

IMPACT OF CAPITAL FLIGHT ON NIGERIA DOMESTIC INVESTMENT IN A FINANCIALLY GLOBALIZED WORLD ECONOMY

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ABSTRACT: This study investigates the impact of capital flight on Nigerian domestic investment within the context of a financially globalized world, employing the Autoregressive Distributed Lag (ARDL) model to explore long-run relationships. The study examines key variables, including capital flight, interest rates, exchange rates, foreign direct investment (FDI), and external debt, to assess their effects on domestic investment. The ARDL model results reveal that capital flight has a positive but statistically insignificant impact on domestic investment. Conversely, interest rates exhibit a negative relationship with domestic investment, implying that higher interest rates discourage investment activities. Exchange rates, on the other hand, have a significant positive impact, indicating that currency depreciation may boost domestic investment by improving competitiveness. Foreign direct investment shows a weak positive relationship with domestic investment but lacks statistical significance, suggesting its limited direct influence in the long run. External debt has a significant negative effect on domestic investment, signifying that high debt levels crowd out investment by diverting resources to debt servicing. The study concludes that, while capital flight does not significantly affect domestic investment, external factors such as exchange rates and external debt play critical roles in shaping investment decisions in Nigeria. The findings highlight the need for policy measures aimed at stabilizing exchange rates, managing external debt, and reducing interest rates to foster a more conducive environment for domestic investment. Furthermore, curbing capital flight through stricter regulations and improving financial sector reforms could help enhance domestic investment in a financially globalized world.

KEYWORDS: *Capital Flight, Domestic Investment, Interest Rate, Exchange rate, Foreign Direct Investment, External Debt.*

I. INTRODUCTION

Capital flight, a phenomenon that involves the large-scale exit of financial assets and capital from a country, has long been a critical issue for developing economies, particularly in Africa. In Nigeria, capital flight has become a central topic in discussions about economic development and domestic investment. As one of Africa's largest economies, Nigeria's ability to harness local investments for infrastructural development, job creation, and poverty alleviation is often undermined by the exodus of capital to safer, more stable, and often foreign financial markets. In the context of a financially globalized world, where borders are more porous for capital flows, the impact of capital flight on Nigeria's domestic investment landscape is significant (Emmanuel, Ene, Abubakar S. & Udi, 2021).

Capital flight, in its most basic form, refers to the rapid outflow of capital from one country to another. This can occur through legal channels, such as foreign investments, or illegal mechanisms, such as money laundering or tax evasion. In Nigeria, capital flight often involves both legal and illegal transfers, with illicit financial flows comprising a significant portion of the outflows. According to Global Financial Integrity, between 2004 and 2013, Nigeria lost an estimated \$15.7 billion annually to illicit financial flows (Kar & Spanjers, 2015). These outflows undermine the economy by reducing the resources available for domestic investments, which are vital for growth and development.

In a financially globalized world, the mobility of capital has increased exponentially. Globalization has created an interconnected financial system, allowing for more significant and rapid transfers of funds across borders. While this has benefits, such as increased access to foreign investments and diversification of portfolios, it also presents challenges, particularly for developing economies like Nigeria. Financial globalization has made it easier for capital to flee countries with weak governance, economic instability, or low investor confidence. For Nigeria, where corruption, weak institutions, and macroeconomic volatility are pervasive, financial globalization has inadvertently facilitated capital flight, exacerbating the country's economic challenges (Akinlo, 2021).

The Nigerian economy is heavily reliant on oil exports, which account for a significant portion of government revenue and foreign exchange earnings. However, the oil sector's volatility, coupled with corruption and poor economic management, has led to instability in the Nigerian economy. This instability drives capital flight, as local and foreign investors seek safer environments for their assets. Moreover, Nigeria's infrastructure deficit, high levels of poverty, and unemployment require substantial domestic investment. Yet, capital flight drains the resources that could otherwise be invested in sectors critical for economic development, such as agriculture, manufacturing, and technology (Adeola, 2020).

