

Foreign Capital Inflows and Employment Growth in Ecowas

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Abstract

This study explores the link between foreign capital inflows and employment growth in selected countries in the ECOWAS sub-region with a focus on Ghana, Guinea, Liberia, Nigeria, Sierra Leone, Niger, Mali, Senegal, Cote d'Ivoire and Burkina Faso. This was motivated by the growing recognition of the West African sub-region as an important destination for foreign capital in recent times. In particular, foreign capital inflows were measured by foreign direct investments (FDI) inflows, net official development assistance (ODA) inflows, remittances inflow and external debt stocks. Panel datasets required for this study were obtained from the World Bank database, UNDP Human Development Reports and IMF Financial Statistics. The data were analysed using descriptive statistics, panel unit root test, Rao cointegration tests, panel ARDL estimation involving mean group (MG) and pooled mean group (PMG) estimators, and the Hausman test. The Rao cointegration test results showed a long-run relationship among the variables in each of the four models at the 5% significance level. The panel ARDL results showed that FDI inflow has a positive and significant effect on employment generation, Evidence of a positive and significant contribution of remittances inflow on employment growth was also established from the long-run results. The results further showed that external debt significantly reduced employment growth during the study period. Owing to the findings, this study concludes that governments in the ECOWAS sub-region should strengthen their efforts in mobilizing foreign capital, especially FDI and remittances to create more opportunities for employment growth.

Keywords: Foreign Capital, Employment, Remittances, External Debt, Foreign aid and Foreign Direct Investments

Introduction

The implications of capital inflows for human development have persistently captured the interest of scholars, policymakers, and development organisations in developing economies such as Nigeria. This is in line with the understanding that emerging markets are becoming more and more significant hubs for international investment. The empirical validity of the relationship between capital inflows and economic development has remained largely unclear, despite the fact that neoclassical economists are credited with providing the theoretical explanation of capital inflows to capital-deficit regions. According to the study published by the International Monetary Fund (IMF, 2016), capital flows have become a crucial component of the global monetary system, offering immediate and lasting benefits to the recipient economies.

It is believed that West Africa is one of the regions that receives a large chunk of international aid, yet the level of development has not been quite impressive. This has raised concern about the aid's effectiveness in terms of achieving the set developmental goals. The quality of education and healthcare delivery in West Africa is considered to be relatively low compared to the experience of other countries. This has continued to erode public confidence in the intended and desired improvement of social services following the aid inflows. There is also a problem of school enrolment in West Africa notwithstanding the large influx of foreign aid in the region. Available statistics from the Brookings Institution (2020) show that 27% of primary school-age

children and 56% of upper-secondary school-age children were out of school in 2019. This suggests that benefits aid as an integral component of foreign is yet to be optimized by the countries in the West African region.

In addition to FDI inflows, remittances account for a larger portion of GDP in West African nations. According to the World Bank and the United Nations Department of Economic and Social Affairs Population Division, remittance inflows to West Africa totalled US\$35.6 billion in 2019. Remittances as a percentage of GDP for Ghana, Senegal, Liberia, and Nigeria were 7.3%, 9.1%, 12.0%, and 6.1%, respectively, according to the World Bank (2020) report. Furthermore, Nigeria emerged as the nation in West Africa with the highest remittance inflow in 2022, at US\$20.1 billion (World Bank, 2022). The West African sub-region is also well known in the body of existing literature to be the recipient of foreign help, including sector-specific aid, bilateral aid, technical cooperation grants, and official development assistance (ODA). Again, there has been an increase in bilateral and multilateral loan inflows, which has an impact on debt servicing. All things considered; West Africa has continued to be a prominent recipient of loan infusions as well as aid meant to further developmental objectives. In spite of the continuous influx of foreign capital, West African countries have continued to lag behind their more industrialised counterparts economically. For instance, extreme poverty rose by 3% in 2020, according to the United Nations (2021) study. Approximately 25 million people in West Africa are struggling to meet their basic needs as a result of the worsening economic conditions. This has a negative impact on food security and nutrition in the region. Due to these, questions have been raised on how well foreign capital inflows support employment growth. To this end, this research aims to investigate the effects of foreign capital inflows on employment generation given the inconsistent and contradictory findings from other studies.

