International Financial Flows and Capital Formation in Nigeria

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Abstract
The study examined the impact of international financial flow on capital formation in Nigeria from 1986-2019. Ordinary Least Square (OLS) and Error Correction Mechanism (ECM) were used to test for long run and short run relationship between the dependent variable (Gross Fixed Capital Formation (GFCF) proxy for capital formation) and independent variables (Foreign Direct Investment (FDI), Foreign Portfolio Investment (FPI) and Remittances). The result showed that in the long run foreign direct investment and foreign portfolio investment had positive and significant impact on gross fixed capital formation, remittance had negative and insignificant impact on gross fixed capital formation. The result implied that one (1) percent increase in FDI and FPI would increase capital formation by 3.2 percent and 0.5 percent respectively. In the short run, FDI had a positive but not significant relationship with GFCF, while FPI and REM had negative relationship with GFCF. Based on the results we recommend that appropriate investment policy framework should be put in place to encourage the inflow of capital investment in the relevant and productive sectors of the economy such as the manufacturing and agricultural sectors as these sectors have been neglected after oil discovery.
Key Words: Foreign Direct Investment, Foreign Portfolio Investment and Migrant Remittances
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I. Introduction

A country that must develop must save and invest thereby increasing its stock of capital which will vastly improve industrial activities and strengthen the financial market in the country. Capital or finance is a key requirement to economic development of any country in general. There is great need for countries and economies to strive for capital formation and accumulation as it has in it a great array of benefits (Sunny & Osuagwu, 2016). Shuaib & Dania (2015) asserted that gross capital formation can lead to technical progress which helps to realize the economies of large scale production (or economies of scale) and increases specialization in terms of providing machines, tools and equipment for growing labour force. Capital formation can accelerate the pace of economic development through fuller utilization of available resources.

Given the huge role capital play in an economy, every country including Nigeria, have made immense efforts to attract and accumulate saving and investment through different policies and strategies. This has however proven futile as capital formation has been deficient domestically. Adofu (2009) noted that the deficiency in capital accumulation needed for increased level of investment in Less Developed Countries (LDCs), especially Nigeria is due to low level of savings which is caused by factors such as high level of poverty, weak financial system which cannot properly mobilize funds internally (Ekineabor, Agwumba, & Liman, 2016).

The poor savings and investment attitude of LDCs especially Nigeria have opened up a savings-investment gap (Ekineabor, Agwumba, & Liman, 2016). It is pertinent to close this gap since the lack of capital or finance impedes economic growth. Every nation with such aim of expanding its economy strive to attract capital and financial resources to the country in the form of international financial flows. International capital or financial flows may be in the form of direct or portfolio foreign investments, loans from foreign nations, business and financial institutions, central banks, governments and international economic institutions such as International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC), International Development Association (IDA) and several other agencies. The capital flow may also be in form of private or inter-governmental unilateral assistance and technology transfer (Economic Discussion, 2019). Many authors have asserted that Nigeria has received enough

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capital to develop her economy; it is however the rigidities in the economy and the failure to harness the previous and existing capital flows that has hindered the growth and development of the economy.

Jhighan (2016) observed that authors like the protectionists, have asserted that international capital flow have adverse effect on the economy and has hindered the development of most LDCs. This is because, increased international capital flow not only increases balance of payment deficit but also creates inflationary pressure in the receiving countries, as increased investment and spending consequently leads to increased income which is bound to cause increase in inflationary condition (Tejvan, 2018). Also, domestic firms are likely to lose out to new multinational firms especially in the case of foreign direct investment, which can most times lead to monopoly and exploitation if not well regulated.

