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Foreign Capital Inflow and Economic Development in Nigeria

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Abstract
The study focus on the impact of foreign capital inflow on economic development of Nigeria was conducted to shed more light on the impact of foreign capital inflow on the misery index in Nigeria from the period of 1990 to 2023. The study used data from the Central Bank of Nigeria statistical bulletin, 2023. The Foreign Direct Investment, Foreign Portfolio Investment, and Remittances formed the independent variables while Misery Index was the dependent variable. The AutoRegressive Distributed Lag regression analysis covering the bounds test for cointegration and ARDL Error Correction Mechanism were used for the data analysis. The descriptive statistics, unit root tests were the pre-estimation tests while heteroskedasticity and serial autocorrelation were the post-estimation tests. The study found that there is a negative but significant impact of Remittances, Foreign Direct Investments, and Foreign Portfolio Investments on Misery Index, indicating that the more the independent variables, the less the misery of the people. Remittances, Foreign Direct Investments are especially significant as they have been shown to have a larger effect on the reduction of misery index in Nigeria over the period. The study concluded that the misery of the people can be lessened by increasing the foreign capital inflows into the economy. The study recommends that the government should subsidize remittances for people who are based overseas while improving the policies that attract foreign direct investments.

Keywords: Foreign Direct Investment, Foreign Portfolio Investments, Remittance, Misery Index, Economic Development

Introduction

The interplay between foreign inflows and macroeconomic stability has been a significant subject of economic discourse, especially in developing economies like Nigeria. Foreign inflows, comprising foreign direct investment (FDI), remittances, foreign aid, and portfolio investment, play a critical role in influencing the economic trajectory of a country. These inflows are often seen as catalysts for growth, bringing much-needed capital, technology, and expertise into a domestic economy (UNCTAD, 2021). However, their impact on the socio-economic conditions of citizens, as reflected in indices like the misery index, remains a topic of debate. The misery index, introduced by Okun (1966), is a widely recognized measure of economic hardship, calculated as the sum of unemployment and inflation rates. A higher index signals greater economic discomfort, highlighting the extent of distress caused by adverse economic conditions.
The relationship between foreign inflows and the misery index in Nigeria is complex. On one hand, foreign investments can stimulate economic growth by creating jobs and increasing productivity, which could reduce unemployment, a key component of the misery index (Adeoye & Atanda, 2011). Consequently, an influx of foreign capital can fuel inflation if not well managed, particularly in an economy like Nigeria's, which has faced structural challenges such as weak infrastructure, overreliance on oil revenues, and inadequate economic diversification (Central Bank of Nigeria, 2020). Inflationary pressures erode purchasing power, contributing to the overall economic discomfort experienced by citizens.Between 1990 and 2023, Nigeria experienced several economic cycles influenced by both domestic policies and external factors. The 2008 global financial crisis, for example, led to a sharp decline in foreign inflows, exacerbating the country‘s economic woes and driving up both unemployment and inflation rates (Mordi, 2009). Similarly, the economic recession of 2016, triggered by a drop in oil prices and foreign exchange shortages, further heightened the misery index (Akinlo& Babatunde, 2017). In contrast, periods of increased foreign inflows, particularly during the oil boom years of the early

2000s, corresponded with lower unemployment rates and relatively stable inflation (Obadan & Odusola, 2014).

Chukwu et al. (2022) reported that capital inflows to Nigeria in March 2021 amounted to USD 52m, an increase from USD 39m in February 2021. Between January 2007 and March 2021, foreign direct investment into Nigeria generally increased, with data showing peaks of 824m USD in July 2007 and a low of 1.2m USD in August 2009Studies, such as Li (2018) for China, Nxumalo and Makoni (2021) for South Africa, and Ndiweni and Bonga-Bonga (2021) for Sub-Saharan African countries, have also produced mixed results when studying the effect of foreign capital inflows on the welfare of the people. The inconsistency in these findings suggests the need for a reevaluation of the impact of international capital flows on economic development in Nigeria, using up-to-date data.This article seeks to explore the relationship between foreign inflows and the misery index in Nigeria from 1990 to 2023, analyzing how fluctuations in foreign investments, remittances, and aid have influenced key macroeconomic indicators. By examining this relationship, the study aims to shed light on the broader implications of foreign capital on the welfare of Nigerian citizens and provide insights for policymakers in addressing the economic challenges facing the country.