Nigeria's struggle with capital flight is a multifaceted problem, with significant consequences for domestic investment. The country's capital stock comprising both physical and financial resources has been severely depleted by persistent capital flight. The departure of wealth from Nigeria limits the availability of resources for domestic investments, which are crucial for job creation, industrialization, and economic growth. Capital flight not only erodes the financial base of the country but also reflects deeper structural issues within the Nigerian economy, such as poor governance, corruption, and weak financial institutions (Lionel, Alfa & Samuel, 2020).

Despite Nigeria's abundant natural and human resources, the country has struggled to translate these assets into sustainable economic growth. One of the primary reasons for this is the outflow of capital, which could otherwise be channelled into domestic investment opportunities. The loss of capital means fewer funds for infrastructure development, such as roads, power generation, and telecommunications, which are essential for attracting further investments and improving the quality of life for Nigerian citizens. In addition, the lack of domestic investment hampers the growth of small and medium-sized enterprises (SMEs), which are the backbone of most economies and crucial for job creation (Asongu & De Moor, 2017).

The problem is further compounded by the nature of financial globalization. While globalization offers opportunities for countries to integrate into the global economy, it also exposes them to global financial shocks and competition. For Nigeria, financial globalization has meant greater exposure to volatile capital flows and the risk of sudden capital flight. This has left the country vulnerable to external shocks, such as fluctuations in oil prices, which in turn exacerbate domestic economic instability and fuel further capital flight (Olayiwola, 2023).

Nigeria's capital flight problem is also a symptom of deeper governance issues. Corruption, weak financial regulations, and a lack of accountability create an environment where capital flight can thrive. High levels of corruption in both the public and private sectors incentivize capital flight, as individuals and businesses seek to safeguard their assets from potential seizure or devaluation. This erodes investor confidence and reduces the incentives for local investment, leading to a vicious cycle of underinvestment and economic stagnation (Bakare, 2022). It is against this the researcher intend to investigate the impact of capital flight on the Nigerian domestic investment in a financially globalized world.

II. LITERATURE REVIEW

2.1 Conceptual Review

Concept of Capital Flight

Capital flight for this study is defined as the movement of capital resources from developing countries to developed nations in response to political or macroeconomic policy instabilities. In this light, governance or the system of government practised plays a major role in determining whether there will be a high level of capital flight or not; the level of domestic investment will also depend on the business environment created by the government of the day (Adetiloye, 2012; Aderoju, 2017).

According to Schneider (2013), capital flight is the portion of resident capital outflow that is driven by political and economic uncertainty. In his definition, capital flight is the movement of large sums of money between nations in order to escape political or economic turmoil or seek higher returns. Helleiner (2005) defines capital flight as "an outflow of capital that is not part of normal commercial transactions" from a nation with a relatively low capital stockpile. It assumes that an individual does not have complete control over capital, but rather that it is subject to intricate and adaptable social control. The behaviour of a risk-averse individual who diversifies their wealth to maximize returns is directly linked to capital flight. As part of portfolio diversification, this informs the decision to hold assets overseas

Capital flight on the other hand is an illegal movement of financial resources from one country to another. It is an abnormal flow of capital, not being sanctioned by the government. This is because exchange of capital controls imposed by the particular country is not adhered to (Kindleberger, 1987). It is also seen as the outflow of capital in the form of massive transfer of currency from one country to another, but Cuddington (1986) in specific terms defines capital flight as short-term speculative outflows by the non-bank private sector. These outflows are caused by short-term flows as well as errors and omissions in the balance of payments accounts. Liquidity shortage that puts pressure on interest rates in the financial sector and scarcity of foreign exchange which may lead to persistent depreciation of domestic currency or loss of reserves are seen as the two basic root causes of capital flight in developing economies. Other causes of capital flight include tax avoidance, foreign debt servicing and trade faking activities. Trade induced capital flight includes the faking of trade documents to

circumvent exchange controls in less developed countries. This is because controls most often are characterized by widespread abuses and malpractices such as over-invoicing, forged import licenses or foreign exchange approvals by rent seeking agents and officials (Bhagwati 1964).