Foreign aids, grants and loans are most times used for unproductive purposes in LDCs especially Nigeria, this, overtime results to increased and piling up of external debt as seen in the country now (Economics Help, 2018). From the foregoing, it is clear that the true nature and direction of international financial flows in Nigeria is still undetermined. This controversy has prompted the investigation of the impact of international financial flows on capital formation in Nigeria. Extant literature on the impact of international financial flows on economic growth and capital market in Nigeria abound. However, little or no emphasis has been placed on the impact of migrant remittance on capital formation in Nigeria. Recently the inflow of migrant remittances to the country has been on the increase. Its value as of 2019 stood at N26.68 billion compared to its value of N1.3 billion in 1999.

Ajayi, Adedeji, Giwa, & Araoye (2017) assert that remittance has significant positive effects on economic growth of Nigeria and that it is due to the spillover effects remittance has over local component of GDP such as consumption and investment. Corroborating this, Adigun & Ologunwa (2017) affirm that remittance remains positive sources of economic growth and can help the poor to finance some of their consumption and investment expenditure which is equivalent to capital formation.

This study therefore investigates the impact of international financial flows on capital formation in Nigeria, with special interest on the effect of migrant remittance on capital formation in Nigeria.

II.   Literature Review
A. Theoretical Literature
The theoretical backing of this study is the two-gap model of Chenery and Strout (1966). According to the model, developing economies are faced with savings and foreign exchange gap which prevents them from embarking on developmental projects that will enhance productivity and promote growth. The savings gap is the gap between savings and investment while the foreign exchange gap is the gap between export and import. The foreign exchange gap arises when investment has an import content then domestic savings is not sufficient to guarantee growth, since the saving may not be exchangeable into foreign exchange earnings with which to acquire imports.

The model assumes that only foreign aid can be used to close the gap in savings and foreign exchange, that is, domestic savings cannot be utilized as a substitute for the required foreign exchange. It advocates the need for the inflow of foreign capital in relieving the savings and foreign exchange constraint. In addition, the theory posits that with the inflow of foreign capital, developing economies can attain the target growth needed to ensure sustainable development.

B. Empirical Literature
International financial/capital inflows play a major role in the development of currently industrialized countries in their course of economic advancement. Developing economies rely on foreign capital and construct policies to attract FDI (foreign domestic investment) and FPI (foreign private investment) (Comes et al., 2018). In developing countries, foreign capital inflow can contribute significantly to the advancement of the host country by helping to fill the savings - investment gap (Aisien, 2018).

The volume of investment capital flows between foreign nationals and developing nations has necessitated that a study be conducted to assess the impact of this foreign capital flows on the economic growth of these developing nations. Akanyo & Ajie (2015) examined the impact of capital flows on the level of economic growth in Nigeria spanning 1981-2012, and using Johansen co-integration test, the paper showed that net capital flow significantly and positively influenced the level of economic growth in Nigeria.

In the same vein Okoro, Nzotta & Alajekwu (2019) accessed effect of international capital inflows on economic growth of Nigeria for the periods 1986 to 2016. The study employed four core channels of international capital inflows which includes foreign direct investment (FDI), official development assistance (ODA), personal remittances (REM), and external debt stock (EXTDS) into Nigeria as the explanatory variables and GDP growth rate as the dependent variable. The model of the study was hinged on the Harrod-Domar growth model and employed Johansen cointegration and Ordinary Least Square (OLS) techniques for data

analyses. The result showed that international capital inflows have long run effect on economic growth of Nigeria. Specifically, the OLS revealed that FDI and REM had significant positive effects on economic growth.

Adekunle & Sulaimon (2018) examine the relationship between foreign capital flows and economic growth in Nigeria by collecting annual data over the period of 1986 to 2015. The study reported the absence of a long-run relationship between economic growth and its determinants in Nigeria. Furthermore, owing to absorptive capacity constraints (such as, infrastructural deficit, underdeveloped local financial market and negative and/or very weak positive spill-over effect on domestic investment), net FDI inflows exerted positive short-run influence on growth, while net portfolio flows and net foreign remittance had significant negative short-run effects on growth. Also, lower levels of net foreign aids and net external debt promote growth, while excessive levels of these flows dampen growth.