Literature Review

Theoretical Review

This study is grounded in Adam Smith's Theory of Economic Development, which highlights the importance of capital accumulation in accelerating economic growth. International capital inflows are recognized as a key driver of growth and development, as they are crucial for capital realization and long-term economic expansion. Adam Smith presented his ideas in his seminal work, "The Wealth of Nations," with one of its most significant contributions being the Theory of Economic Development.

Physiocracy emerged as a reaction to mercantilism, advocating for the natural laws of economics and emphasizing agriculture as the primary industry capable of generating national wealth. Smith's "Wealth of Nations" is considered scientific not because it offered absolute truths, but because it marked a turning point in economic thought, serving as both a conclusion to earlier ideas and a foundation for future ones. Smith argued that the natural order of development-from primary to secondary to tertiary activities—is driven by the evaluation of relative risks and potential profits in different uses of capital. Unlike some modern approaches that focus on measurable variables such as the amount of capital or national savings, Smith's theory emphasizes the behavior of economic agents in the face of risk (Bell, 1992).

The rate of economic development, according to Smith, is determined by the size and productivity of the labor force. Labor productivity, in turn, depends on a country's technological progress, which is itself a result of the division of labor. In Smith's theory, the division of labor is a dynamic force that drives economic growth. Schumpeter pointed out that Smith placed an unprecedented emphasis on the division of labor, making it practically the sole factor in economic progress. The division of labor increases productivity through the specialization of tasks. When a job is broken down into smaller tasks and workers focus on specific parts, their efficiency improves because they can concentrate more effectively. This concept of dividing labor involves breaking down complex production processes into simpler ones, facilitating the adoption of various production methods. Smith's focus was on the social division of labor, which underscores the cooperation of individuals to satisfy collective needs. It is the process by which different types of labor, initially aimed at meeting individual producers' needs, are transformed into social labor that produces goods for exchange (Bell, 1992). This approach ultimately contributes to improving the human development index and fostering a stronger economy.

Conceptual Review

International capital inflows refer to the movement of funds into a country for the purposes of commerce, investment, or business activities. This includes the transfer of money within a company as investment capital, capital expenditures for operations, and funds for research and development (R&D). The term describes the influx of foreign financial resources into a local economy to support commercial, business, and investment activities. On the other hand, an investment is money committed to a business venture with the expectation of earning future returns (Awe, 2017). It is often measured by the surplus in the capital account of the balance of payments, which represents the increase in net international indebtedness of the public and private sectors over a specific period (Zango, 2016). Excluding errors and omissions, the capital account surplus is equal to the current account deficit plus the change in official holdings of foreign reserves. The current account deficit, which is the excess of expenditure over revenue, is therefore linked to rising capital inflows, expanding current account deficits, and/or reserve building.

According to Ikpesu (2019), capital importation involves the movement of capital from one country to another and does not relate to the transportation of goods or the settlement of exports and imports. These activities are carried out by public, corporate, and intergovernmental organizations. On a larger scale, governments allocate tax revenue for projects, operations, and trade with other countries. Additionally, individual savings and investment funds are invested in securities such as stocks, bonds, and mutual funds (Ogbonna, 2015). In developing economies like Nigeria, where domestic capital is often insufficient, the inflow of foreign capital can provide a significant boost. As a result, developing countries that actively encourage and attract foreign funds can benefit from the relationship between capital inflows and economic growth (Okoro, Nzotta & Alajekwu, 2019). International capital inflows in this context include foreign direct investment, foreign portfolio investment, external borrowing, and remittances from Nigerians in the diaspora.