Domestic Investment

Domestic investment can generally be referred to as the investment in the companies and products of one's own country rather than in those of foreign countries. Domestic investment comprises of private and public investment. Private investment can be defined as investment by private businesses for the motive of generating profit while public investment refers to investment by the government sector primarily, but not exclusively, on social and core economic infrastructure (Matsila, 2014). Domestic investment is one of the most important components of economic growth that countries consider as the main engine of the economic cycle. Recent theories on the neo-classical growth model as well as theories of endogenous growth has emphasized the role of domestic investment in economic growth such as capital spending on new projects in the sectors of public utilities and infrastructure like roads projects, housing, electricity extensions, as well as social development in the areas of health, education, and communication projects among others.

According to Jhingan (2006), domestic investment can be defined as net changes in the level of inventories in addition to gross fixed capital formation in a country over a given period. Heim (2008) opined that investment is the accumulation of resources for the production of goods and services in the future. Domestic investment is synonymous with gross capital formation or capital within a particular economy. It involves the addition to the capital stock of a country in terms of new factories, machinery, and equipment which results in a greater increase in the productive capacity of the country (Todaro & Smith, 2015). The paucity of savings and investment in some countries of the world especially developing countries formed the basis for the necessity of Foreign Direct Investment (FDI) and the various interventions from the international organizations of the World Bank and the International Monetary Fund received by these nations. Thus, domestic investment is achieved through both the help of foreign investors and domestic investors. Capital flight is seen as a leakage to the gross capital formation of a country.

2.2 Theoretical Framework

Investment Diversion Theory

Investment diversion theory has been applied and discussed in numerous works, particularly in the late 20th and early 21st centuries, that is from 1970s-1980s. The Investment Diversion Theory suggests that capital flight occurs when investors perceive more profitable or safer investment opportunities abroad compared to their domestic environment. Investors divert capital from domestic markets to foreign economies, driven by factors like political instability, economic mismanagement, inflation, or unfavourable fiscal and monetary policies at home. In countries with weak legal frameworks, high taxation, or political risks, domestic investors may seek to diversify or shield their wealth by investing abroad.

For example, a country experiencing hyperinflation or political unrest may see its wealthy citizens move their money to foreign banks or invest in foreign assets like real estate or stocks. This diversion reduces domestic investment, weakening the national economy. Additionally, if returns on domestic investments are perceived to be too low or unstable compared to foreign markets, investors are more likely to divert their capital, accelerating economic downturns. In summary, the Investment Diversion Theory explains how unfavorable domestic conditions prompt capital outflows and deter domestic investment, aggravating economic challenges.

Portfolio Choice Theory

The portfolio choice theory is attributed to Harry Markowitz in the year 1952. The Portfolio Choice Theory is rooted in Markowitz's Modern Portfolio Theory (MPT), which describes how investors can maximize returns by diversifying their investments across different assets with varying risk profiles. According to the theory, investors make decisions based on the trade-off between risk and return, seeking to minimize risk for a given level of expected return or to maximize return for a given level of risk.

When applied to capital flight and domestic investment, Portfolio Choice Theory argues that capital flight occurs when investors see better risk-adjusted returns abroad compared to their home country. If foreign investments provide higher returns for the same or lower levels of risk, capital will flow out of the domestic economy. The theory focuses on investors' preferences for diversification and risk minimization, highlighting that the perceived higher risk of domestic investments (e.g., political instability, inflation, regulatory changes) can lead to capital outflows.

For example, if investors in a developing country expect political instability or currency devaluation, they may choose to hold foreign assets, such as U.S. treasury bonds, which are perceived as safer and less volatile. In this way, Portfolio Choice Theory helps explain why even rational investors seeking diversification and risk management might engage in capital flight, reducing the capital available for domestic investment and, by extension, slowing down economic growth.

Debt-Driven Flight Theory

The Debt-Driven Flight Theory is not attributed to a specific individual but is rather a concept that has developed in macroeconomic discussions of capital flight and sovereign debt crises. It gained prominence during the debt crises of the 1980s, when numerous developing countries, particularly in Latin America, experienced massive capital outflows.