Anochie, Ude & Mgbemena (2015) investigates the empirical relationship between Foreign Direct Investment and economic growth in Nigeria. The result of the OLS techniques indicates that FDI has a positive and insignificant impact on the growth of Nigerian economy for the period under study. Ugwuegbe, Modebe & Onyeanu (2014) investigated the impact of FDI on capital accumulation in Nigeria for the period of 1986-2012. The OLS estimation indicates FDI, Total Credit to the Private sector and interest rate impact positively but insignificantly on capital formation in the short-run with government expenditure exerting negative effect on GFCF. The result also indicate that in the long-run all the variables included in the model has a positive impact on GFCF with only FDI and TCR exerting a significant impact on capital accumulation in Nigeria for the period under review.

Also, Okonkwo, Egbunike & Udeh, (2015) investigated the effect of foreign direct investment on Nigeria's economic growth over the period 1990 to 2012. The result showed that FDI has a negative sign and shows an inverse relationship between GDP and FDI. Uremadu (2008) investigated the impact of foreign private investment (FPI) on capital formation in Nigeria, 1980-2004. results showed a positive influence of cumulative foreign private investment (CFPI), index of energy consumption (INDEXEC) and total banking system credit to the domestic economy (BSTCr), and a negative influence of gross national savings (GNS), domestic inflation rate (INFR), maximum lending rate (MLR), foreign exchange rate EXCHR) and debt service ratio (DSR) on capital formation. They discovered that foreign exchange rate leads to capital formation in Nigeria.

Akinbobola, Ibrahim & Ibrahim (2017) investigated the direction of causal relationship between foreign portfolio investment and economic growth in Nigeria between 1986 and 2013. The empirical results suggest that foreign portfolio investment and economic growths are positively cointegrated indicating a stable long run equilibrium relationship. Ezeanyeji & Ifeako (2019) explored the impact of foreign portfolio investment on economic growth in Nigeria from 1986 to 2017. The result revealed that foreign portfolio investments have positive significant impact on economic growth in Nigeria. Tokunbo, et al., (2010) stressed that despite the increased flow of foreign portfolio investment to developing countries in especially sub Sahara African countries including Nigeria, low level of per capita income, high unemployment rate, low and falling GDP are still prevalent.

Ajayi, Adedeji, Giwa, & Araoye (2017) investigated the dynamic Impact of Remittance on Economic Growth in Nigeria. Findings from the study show that remittance has significant positive effects on economic growth of Nigeria. This effects work through the spillover that remittance has over local component of GDP namely, consumption, investment and import, following Keynesian open economy model of income.

Adigun & Ologunwa (2017) examined remittances in Nigeria and its impact on economic growth between 1980 and 2015. The study found that workers remit money to finance consumption and investments of their relations which has impacted on the well-being of the recipients, though the impact on economic growth is diverse and so require investigation. The result also shows that remittance remains positive sources of economic growth and can help the poor finance some of their consumption and investment expenditure. Remittance is significant but the magnitude of impact on economic growth and development remain small the study recommended that recipients of remittance should spend more on investment than consumption to impact on the economy.

Fayomi, Azuh & Ajayi (2014) investigated the activities of Nigerian Diasporas in Ghana from the perspective of the money remitted to Nigeria for its economic growth. The analysis which employed both a non-parametric (chi-square) and a linear regression estimator shows that remittances from the Nigerian Diasporas in Ghana are significant to the economic growth of Nigeria. Also, the result revealed that remittances have significantly supported savings and investment in Nigeria including community-based developmental projects and charity support activities.

III. Research Methodology

The study employed the ex-post-facto research design. This research design is suitable because the data for this study is basically secondary in nature and the researcher does not intend to manipulate the data as obtained from the source. For the purpose of this study, Gross fixed capital formation is employed as a proxy of capital formation which is the dependent variable in the model, while the independent variable -international financial flow is proxied by foreign direct investment (FDI), foreign portfolio investment (FPI) and migrant remittances (REM).