Empirical Review

Nguyen, Ham, Tran, and Nguyen (2021) analyzed the impact of foreign capital inflows on economic growth in Vietnam, using secondary time-series data from 1995 to 2018. The study employed a linear approach to assess the effects of FDI, foreign aid, foreign loans, and exports on Vietnam's economic growth, using data from the World Bank and relevant Vietnamese agencies. The results indicated that FDI (net inflows), foreign aid, foreign loans, exports, and GDP (current) had a positive and statistically significant effect at the 1% level on economic growth, suggesting that increases in these factors benefitted the Vietnamese economy during the study period.

Oke and Ruth (2021) examined the impact of foreign capital flows on Nigeria's economic growth from 1999 to 2020. The independent variables included foreign capital flows measured by foreign debt inflows, foreign remittance inflows, foreign medical services, education expenditures, and foreign direct investment outflows. The dependent variable was economic growth, measured by real GDP per capita growth rate. Data were sourced from the CBN Statistical Bulletin, World Bank Data Bank, and the International Monetary Fund (2020). The study utilized Ordinary Least Square regression techniques through Econometric Views version 9.0. The findings revealed that foreign debt inflows and foreign expenditures on medical services and education had a significant negative effect on economic growth. Conversely, foreign remittance inflows had a significant positive effect on economic growth in Nigeria, while foreign direct investment outflows had a positive but not statistically significant impact.

Nxumalo and Makoni (2021) explored the cointegrating and causal relationships between foreign direct investment (FDI), foreign portfolio investment (FPI), and institutional quality in 12 emerging market economies from 2007 to 2017. They constructed a composite index for institutional quality using the Worldwide Governance Indicators and Principal Components Analysis (PCA). The study applied a panel autoregressive distributed lag (ARDL) model and an error correction model (ECM) to assess the relationships between the key variables. The results revealed significant cointegrating relationships between institutional quality and foreign capital inflows (FDI and FPI), with unidirectional causality from FDI and FPI to institutional quality in the long run. The findings also suggested that the long-term relationship between these two types of foreign capital inflows was influenced by the dynamics of the institutional environment in the host economy.

Rehman, Bashir, Maqbool, Ahmad, and Liaqat (2021) empirically examined the role of institutional quality in attracting foreign capital flows in emerging market economies (EMEs). Using a panel data set from 1995 to 2018 for 24 major EMEs—including countries like Argentina, Brazil, China, India, and South Africa—the study employed the system GMM estimation technique for dynamic panel data, as developed by Arellano-Bover (1995) and Blundell-Bond (1998). The empirical results indicated that FDI inflows are positively and significantly influenced by institutional quality, whereas portfolio equity capital inflows are not affected by any indicators of institutional performance.

Ndiweni and Bonga-Bonga (2021) analyzed the relationship between international capital inflows and economic growth in developing economies, using threshold regression methods to determine whether the effects of capital flows differ based on the strength of a country's institutional infrastructure. Their findings revealed a threshold effect in the relationship between capital inflows and growth. Specifically, the study showed that capital inflows have a positive and significant impact on economic growth only when a certain threshold level of institutional quality is surpassed. Below this threshold, the relationship between capital inflows and growth is effectively non-existent. These results suggest that the link between capital inflows and economic growth depends on the level of institutional development in an economy.

Nxumalo and Makoni (2021) explored the key determinants of foreign direct investment (FDI) and foreign portfolio investment (FPI) in emerging market economies, focusing particularly on the role of institutional quality. They utilized a panel data system generalized method of moments (GMM) model, analyzing annual data from 2007 to 2017 for 12 emerging market economies. The study measured institutional quality using the Worldwide Governance Indicators and constructed a composite index via Principal Components Analysis (PCA). The results indicated that FDI in these markets was driven by institutional quality and economic growth. Additionally, capital account openness, institutional quality, and economic growth were identified as positive determinants of FPI, with stock market development emerging as the most critical factor for attracting foreign capital inflows.