The Debt-Driven Flight Theory suggests that capital flight is often triggered by the accumulation of unsustainable levels of external debt by a country, leading investors to lose confidence in the government's ability to service its debt obligations. As debt levels rise and the risk of default increases, both domestic and foreign investors start moving their capital out of the country to avoid losses.

In many developing countries, governments borrow extensively to finance growth or cover deficits. However, when the burden of servicing these debts becomes overwhelming, it raises fears of inflation (due to excessive money printing) or currency devaluation (as governments may resort to depreciating the local currency to make their debt repayments cheaper). Investors react by transferring their capital to safer foreign assets, leading to capital flight.

A good example of the Debt-Driven Flight Theory can be seen in Latin American economies in the 1980s, where high external debt levels led to a loss of confidence in governments' ability to repay, triggering massive outflows of capital. The capital flight further exacerbated the financial crises in these countries, as they were deprived of the very investment needed to stabilize their economies and repay their debts.

This theory highlights the cyclical nature of debt crises and capital flight: as debt levels increase, investor confidence decreases, leading to capital flight, which in turn makes it harder for governments to manage their debt and service their obligations, further weakening the domestic economy.

In summary, these three theories help explain why capital flight occurs, each focusing on different drivers such as unfavourable domestic conditions (Investment Diversion Theory), risk-return optimization by investors (Portfolio Choice Theory), and high levels of external debt leading to fear of default (Debt-Driven Flight Theory). Together, they paint a comprehensive picture of the dynamics behind capital flight and its impact on domestic investment.

2.3 Empirical Literature

Several empirical literatures have discussed the link between capital flight and domestic investment within the country and across borders. Some of the empirical literatures are discussed in this study.

In a study by Gibson (2024) on Illicit financial flow, capital flight and Nigeria's economic growth performance. This study investigates the effect of capital flight on economic growth in Nigeria over the period of 1980-2021. Relying on the autoregressive distributed lag (ARDL) regression estimation framework, the result reveals an overall negative and statistically significant effect of capital flight on economic growth. The short-run ARDL estimates revealed that capital flight exerted a positive but insignificant short-run effect on economic growth. The error correction term (-0.788) indicates that 78.8% of the instability in the model is corrected annually. Given the findings, the study recommended that there is need to propel domestic investment via promotion of domestic enterprises. Of utmost significance is the establishment of supporting business environment.

Ahmed, Adedeji, Joseph, Harada and Muhammed (2023) investigate the Dynamics of capital flight components and domestic investment in Nigeria. The purpose of this study is to examine the connection between capital flight components and domestic investment in Nigeria. The study employed the autoregressive distributive lag model (ARDL) to analyze the time series data for Nigeria spanning from 1981 to 2018. The study found that changes in external debt, current account balance, and foreign direct investments have a negative effect on domestic investments in the short run and long run. Furthermore, the results obtained show that the intercept has a positive effect on domestic investment. The long-run coefficient of current account balance has a positive effect, while the other components of capital flight – foreign direct investment, external reserves and external debt – have a negative effect on domestic investment. The error correction coefficient is significant and conforms to the a priori expectation. Hence, the study concludes that growth in domestic investment can be achieved by regulating the components of capital flight within the desirable limits. The study recommends that emphasis should be placed on the components of capital flight to stimulate domestic investment for economic growth.

Fentaw (2022) conduct a study on the effect of capital flight on domestic investment: Evidence from Africa. Capital flight is a major issue in developing economies; the problem is more severe in Africa, where domestic investment has been affected. Much attention has been given to the effect of legal and foreign capital flows in the international capital movement, disregarding illicit capital outflows (capital flight) from developing countries including Africa. This study use the dynamic system generalized method of moments (GMM) for 30 African nations between 2000 and 2019. The econometric analysis revealed that capital flight is one of the conditions that severely constrains domestic investment financing in Africa. However, the impact of financial

liberalization on domestic investment is shown to be insignificant. The empirical evidence is used to draw some policy implications aimed at reducing capital flight and enhancing domestic investment.