3.2 Model Specification

First, we present the mathematical relationship between the dependent and independent variables in functional form as:

GFCF = f(FDI, FPI, REM) …………………………1

Second, the functional model is expressed in econometric form as:

GFCF = λ_0+ λ_1FDI + λ_2FPI + λ_3REM + μ ………………2

Where:

GFCF = Gross fixed capital formation

FDI = Foreign direct investment

FPI = Foreign portfolio investment

REM = Remittances

μ = Error term

λ_0= Constant term/ Intercept

λ_{1-3} = Coefficients of independent variables

Given its property of BLUE (best linear unbiased estimator), the study employed the Ordinary Least Squares (OLS) technique to analyze data collected for the study. Augmented Dickey-Fuller (ADF) unit root test was conducted to ascertain stationarity of data for the study, while Johansen Co-integration technique and Error Correction Mechanism (ECM) were employed to test for long-run relationship among the variables (dependent and independent) of the model. These evaluations were carried out using the E-Views 11 statistical package. The study also employed theoretical, statistical and econometric criteria for the evaluation of the regression estimates.

IV. Results and Discussion

Augmented Dickey-Fuller unit root test result is presented in table 4.1.

Table 4.1 Augmented Dickey-Fuller Test Result

Variable	ADF Statistics		Critical Value 5%	Order of Integration
	Level	First Difference		
GFCF	-0.303640	-4.317074	-2.960411	I(1)
FDI	-1.403343	-6.439673	-2.960411	I(1)
FPI	-0.512067	-4.747795	-2.991878	I(1)
REM	-1.197563	-4.889702	-2.991878	I(1)
ECM	-5.220344	-	-2.960411	I(0)

Source: Author's computation using EViews 11

The result in table 4.1 shows that the variables in the model were non-stationary at level at 5% critical value, but became stationary at first difference. This justified the application of the OLS estimate in the model. The ECM which is the residual of the model is stationary at level, this meet the requirement for the application of an error correction mechanism, and this further indicates that the linear combination of the variables is void of unit root and hence cannot lead to spurious regression.

The next step is to test for any long run relationship between the dependent variable and independent variables. To achieve this, we use the Johansen Co-integration test. The test result of the Johansen co-integration test is presented in Table 4.2.

Hypothesized	Eigenvalue	Trace	0.05	Prob.**

No. of CE(s)		Statistic	Critical Value	
None *	0.695643	52.26337	47.85613	0.0182
At most 1	0.305034	15.38716	29.79707	0.7545
At most 2	0.081046	4.106516	15.49471	0.8948
At most 3	0.046817	1.486412	3.841465	0.2228

Table 4.2 Johansen Co-Integration Test
Source: Author's computation using EViews 11

The trace statistic in table 4.2 revealed that there was only one (1) co-integrating equation at 5 percent level of significance. Therefore, the null hypothesis which states that there is no significant co-integration was rejected at 5 percent level of significance and the alternative hypothesis accepted. This result implied that gross fixed capital formation, foreign direct investment, foreign portfolio investment and migrant remittances have long run relationship.

Given that all the variables became stationary after first difference and long run relationship between the variables, we applied the ordinary least squares (OLS) regression technique to estimate the long run relationship between the variables. The result of the OLS estimate is presented in table 4.3.

Table 4.3 Summary of Regression Result
Dependent variable: GFCF

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FDI	0.032289	0.004992	6.468190	0.0000
FPI	0.005554	0.002278	2.438395	0.0211
REM	-1.82E-08	9.69E-09	-1.881577	0.0700
C	25.91875	2.968764	8.730484	0.0000

R^2 = 0.803539   Adjusted R^2 = 0.783215   DW = 1.528524   F-stats = 39.53730
Prob (F-stats) = 0.000000
Source: Author's computation using EViews 11

Substituting these values in our model, we have:
GFCF = 25.91875 + 0.032289**FDI** + 0.005554**FPI** - 1.82E-08**REM** + μ
The OLS result as presented in table 4.3 above shows that foreign direct investment and foreign portfolio investment are significant with their respective t-values of 6.468190 and 2.438395 greater than the ±1.96 critical value. Migrant remittance on the other hand has negative impact on gross fixed capital formation in Nigeria during the study period with its t-values of -1.881577 less than the ±1.96 critical value. The result of F-stat is 39.53730 and its prob(F-stat) value of 0.000000 is less than 0.05 indicating that the overall regression is statistically significant at 5% level of significance. This indicates that the model is of good fit and that the independent variables are jointly significant in explaining the dependent variable.