Nwosa, Ugwu, and Ehinomen (2020) examined the impact of capital inflow volatility on economic growth in Nigeria from 1986 to 2018. The study addressed whether the volatility of different components of capital inflows—such as foreign direct investment, foreign portfolio investment, and other investment flows—affects economic growth differently. Using the Auto-Regressive Distributed Lag (ARDL) method, the study found that volatility in capital inflows, whether aggregated or disaggregated, negatively impacted economic growth, although the effect of volatility in foreign direct investment was not statistically significant. The study also revealed that the volatility of different components of capital flows influenced economic growth in varying degrees of significance and magnitude.

Chukwu, Ubah, and Ezeaku (2020) investigated the effect of capital importation on Nigeria's economic growth, utilizing secondary data from the Central Bank of Nigeria's Statistical Bulletin for the period 2010 to 2019. The study employed a Vector Autoregression (VAR) model to assess the effect of capital importation—measured through foreign direct investment, portfolio investment, and other financial investments—on real gross domestic product (GDP). The findings indicated that while capital importation had a positive effect on Nigeria's economy during the study period, the effect was statistically insignificant.

Orji, Ogbuabor, Kama, and Anthony-Orji (2020) studied the impact of capital flight on Nigeria's economic growth using data from the Central Bank of Nigeria's Statistical Bulletin covering the period 1981 to 2017. Employing the Autoregressive Distributed Lag (ARDL) bounds test approach, the study found that capital flight significantly reduced economic growth in both the short and long term. Other variables such as money supply, credit to the private sector, and domestic investment were also found to significantly influence economic growth.

Monogbe, Okereke, and Ifionu (2020) conducted an empirical investigation into the extent to which foreign capital flows contribute to economic development in Nigeria, using time-series data from 1986 to 2018 sourced from the Central Bank of Nigeria's Statistical Bulletin and World Bank databases. The study used foreign direct investment, foreign portfolio investment, foreign aid, and external borrowings (divided into multilateral and bilateral loans) as proxies for foreign capital flows, while the Human Development Index (HDI) was used as a proxy for economic development. Through unit root tests, co-integration tests, error correction models, and Granger causality tests, the study found that three out of the five indices of foreign capital inflows— foreign portfolio investment, foreign aid, and bilateral loans—had a significant positive impact on economic development in Nigeria, whereas foreign direct investment and multilateral loans were negatively associated with economic development.

Methodology

The research designs adopted for this study was the quasi-experimental research design. The quasi-experimental design was used to establish the cause-and-effect relationship amongst the variables. A time series data spanning through the period of 1990 to 2023 were obtained from the Central Bank of Nigeria (CBN) Statistical Bulletin while the ARDL based on the Ordinary Least Squares (OLS) multiple regression econometric techniques was used to analyze the data. The misery index was used as a proxy for economic development of Nigeria while remittances, foreign direct investments (FDI), and foreign portfolio investments were used as proxies for foreign capital inflows.The model is specified in the general form as;

$MI = f(REM, FDI, FPI)$ (1)

Where MI= Misery Index, REM = Remittances, FDI = Foreign Direct Investments, and FPI = Foreign Portfolio Investments

The mathematical form upon which the model is based is given as;

$Y = F(X_1, X_2, X_3)$

WhereY is economic development represented by MI = dependent variable and X_1 to X_3 are independent variables, $Y = a_0 - \beta_1 x_1 - \beta_2 x_2 - \beta_3 x_3 + U_t$,$MI = a_0 - \beta_1 REM - \beta_2 FDI - \beta_3 FPI + U_t$,a= Constant, β_1, β_2 and β_3 = Coefficients., and U_t =Stochastic Error Term

The logged form of the equation is stated thus:

$\text{LogMI}_t = \beta_0 - \beta_1 LogREM_t - \beta_2 LogFDI_t - \beta_3 LogFPI_t + \mu_t$ (2)

$\beta_1, \beta_2, \beta_3 < 0$

Data Analysis, Results, and Discussion

The data shows that the MI have worsening in the recent years. As the available data shows, the MI has surged to over 50.3% in 2023, an indication that Nigerians are worse off in terms of their

economic well-being. The data also reveals that FDI has been fluctuating over the period, rising from 4.28b in 1989 to an all-time low in 2022 at -0.03. A clear indication that investors are avoiding and abandoning the economy for other emerging economies in Africa.

Table 1:Descriptive Analysis

	LOG_MI_	LOG_REM_	LOG_FDI_	LOG_FPI_
Mean	10.58082	6.499824	2.868087	2.682408
Median	10.59500	6.639820	2.450044	3.098507
Maximum	11.18573	8.183062	6.712592	4.404644
Minimum	9.987732	4.038303	-0.713350	-2.040221
Std. Dev.	0.463679	1.267715	2.036589	1.535416
Skewness	-0.004663	-0.376630	0.077339	-1.643938
Kurtosis	1.377723	1.943162	2.255948	5.679704
Jarque-Bera	3.289836	2.105385	0.721923	22.48867
Probability	0.193028	0.348997	0.697006	0.000013
Sum	317.4246	194.9947	86.04262	80.47223
Sum Sq. Dev.	6.234939	46.60595	120.2832	68.36759
Observations	30	30	30	30

Source: Researchers' Computation

The descriptive statistic gives the researcher an idea of the type of data they are using at a glance. From the table above, the researcher focused on the skewness, kurtosis and Jarque-Bera (JB) of the data set to determine whether they are normally distributed or not. Based on the results of the JB, the FPI is not normally distributed while other variables are normally distributed as shown by their respective JB probability ratios (Prob>0.05).

Table 2: Unit Root: ADF Tests

Test at levels	**Variables**	**P -Value**	**Order of Integration**
	LOGFPI	0.0317	I(1)
	LOGFDI	0.9609	I(0)
	LOGREM	0.8608	I(0)
	LOGMI	0.6539	I(0)
Test at First Difference	**Variables**	**P-Value**	**Order of Integration**
	LOGFPI	0.0000	I(1)
	LOGFDI	0.0002	I(1)
	LOGREM	0.0000	I(1)
	LOGMI	0.0062	I(1)

Source: Authors computation using Eviews

The unit root test results are shown in the table able shows that the variables are stationary at various levels. However, LOGFPI is stationary at levels. The mixture of the variables in the ADF analysis satisfies for the use of ARDL model in the regression analysis.

Table3:Long Run Form and Bounds Test for Cointegration

Test Statistic	Value	Signif.	I(0)	I(1)
			Asymptotic: n=1000	
F-statistic	4.475508	10%	2.75	3.79
K	5	5%	3.12	4.25
		2.5%	3.49	4.67
		1%	3.93	5.23

Source: Authors computation from Eviews

Drawing from the result of the stationarity test, it is clear that the order of integration for the variables in the specified model is not the same. A mixed order of integration was evident in the model. By this, the test of cointegration adopted for the model is the ARDL Bounds Cointegration test. This is used to test if there is a long-term relationship between the variables used.