Agbo & Gina (2022) explore the effect of capital flight on economic growth in Nigeria. The study proxies capital flight using net foreign investment and gross domestic product. These methodologies are superior to the OLS for many reasons. The study employed a descriptive and time series research design, which is a very important in determining the relationship between time-series variables. The population of the study consist of all data on capital flight and economic growth from Central Bank of Nigeria Statistical Bulletin. For the purpose of the research, a sample size from 1981 to 2019 is selected from the CBN Statistical Bulletin in order to determine the relationship between the variables. The Descriptive Statistics, Correlation Matrix and Fully Modified Least Squares regression technique were adopted to analyse the relationship between the variables. The results reveal that the effect of NFI on RGDP is negative and across all the estimations and significant in DOLS at 5% and FMOLS at 10%. Based on the findings of the study, the recommendation is to keep an eye on net foreign investments, make sure that more investments are brought into Nigeria, and make sure that these channels for foreign investment are not used to transfer capital to other countries

Emmanuel, Ene, Abubakar S. & Udi, (2021) examine Capital Flight and Domestic Investment in Nigeria: The Mediating Influence of Leadership System. According to them, unfavourable business climate, poor level of infrastructural development, macroeconomic instabilities, and political uncertainties are some of the factors responsible for capital flight. This study examined the moderating influence of the leadership system (LS) on the nexus between capital flight (CAPF) and domestic investment (DI) in Nigeria from 1981 to 2018 within the auto-regressive distributed lag (ARDL) framework. An inverse relationship was found between LS and DI both in the short run and long run. Furthermore, the interactive influence of capital flight and leadership system (CAPF*LS) revealed a positive and significant (at ten per cent) influence on DI. This study, therefore, recommends that concerted effort should be made to improve the quality of governance through the provision of basic infrastructure and the formulation and implementation of policies that will increase domestic investment and mitigate the level of capital flight from Nigeria.

In another study by Anyamaobi & Rogers-Banigo (2021) on Capital Flight and Domestic Investment in Nigeria. Time series data were sourced from Central Bank of Nigeria Statistical bulletin and publications of Nigeria Bureau of Statistics from 1986-2019. Domestic real investment was modeled as the function of external debt servicing, value of import, profit repatriation, Nigeria investment abroad and depreciating naira exchange rate. Ordinary least square methods of cointegration, granger causality test, unit root test and Vector error correction model. The study found that capital flight measures as formulated in the regression model explain 44.4 percent of the variations in domestic real investment. The estimated beta coefficient proved that, external debt have positive and no significant effect on domestic real investment. Importation has positive and no significant effect on domestic real investment. Profit repatriation negative positive and no significant effect on domestic real investment, Nigeria investment abroad have positive and no significant effect on domestic real investment while depreciating naira exchange rate have positive and no significant effect on domestic real investment. The study conclude that, capital flight have moderate effect on domestic real investment in Nigeria. We recommend that fiscal responsibility must be proper integrated in the process of external debt servicing, there need for economic diversification to reduce the growing importation to the country and The domestic economy should made more attractive for the investors by creating a wider menu of domestic financial assets on which domestic capital.

Lionel, Alfa & Samuel (2020) explore Capital Flight and Domestic Investment in Nigeria: Evidence From ARDL Methodology. Deploying the Auto Regressive Distributed Lag (ARDL) econometric methodology, the study finds that capital flight has negative and significant impact on domestic investment. In particular, the long run impact of capital flight on domestic investment (0.57) turns out to be more severe than its impact in the short run (0.27), implying that a continuous and persistent build-up of capital flight exerts a negative cumulative effect on domestic investment over time. The study further reveals that the quality of institutions in Nigeria is a disincentive to domestic investment. It therefore recommends the strengthening of institutions to rein in on the illegal outflow of capital from the Nigerian economy in order to guarantee the availability of investible funds. The real sector of the local economy must be grown to bolster the value of the naira. This will stem the tide of capital flight and attract investments into critical sectors.