The R^2 value of 0.803539 implies that about 80% variation in gross fixed capital formation is explained by foreign direct investment, foreign portfolio investment and migrant remittances. The Adjusted R^2 of 0.783215 further justifies the inclusion of foreign direct investment, foreign portfolio investment and migrant remittance in the regression model. The Durbin Watson value of 1.528524 indicates that there is no presence of serial correlation in the model. This further proves the goodness of our model.

Test of Hypotheses
The hypotheses of the study is analysed using the t-test already conducted as presented in table 4.3 above. The decision rule is as follows:

Decision Rule: Accept the null hypothesis if the prob. value is greater than 0.05 significance level. Reject the null hypothesis if the prob. value is less than 0.05 level of significance.

Hypothesis 1: $H0_1$: foreign direct Investment has no significant impact on gross fixed capital formation in Nigeria

From Table 4.3, the t-value of FDI is 6.468190 with a prob. value of 0.000 is less than the 0.05 level of significance. We therefore reject the null hypothesis and conclude that FDI has significant impact on capital formation in Nigeria. The coefficient of FDI from the table shows a value of 0.032289 indicating a positive relationship with gross fixed capital formation. Accordingly, a 1% increase in foreign direct investment will increase gross fixed capital formation by 3.2%. This suggests that FDI plays a huge role in the determination of capital formation in Nigeria.

Hypothesis 2: $H0_2$**:** foreign portfolio investment has no significant impact on gross fixed capital formation in Nigeria

The t-value of FPI is 2.438395 with a corresponding prob. value of 0.0211. This therefore suggests rejection of the null hypothesis since the prob. value is less than 0.05 level of significance. We conclude therefore that foreign portfolio investment has significant impact on capital formation in Nigeria between 1986 and 2019. The coefficient (0.005554) of FPI further indicates a positive relationship with gross fixed capital formation. Thus, a 1% increase in foreign portfolio investment will increase gross fixed capital formation by approximately 0.6%.

Hypothesis 3: $H0_3$**:** There is no significant relationship between migrant remittance and gross fixed capital formation in Nigeria
The t-value of migrant remittance is -1.881577 with a prob. value of 0.0700 which is greater than the 0.05 level of significance. We therefore fail to reject the null hypothesis and conclude that there is no significant relationship between migrant remittance and gross fixed capital formation in Nigeria. The coefficient (-1.82E-08) indicates a negative relationship with capital formation.

Having established a long run relationship among the variables used in the model using the Johansen cointegration test shown in Table 4.3 above which is a prerequisite condition for running an error correction mechanism, we estimate an error correction model which will help us to see the short-run dynamics of the model. The ECM will also capture the speed of adjustment from short-run to long-run equilibrium. To estimate this, the lag length structure criterion was established using the Schwarz Information Criterion (SIC) which recommended one (1) lag.