Table4:ARDL Model Estimation

SHORT RUN RESULTS

Dependent: LOGMI

Variable	Coefficient	Std. Error	t-Statistic	Prob.
@TREND	0.016594	0.006962	2.383321	0.0254
LOG_REM_**	-0.065679	0.128858	-0.509702	0.6149
LOG_FDI_**	5.334369	3.162590	1.686709	0.1046
LOG_FPI_**	-5.834198	3.381586	-1.725285	0.0973

Dependent: LOGMI LONG RUN RESULT

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG_REM_	-0.265679	0.128858	-2.061797	0.0009
LOG_FDI_	-1.004369	0.162590	-6.177311	0.0000
LOG_FPI_	-3.356198	1.381586	-2.429257	0.0073
CointEq(-1)*	-0.578051	0.136447	-4.236441	0.0003
R-Squared =0.805644	F-Stat = 9.896152	Prob(F-stat) 0.000529	D-W stat=2.191892	

Source: Researchers' Computation

The results above present both the shortrun and longrun tests results of the ARDL model. The coefficient of determination, which tests the goodness-of-fit, shows that the independent variables explains the changes in the dependent variable at 80.1%. The F-test, which tests for the overall significance of the model, is also statistically significant while the speed of adjustment between the shortrun and the longrun is 0.57 (57%) annually.

Table5:Breusch-Godfrey Serial Correlation LM Test

F-statistic	0.652575	Prob. F(2,20)	0.5314
Obs*R-squared	1.776535	Prob. Chi-Square(2)	0.4114

Source: Author's computation from Eviews

The serial autocorrelation helps to determine if the variables are serially autocorrelated or not. As the result shows using the Prob of F-stat (0.5314), there is no problem of serial autocorrelation.

Table6: Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	0.890781	Prob. F(6,22)	0.5185
Obs*R-squared	5.668228	Prob. Chi-Square(6)	0.4614
Scaled explained SS	6.701169	Prob. Chi-Square(6)	0.3494

Source: Author's computation from Eviews
The variance of the model is also constant based on the results of the heteroskedasticity test.

Table 7:Pairwise Granger Causality Tests

Null Hypothesis:	Obs	F-Statistic	Prob.
LOG_REM_ does not Granger Cause LOG_MI_	28	1.39236	0.2687
LOG_MI_ does not Granger Cause LOG_REM_		0.85844	0.4370
LOG_FDI_ does not Granger Cause LOG_MI_	28	2.15280	0.1390
LOG_MI_ does not Granger Cause LOG_FDI_		1.14892	0.3345
LOG_FPI_ does not Granger Cause LOG_MI_	28	9.55324	0.0010
LOG_MI_ does not Granger Cause LOG_FPI_		1.87504	0.1760

Source: Author's computation from Eviews

The pair-wise granger causality test shows the direction of cause between the dependent and the independent variables. This does not necessarily connote a relationship between the variables. shown above, there is a bidirectional causality between the FDI and MI while there is unidirectional causality between FPI and MI. However, there is no causality between MI and REM over the period.