Literature Review

Theoretical Literature

The works of Solow (1956) and Swan (1956), which analyse the patterns and determinants of capital movements between countries, are credited with helping to develop the neoclassical theory of capital flows, often known as the neoclassical approach to international capital movement. The fundamental tenet of the idea is that variations in capital returns among nations are what propel capital movements. Stated differently, capital tends to move from countries with abundant supply and poor returns to those with scarcity and high returns. The goal of maximising returns for investors is what drives this capital flow. Neoclassical theorists contend that low savings, the income gap, and constrained growth are only a few of the reasons why foreign investment will give access to capital and other resources that are not created domestically. They also believe that capital inflows typically result in higher production and increased efficiency. According to Kinda (2010), the foundation for balancing the marginal returns on capital is laid by the neoclassical theory, which is based on the notion that capital should flow from capital-dominant countries to economies that lack capital.

In addition, the two-gap model proposed by Chenery and Bruno (1962) and expanded by Chenery and Strout (1966) is based on the assumption that inward mobility of international resources provides an opportunity for the host economies to fill their savings and foreign exchange gaps. The Post-Keynesian growth models of closed economies associated with Harrod (1939) and Domar (1946) are the foundation of the two-gap models. As a result, it assumes that developing economies also struggle with the savings-investment gap that the Harrod-Domar model explains. Because of this, it is anticipated that the influx of foreign money will present chances to close these differences by importing capital goods. There is a claim that developing economies frequently experience a foreign exchange gap, and that foreign aid can provide the means to bridge this gap and free up funds for socioeconomic development.

However, the basic assumption of the three-gap theory is that the inflow of foreign capital is expected to provide opportunities for filling the resource gap in the recipient of the economy and boost productive investments in critical sectors that support economic development. The three-gap model states that in addition to the savings from both domestic and foreign sources which Chenery and Strout (1966) first addressed about the two-gap model—fiscal constraints on government spending and, consequently, on its public investment decisions also limit the use and growth of current productive capacity. According to Sepehri and Akram-Lodhi (1999), countries frequently turn to foreign borrowing since their financial markets are underdeveloped. Foreign resources are thought to have a significant role in development, particularly in cases when cutting current spending and securing inflation-based financing are unfeasible. Once more, it has been determined that political conditions or outside pressure on the fiscal authorities to reduce inflation are the main factors behind foreign resource inflows.

Empirical Literature

Anisiobi, Okeke, and Madueke (2022) examined the impact of foreign direct investment on employment generation in Nigeria within the period 1991 to 2021. The variables used in the study included employment rate, foreign direct investment, trade openness and real exchange rate. The paper used the autoregressive distributed lag (ARDL) model for its regression analysis. The data for the analysis was sourced from the CBN statistical bulletin and World Bank Development indicator. The study finds that foreign direct investment and Trade openness had a positive impact on employment generation in Nigeria. The real exchange rate had a negative impact on employment generation in Nigeria. The paper finds that a short-run relationship exists between foreign direct investment, real exchange rate, trade openness and employment generation in Nigeria. Based on the findings, the paper recommends that government should make effort to attract more foreign direct investment into the country to create more employment opportunities through multi-national corporations.

Osabohien, Awolola, Matthew, Itua and Elomien (2020) researched foreign direct investment inflow and employment in Nigeria for the period of 1985-2017. The study used the Fully Modified Ordinary Least Squares (FMOLS) and the Johansen co-integration econometric approach on the data, which were gathered from the World Development Indicators (WDI) and the Central Bank of Nigeria (CBN) statistical bulletin. The results obtained show that foreign direct investment is statistically significant and positively related to the employment level in Nigeria. The study therefore recommended that policies should be formulated to exploit the role of FDI on employment in Nigeria, in an attempt to reduce the unemployment rate.

Ajayi, Rafiu and Samuel (2019) investigated the impact of Foreign Direct Investment on employment and unemployment rate in Nigeria for the period of 1980-2014. The study sourced data from CBN Statistical Bulletin, National Bureau of Statistics and World Bank Indicators and the data were analyzed by E-view 9.5. The study employed the Autoregressive Distributed Lag (ARDL) methods to examine the relationship between FDI and employment generation in Nigeria. The findings revealed that FDI has a significant role on employment rate in Nigeria. Thus, it was recommended that policies should be implemented to exploit the impact of FDI on employment in an attempt to reduce the unemployment rate in Nigeria.