III. METHODOLOGY

The ADF test was used to check for unit root, and in examining the impact of Capital Flight Capital Flight (CF) on Domestic Investment (DINV), the Auto-Regressive Distributed Lag (ARDL) was employed after checking for long-run relationships using the Bound-test. Post diagnostic tests were employed to test for the absence of spurious estimates, while the CUSUM and recursive coefficients tests were used to check for the stability of the variables. The data for this study covering the period of 1981 to 2022 was sourced from the Central Bank of Nigeria's Statistical Bulletin (2022) and the World Bank Development Indicators (WDI).

Model Specification

This model seeks to empirically examine the relationship between capital flight and domestic investment in Nigeria. Capital flight refers to the large-scale exodus of financial assets or capital from a country due to economic, political, or financial instability. Domestic investment is crucial for sustainable economic growth, and understanding how capital flight influences it is key to policy formulation. The relationship between domestic investment and capital flight, alongside other control variables, can be specified using the following linear regression model:

$$DINV_t = f(CF_t, INTR_t, EXR_t, FDI_t, EXD_t) \dots\dots\dots (3.1)$$

The econometric form of the model is given as:

$$DINV_t = \beta_0 + \beta_1 CF_t + \beta_2 INTR_t + \beta_3 EXR_t + \beta_4 FDI_t + \beta_5 EXD_t + \mu_t \dots\dots\dots (3.2)$$

Where

DINV = Domestic Investment (dependent variable): This variable represents the level of investment in physical assets, such as infrastructure, machinery, and equipment within Nigeria. It can be captured by gross fixed capital formation (GFCF).

CF = Capital Flight (independent variable): The primary independent variable representing the outflow of capital from Nigeria. This can be proxied by private capital outflows, net errors and omissions in the balance of payments, or estimated residual capital flight using the World Bank method.

INTR = Interest Rate (independent variable): Represents the cost of borrowing within Nigeria. Higher interest rates typically discourage domestic investment.

EXR = Exchange Rate (independent variable): Measures the value of the Nigerian Naira against major foreign currencies. Volatility in exchange rates may influence capital flight and reduce investor confidence.

FDI = Foreign Direct Investment (independent variable): Measures inflows of foreign investments into Nigeria. It may complement or substitute domestic investment, depending on economic conditions.

EXD = External Debt (independent variable): Represents the country's external debt burden. A higher debt burden may lead to capital flight and limit resources for domestic investment.

Estimation Technique

The model can be estimated using Ordinary Least Squares (OLS), provided that the assumptions of the classical linear regression model hold. Additionally, diagnostic tests like the Augmented Dickey-Fuller (ADF) test for stationarity and Johansen co-integration test should be conducted to check for long-term relationships between variables. If the data exhibits non-stationarity, a Vector Error Correction Model (VECM) or Autoregressive Distributed Lag (ARDL) model may be used.

IV. RESULTS AND DISCUSSIONS

Descriptive Statistics

This section starts with an overview of the variables under study. It summarizes key statistics such as mean, median, maximum, minimum, standard deviation and normality tests. Each variable has forty-one (41) observations with none missing. The Jarque-Bera probability values were also indicated at the 5% significant level. The result is presented below in table 4.1

Table 4.1 Descriptive nature of the variables

	DINV	CF	INTR	EXR	FDI	EXD
Mean	8683.403	-4.03E+09	13.08333	115.7412	2.47E+09	2702.228
Median	8316.085	-1.07E+08	13.25000	115.2550	1.61E+09	669.3250
Maximum	15789.67	2.08E+10	26.00000	425.9800	8.84E+09	18702.25
Minimum	5668.870	-2.67E+10	6.000000	0.610000	-1.87E+08	2.330000
Std. Dev.	1977.154	9.83E+09	3.947702	119.1408	2.54E+09	4281.546
Jarque-Bera Probability	19.93149	1.368405	6.803046	7.387874	9.669684	83.84852
	0.000047	0.504492	0.033322	0.024874	0.007948	0.000000
Observations	42	42	42	42	42	42

Source: Author's computation using E View 12.