Table 4.4 Short Run Model/ Error Correction Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(GFCF(-1))	0.252373	0.187798	1.343858	0.1927
D(FDI)	0.001379	0.006066	0.227350	0.8223
D(FDI(-1))	0.006175	0.009906	0.623337	0.5395
D(FPI)	-0.003800	0.002856	-1.330499	0.1970
D(FPI(-1))	0.003943	0.003052	1.292170	0.2097
D(REM)	-9.59E-09	5.88E-09	-1.631885	0.1169
D(REM(-1))	3.74E-09	6.12E-09	0.610727	0.5476
ECM(-1)	-0.428262	0.182887	-2.341679	0.0287
C	1.101816	1.135950	0.969950	0.3426

R^2 = 0.556349   Adjusted R^2 = 0.395021   D.W = 2.055826 F-stats = 3.448564
Prob.(F-stats)= 0.010065
Source: Author's computation using E-view 11

The result of ECM as shown in the table above reveals that the coefficient of ECM(-1) is negative (-0.428262) as expected, and statistically significant at 5% level of significance with a probability value of 0.0287. This implies that the disequilibria in the short run from the previous year's shock converge back to the long run equilibrium in the current year at an adjustment speed of approximately 43%. It also revealed that in

the short run FDI has a positive relationship with GFCF while FPI and REM have a negative relationship with GFCF.

4.2 Discussion of Findings

From the analysis, it was observed that the variables in the model exhibited stationarity at first difference. The residual of the model showed stationarity at level as expected, further justifying the reliability of our model. Also established was the long run relationship among the variables, this was done through the Johansen co-integration test using the Trace statistics. The uniformity in the stationarity of all the variables justified the use of the Ordinary Least Square (OLS) estimation technique in estimating the model.

The result of the OLS estimate showed that foreign direct investment (FDI) has a positive and significant relationship with gross fixed capital formation thereby conforming to a priori expectation. This was in tandem with the finding of Ugwuegbe (2014). The result also showed that foreign portfolio investment (FPI) has a positive and significant relationship with gross fixed capital formation. This result also conformed to a priori expectation. Remittances on the other hand exerted a negative but insignificant impact on gross fixed capital formation. The negative sign can be attributed to the fact that remittances are used mostly for consumption purposes rather than being used for meaningful investments. This therefore means that remittances do not contribute directly to capital formation in Nigeria. The implication is that policies that encourage foreign direct investment and foreign portfolio invest (FDI and FPI) will be beneficial to the economy as it will have huge impact and benefits to the economy.

V. Conclusion and Recommendations

The study investigates the impact of international financial flows on capital formation in Nigeria for the period 1986 to 2019. Gross fixed capital formation was employed as proxy for the dependent variable (capital formation) while foreign direct investment, foreign portfolio investment and migrant remittances as proxies for the independent variable (international financial flows. The augmented Dickey-Fuller test reveals that all the variables became stationary after first difference. The Johansen cointegration test shows that there is one cointegrating equation thus suggesting that a long run relationship exists among the variables in the study model.

The stationarity of the variables after first difference gave justification for the adoption of the ordinary least squares technique for the estimation of the parameters in the model. The OLS estimates reveal that foreign direct investment and foreign portfolio invest have positive and statistically significant impact on capital formation in Nigeria in the long run, while migrant remittances have a negative nut insignificant impact on capital formation in Nigeria in the long run.

Given that the explanatory variables explain about 80 percent of the variation in the dependent variable as shown by the coefficient of determination R^2, we therefore conclude that international financial flows impacts positively on capital formation in Nigeria and hence make the following recommendations:

i.   An appropriate investment policy framework such as tax cut or tax holidays should be put in place to encourage the inflow of capital investment in the relevant and productive sectors of the economy such as the manufacturing and agricultural sectors as these sectors have been neglected after oil discovery.

ii.   The government of Nigeria should consciously improve the business environment by curbing social unrest; corruption and epileptic electricity supply, unstable exchange rate, etc. Also ensuring political stability, security of life and property, as well as maintaining consistent policies are all important to enable foreign capital contribute immensely to the economy.

iii.   Government should initiate policies that will promote the long-run growth and development of the capital/financial market and the economy at large. This will go a long way in attracting foreign portfolio investment (FPI) that will be available for productive purposes.

iv.   Furthermore, the regulators of the capital market must continue to strengthen the transparency of the market through effective oversight, professionalism and improved operational facilities so as to boost the confidence of both local and foreign investors in the market.

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