Johnny, Timipere, Krokeme and Markjackson (2018) assessed the impact of Foreign Direct Investment on unemployment rate in Nigeria between 1980 and 2015. The study was carried out using unit root test, co-integration test, and ordinary least square. It was revealed that negative and insignificant relationship exists between Foreign Direct Investment and unemployment rate in Nigeria while positive and significant relationship occurs between capital formation and unemployment rate. The study therefore suggested that government should implement policies that will attract foreign investors to Nigeria to make more investments and

should also ensure that all resources for productive activities are fully employed before embarking on savings.

Babasanya (2018) examined the relationship between Foreign Direct Investment and employment generation in Nigeria covering the period of 1999 to 2016. The study considered the employment rate and gross domestic product, foreign direct investment, and exchange rate as independent variables. The ordinary least square estimation technique was used in the study and it was discovered that foreign direct investment has a positive relationship with employment rate in Nigeria. It was therefore recommended that government should make concrete efforts in attracting foreign investors into Nigeria to increase production and thereby create employment opportunities.

Aderemi, Omitogun and Osisanwo (2022) examined the effect of FDI on employment in ECOWAS sub region between 1990 and 2019. The study utilized a panel autoregressive distributed lag model to analyze the short run and long run relationship between FDI and employment across ECOWAS sub region. In the short run, the impact of FDI on employment is negative and statistically not significant. Meanwhile, in the long run FDI has a positive and statistically significant impact on employment rate. This implies that FDI has the capacity to generate employment in countries in ECOWAS sub region. Therefore, this study recommends that policymakers in the ECOWAS sub region should facilitate the achievement of productive, employment and decent work for all, policy measure that will facilitate the inflows of FDI should be embarked upon.

Ainembabazi and Kemeze (2022) examined how the varying share of remittance inflows in household income induces the employment of family and non-family workers in family-owned firms. The analysis used the nationally representative panel household data collected from Nigeria and Uganda. It was discovered that as the share of remittance transfers in household income increases, the likelihood of hiring family members decreases as it increases for hired workers. The threshold point occurs when remittance transfers contribute more than half of household income. They also analyze the role of remittances in job preservation and destruction in family firms. The findings point to a sign of the hidden potential of remittances to spur job creation in migrants' communities if the right policies to enhance remittance flows prevail.

Methodology

Ex post facto research design was chosen because it permits the utilisation of data from pre-existing sources and is appropriate for this type of investigation. It is also thought to be ideal for examining the causal relationship between various economic variables. Panel data involving time dimensions (1990–2022) and cross-sectional units (ECOWAS countries) were used in this study. The datasets were gathered from the World Bank World Development Indicators (WDI) and the United Nations Development Programme (UNDP) human development reports. The functional specification of the models is provided as follows:

$$EMP = f(FDI, REM, ODA, EXD) \quad (1)$$

Where:

EMP = employment generation,

FDI = FDI inflows, REM = Remittances,

ODA = net ODA inflows

EXD = external debt stock.

The panel autoregressive distributed lag (PARDL) model specifications with p and q lags is provided below:

$$\Delta EMP_{it} = \lambda_i [EMP_{i,t-1} - \beta_{0i} - \beta_{1i}x_{i,t-1}] + \sum_{j=1}^p \alpha_{ij} \Delta EMP_{i,t-j} + \sum_{j=0}^q \varphi_{ij} \Delta x_{i,t-j} + \mu_i + v_{it} \quad (2)$$

Where:

β_{0i} = heterogenous intercepts,

λ_i = error correction coefficient,

β_{1i} = heterogenous slope parameters,

$x_{i,t}$ = vector of independent variables,

α_{ij} and φ_{ij} = short run parameters and

p and q = optimal lag orders, Δ = first difference operator,

i = cross-sectional units (the selected ECOWAS countries),

t = time dimensions (1990-2022),

u_i = individual effects,

v_{it} = remainder disturbance term

The panel unit root test was utilised in this investigation to evaluate the stationarity of the variables. In accordance with the presumption of cross-sectional dependence in the panel data, second-generation panel unit root tests were added to the first-generation panel unit root tests. For model estimation, this study specifically used the Mean Group (MG) estimator, which is attributed to Pesaran and Smith (1995), and the Pooled Mean Group (PMG) estimator, which was developed by Pesaran, Shin, and Smith (1997, 1999). The MG estimator permits variation in intercepts, error variances, short-run coefficients, and error correction terms throughout the whole cross-section (Fazli & Abbasi, 2018; Onuohaetal, 2018). On the other hand, the PMG estimator only permits the intercept and short-run coefficients to vary between the groups but constrains the long-run coefficients to be equal. This study employed Hausman's (1978) test to determine which of the two alternative estimators of MG and PMG to use for the estimation of the PARDL.

Data Analysis, Results, and Discussion of Findings

The panel unit root test was conducted using the IPS method. The results are presented in

Table 1: IPS panel unit root test results

Variable	Levels test results	1 st diff. test results	Number of panels	Order of integration
EMP	2.1311 (0.9835)	-5.4891*** (0.0000)	10	I(1)
FDI	-3.3880*** (0.0004)	-	10	I(0)
REM	0.2179 (0.5862)	-6.7680*** (0.0000)	10	I(1)
ODA	-3.1493*** (0.0008)	-	10	I(0)
EXD	-1.4675* (0.0711)	-6.1577*** (0.0000)	10	I(1)

Source: Researchers' Computation STATA 17 Output

Note: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$ denote significant at 1%, 5% and 10% level respectively

The IPS panel unit root test results showed that FDI and ODA are stationary at the 5% significance level given that the probability values of their test statistics are less than 0.05. For

this reason, the null hypothesis of nonstationary for each of the variables is rejected. On the other hand, the results showed that employment, remittances inflow and external debt stocks are not stationary. This is based on the fact that the probability values of their test statistics at levels are greater than 0.05. Thus, the null hypothesis of no unit root is rejected for these variables. However, the first difference test results showed that the variables are stationary at first difference. This is based on the fact that the probability values of their test statistics are less than 0.05. Therefore, the results showed that, employment, remittances inflow and external debt stocks are all integrated of order one, $I(1)$. This finding also provides the basis for subjecting the variables in each of the models into cointegration to ascertain if a long-run relationship exists among them. The test results of Rao panel cointegration test are presented in Table 2.

Table 2: Rao-cointegration Test Results

Variables: EMP FDI REM ODA EXD		
Ho: No cointegration	Number of panels	= 10
Ha: All panels are cointegrated	Number of periods	= 21
Test method	Statistic	p-value
Modified Dickey-Fuller t	-2.4810**	0.0352
Dickey-Fuller t	-5.1111***	0.0000
Augmented Dickey-Fuller t	-0.6458	0.2592
Unadjusted modified Dickey-Fuller t	-3.5629***	0.0027
Unadjusted Dickey-Fuller t	-0.1640	0.4349

Source: Researchers' Computation STATA 17 Output

Note: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$ denote significant at 1%, 5% and 10% level respectively. The results of the Kao cointegration test showed that three out of the five test statistics are significant at the 5% level. This provides the basis for rejecting the null hypothesis of no cointegration. Thus, it showed that employment level has a long-run relationship with capital inflows (FDI, remittances, ODA and external debt stocks). This finding is accordance with the results of Abouelfarag and Abed (2020) and Shabbir, Kousar and Zubair-Alam (2021) who reported that a long-term relationship exists between employment and inward capital flows. This finding also provides the required evidence for estimating the panel ARDL results using the MG and PMG estimators." The panel ARDL model was estimated to ascertain the long and short-run effects of capital inflows on employment growth. The PMG and MG results and the associated Hausman test results are presented as follows:

Table 3: Panel ARDL results

Dependent variable: EMP		
VARIABLES	MG	PMG
Ec	-0.286*** (0.0702)	-0.9101*** (0.13024)
D.FDI	-0.0776 (0.120)	0.0102*** (0.0032)
D.REM	-0.130 (0.173)	0.1076** (0.0436)
D.ODA	0.144** (0.0690)	0.0632** (0.0235)
D.EXD	-0.0252 (0.0255)	-0.0355 (0.0242)
FDI	-0.846 (1.533)	0.12802*** (0.04415)
REM	-2.073 (5.391)	0.07377*** (0.02668)
ODA	-2.645 (1.851)	0.5361** (0.2365)
EXD	0.0379 (0.0623)	-0.52481** (0.2068)
Constant	4.775*** (1.226)	-7.6729** (3.2104)
Hausman test results	chi2(4) = 6.14	Prob > chi2 = 0.2148
Observations	220	220

Source: Researchers' Computation Regression Output from using STATA 17

Note: *** p<0.01, ** p<0.05, * p<0.1 denote significant at 1%, 5% and 10% level respectively

The Hausman test result was relied upon in choosing between the MG and PMG results. Specifically, the results showed that the probability value (0.2148) of the Chi-square statistic (6.14) is greater than 0.05, indicating that it is not statistically significant at the 5% level. Consequently, the null hypothesis that the PMG result is appropriate is accepted. This necessitates the choice of PMG results for the discussion of the implications of capital inflows on employment generation. The error correction coefficient (-0.9101) has the expected negative sign and it is statistically significant at the 5% level. This indicates that short run distortions can be corrected to achieve a long run equilibrium position at a speed of 91.01%. This suggests that it less one and half year for the convergence to be achieved. The results showed that FDI has a positive and significant effect on employment generation in the short and long run. It was found that employment increases by 0.0102% and 0.1280% following a percentage short- and long-term increase in FDI inflows respectively. This finding indicates that HDI the growth of FDI inflows creates more opportunities for employment in ECOWAS sub-region. It also attests the growing recognition of the role of FDI in promoting economic development in the recipient countries. At the same time, the results showed that remittance inflows has a positive effect on employment in both long and short run. This finding is significant at the 5% level, indicating that a 1% increase in remittances increase will lead to 0.0737% increase in employment generation. This finding suggests that inflow of remittances provides room for job creation, especially for remittances who invest the received funds in economic activities.

Furthermore, the results showed that the effect of ODA on employment is positive and significant at the 5% level. This finding indicates that employment increases by 0.5361% following a percentage increase in ODA inflows. This finding indicates that the countries in the ECOWAS sub-region can leverage foreign aid inflows to increase the level of employment for

the population. On the contrary, evidence of a negative and significant effect of external debt on employment was established from the results. The estimated parameter showed that a percentage increase in external debt leads to a 0.5248% decrease in employment. This suggests that the increase in foreign borrowings has not translated to an increase in employment opportunities. This further explains that external loans available to the countries in the ECOWAS sub-region have not properly utilized in building the critical infrastructure required for employment generation and overall economic development.

Conclusion/Recommendations

This study explores the link between foreign capital inflows and employment growth in selected countries in the ECOWAS sub-region with a focus on Ghana, Guinea, Liberia, Nigeria, Sierra Leone, Niger, Mali, Senegal, Cote d'Ivoire and BurkinaFaso. This was motivated by the growing recognition of the West African sub-region as an important destination for foreign capital in recent times. Thus, it becomes imperative to examine the contributions of these foreign capital to the process of economic development. The findings showed that FDI inflows significantly improved employment generation. This finding is a pointer that an increase in FDI inflows in the ECOWAS sub-region has the potential to foster economic prosperity. It is also established from the findings that the inflow of remittances positively and significantly affected employment generation during the study period. This suggests that inward remittances play a critical role in improving job creation in the selected countries. The results further showed that ODA significantly enhanced employment generation. However, the results showed that external debt has a negative and significant effect on employment generation. This finding suggests that external debt has not created the necessary opportunity for the growth of employment in the study area. Given the findings, this study concludes that capital inflows in the forms of FDI, remittances and ODA are good for employment generation in the ECOWAS sub-region. To this end, this study recommends that the governments in the ECOWAS sub-region should strengthen their efforts in mobilising FDI to foster enhance the potential for job creation. Policymakers including monetary authorities should synergize their efforts to promote the inflow of remittances and ODA to their home countries to create more opportunities for employment growth.

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