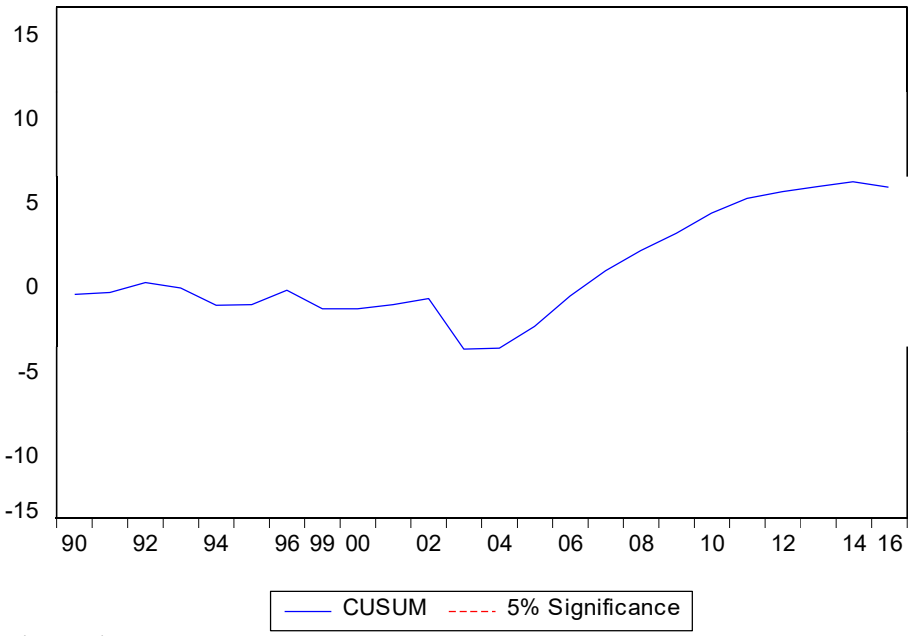

Fig.1: The CUSUM Test

The result shows that there is a negative relationship between REM and MI as expected apriori. As REM increases by a unit, MI decreases by -0.265679 and vice versa. This indicates that misery of the people is reduced as a result of the increase in the foreign remittances. Again, REM is statistically significant at 5% level of significance based on the t-test. We will therefore accept the alternative hypothesis, reject the null and conclude that there is a significant relationship between MI and REM over the period. Furthermore, the result shows that there is a negative relationship between FDI and MI as expected apriori. As FDI increases by a unit, MI decreases by -1.004369 and vice versa. Again, FDI is statistically significant at 5% level of significance. We will therefore accept the alternative hypothesis, reject the null and conclude that there is a significant relationship between MI and FDI over the period. Moreover, the result shows that there is a negative relationship between FPI and MI as expected apriori. As FPI increases by a unit, MI decreases by -3.356198 and vice versa. Again, FPI is statistically significant at 5% level of significance. We will therefore accept the alternative hypothesis, reject the null and conclude that there is a significant relationship between MI and FPI over the period.

Discussion of the Findings

The results above show the extent to which the independent variables affect the dependent variable over the period. Any increase in the independent variables will lead to a decrease in the dependent variable and vice versa. The analysis reveals that REM has a negative but significant relationship with MI over the period, an indication that consistent foreign remittances can decrease the misery of the people and vice versa. This finding agrees with the findings of Monogbe et al (2021) who also noted that remittances improve the social welfare of the people. This also implies that general economic wellbeing of the people is positively related to the foreign remittances sent to them. In addition, the study found that FDI has a negative but significant relationship with MI, suggesting that with the increase in FDI inflows, MI will decrease and vice versa. This implies that FDI increases the investments and income generation capabilities of the people through local job creations, thereby increasing their satisfaction. The findings of Khan et al (2022) also agrees with the findings of the result by noting the significance of FDI in job creation as well as improving the people‘s standard of living through income

generation. Lastly, the relationship between FPI and MI are negative and significant, implying that foreign portfolio investments improve people's welfare and decrease their misery. The findings agree with the findings of Nwaeze et al (2017) who observed that FPI has significant contribution to the economic prosperity of the people.

Conclusion and Recommendations

The study aims isto investigate the relationship between foreign capital inflows and economic development in Nigeria. The results of the analysis found that there is a negative but significant relationship between FDI, FPI, REM, and MI. From the findings, the study concludes that one of the keys to economic prosperity and poverty reduction lies with the improvement in some of the key variables used in this study. The FDI, FPI and REM have significant impact on the MI. With the proper government's policy interventions, there will be an increasing participation and more economic development in the coming years. The study recommends that:

1. Remittances should be made much simpler through adequate financial policy by the CBN so that more people based abroad will take advantage of it. Again, the government should subsidize the remittance of individuals abroad who seek to send funds into the Nigerian economy through tax waivers for such economic activities.
2. Policies to attract more FDI are important at this stage. The study reveals that FDI has dropped to its all-time low since the last three decades. The authorities must be sincere in fixing the variables that drive investors away and come up with new ways to attract the investors back into the economy through changing the policy of taxation in order to eliminate multiple taxation.
3. Policies on improving foreign portfolio investments must be vigorously pursued in order to make it easier for foreigners who cannot invest heavily in the economy to invest with the little amount they can afford. This way, no one is denied the opportunities of participating in the Nigerian economy.

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