistics

	Mean	Maximum	Minimum	Std. Dev.	Observations
RGDP	313,916.96	574,183,825.59	59,372,613.49	159,175.89	23
RLOF	219.17	322.515	120.45	214.53	23
EFEM	26.765	38.51	15.02	11.01	23
EXDS	5901.70	38391.32	177.9600	8563.39	23
POSA (%)	28.59	90.57	0.48	21.75	23

Source: E-Views version 9.0 (2022)

Table 2 reported that**,** RGDP, RLOF, EFEM, EXDS, and POSA had average values of $313,916.96 million, $219.17 million, $26.77 million, $5901.70 million, and 28.59% but deviated by $159,175.89 million, $214.53 million, **$**11.01, 85 million, **$**63.39 million, and 21.75%. By implication, the variables all clustered/oscillated around their average values. More so, they reported maximum values of $574,183,825.59 million, $322.52 million, $38.51, $38391.32 million, and 90.57% but reported minimum values of $59,372,613.49 million, $120.45 million, $15.02 million, $177.96 million, 0.48%.

Table 3: Correlation Analysis

	RGDP	RLOF	EFEM	EXDS	POSA
RGDP	1.000000				
RLOF	0.741213	1.000000			
EFEM	-0.616769	0.452585	1.000000		
EXDS	0.688005	0.385182	0.146506	1.000000	
POSA	0.760475	0.350388	0.136199	0.165022	1.000000

Source: E-Views version 9.0 (2022)

Table 3 evidenced that, RLOF, EXDS, and POSA are both positively related with RGDP. By implication, the higher the RLOF and EXDS, the more developed the Nigerian economy will become. Meanwhile, EFEM is negatively related with RGDP. Meanwhile, on individual regressors, none of them exhibited high correlation depicting low possibility of Multicollinearity problems.

Result Estimates

To overcome the challenge which the Ordinary Least Square-OLS estimate may pose, the study adopted the robust least square to test the interplay between illicit capital flights and economic growth of Nigeria:

Table 4: Robust Least Squares

Regressand: RGDP				
Sample: 1999 2021			**Periods:**	**23**
Variable	**Coefficient**	**Std. Error**	**Z-Statistic**	**Prob.**
Constant	7.77303	2.58130	3.01128	0.0062
RLOF	0.82326	0.30124	2.73294	0.0411
EFEM	-0.62169	0.19326	-3.21691	0.0235
EXDS	-0.45065	0.12305	-3.66223	0.0013
POSA	0.0934	0.585215	1.8684	0.0745

R^2=0.9687; Adj R^2=0.9564; Durbin Watson=2.0185; & Prob(Rn-squared stat.)= 0.0000

Source: E-Views version 9.0 (2022)

Table 4 reported R^2 of 0.9687 and Adj R^2 of 0.9564. This indicates that the model has a high predictive power. Also, it reported Durbin Watson of 2.0185. By implication, the model is free from autocorrelation problem. Again, it reported Prob (Rn-squared stat.) of 0.0000. By implication, the model is significant statistically. This further signals that, illicit capital flights are a major driver of economic growth. Individually, the more looted funds are recovered, the RGDP of Nigeria will increase by 82.24% and that this result is significant statistically. The implication of this result both in theory and practice is that, the improvised state of the Nigerian economy can be improved upon if more funds are smuggled abroad are repatriated. Again, POSA was positive and was significant statistically. However, EFEM and EXDS hampered the growth of the Nigerian economy by 62.22% and 45.07%. These findings are in tandem with THE Lucas Paradox Theory and also supports MacCarthy, et'al (2022); MacCarthy, Ahulu, and Thor (2022); &Sodji (2022) findings but deviated from Adedayo and Ayodele (2016) findings.

5. CONCLUSION

The need for growing countries to opt for sustainable capital inflows so as to bridge their investment gaps is eminent (Agbogun, & Ehiedu, 2022). Although, emerging countries have recorded huge capital inflows, the abilities of these countries to retain these funds are weak due to weak institutional quality in place. Still, most public office holders smuggle money offshore thereby leaving the host country improvised. It is in light of this exposition, the current study examined the asymmetric effect of illicit capital flights on RGDP from 1999 to 2021. Consequent upon our findings, the study concludes that, illicit capital flight is the reason behind the improved state of the Nigerian economy and that with strong institutional policies in place; the Nigerian economy will record high level of development. Hence, the paper recommends that, to reduce the rising capital flight incidence, conscious efforts must be made to address the current macroeconomic volatilities in the Nigerian economy. Again, only those with good track record should be given political positions. Lastly, repatriated looted funds as well as borrowed funds should be used for productive purposes. Lastly, the Nigerian government should invest more on the educational and health care sector. This will help to reduce the excuses made by public office holders.

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