From the empirical results, the mean value of domestic investment is 8,683.40 with a standard deviation of 1,977.15 indicates a moderate variation in domestic investment, suggesting a relatively stable trend with some fluctuations. This indicates that, on average, domestic investment in Nigeria over the sample period is relatively moderate.

Furthermore, the mean value of capital flight is -4.03E+09 (or approximately -4.03 billion) with a standard deviation of 9.83E+09 (about 9.83 billion), reflecting a very high variability in capital flight. This negative mean

suggests that, on average, capital is flowing out of Nigeria, which could have a negative impact on domestic investment.

The mean interest rate is 13.08% with a standard deviation of 3.95, indicating that interest rates have experienced moderate fluctuations, which could influence investment decisions., showing that borrowing costs are relatively high, which may reduce investment by increasing the cost of capital.

In addition, the mean exchange rate is 115.74 a standard deviation of standard deviation of 119.14 shows that exchange rates have been highly volatile, which may have contributed to uncertainty in the investment climate, reflecting the average exchange rate over the period. Exchange rate fluctuations might affect foreign direct investment (FDI) and capital flight.

The mean FDI is approximately 2.47 billion with a standard deviation of approximately 2.54 billion suggests that FDI has varied widely over the period, possibly due to fluctuating economic conditions and the impact of capital flight. This indicates a significant level of foreign investment, which might offset some of the negative effects of capital flight on domestic investment.

Finally, the mean external debt is 2,702.23 with a standard deviation of 4,281.55 indicates that external debt levels have also fluctuated significantly, potentially affecting the country’s financial stability and investment climate., suggesting a moderately high level of indebtedness.

The Jaque-Bera statistics revealed that all the variables are not normally distributed which are statistically significant at 5% level, except capital flow which is insignificant at 5% and is normally distributed.

Test of Stationarity using ADF unit root Test

Table 4.2 Unit Root Test using Augmented Dickey-Fuller (ADF) Test

Variables	Augmented Dickey-Fuller Test		Lag	Order of int.	Remark
	@ level	@ 1 st Diff			
DINV	-6.422794	-	Maxlag=9	I (0)	Stationary
CF	-4.643523	-	Maxlag=9	I (0)	Stationary
INTR	-3.365621	-8.526210	Maxlag=9	I (1)	Stationary
EXR	0.098153	-4.935316	Maxlag=9	I (1)	Stationary
FDI	-1.186121	-7.208104	Maxlag=9	I (1)	Stationary
EXD	-0.279023	-4.657538	Maxlag=9	I (1)	Stationary
Test of CV	1% level	-4.205004			
	5% level	-3.526609			
	10% level	-3.194611			

Source: Author’s own computation using E view 12

The above results revealed domestic investment and capital flight proxy by capital flow are stationary at level that is integrated of order zero. While interest rate, exchange rate, foreign direct investment and external debt were stationary at first difference that is integrated of order one that is I (1). The mixed order of integration (at level and first difference) suggests an underlying long run relationship, hence, the use of the autoregressive distributed lag (ARDL) approach is justified.

4.1.3 Long Run Estimation (ARDL Bounds Test) for Model

Based on the augmented dickey fuller (ADF) unit root result, we are justified to use the autoregressive distributed lag (ARDL) model. Hence, the cointegration bounds tests was employed and the F-statistic can be used to determine whether the variables have a long run relationship. The result is presented in table 4.3 below.

Table 4.3: ARDL Bounds Test result for cointegration

F-Bounds Test		Null Hypothesis: No levels relationship		
Test Statistic	Value	Signif.	I(0)	I(1)
F-statistic	4.474901	10%	2.08	3
k	5	5%	2.39	3.38
		2.5%	2.7	3.73
		1%	3.06	4.15

Source: Author’s computation

Table 4.3 showed the long-run properties of the variables in the model specified. The result showed that the variable exhibits joint convergence in the long-run. In other words, there is a long-run relationship among the variables in the first model. This is because the ARDL F-statistic value of 4.474901 is greater than the 5% upper bound (I1 Bound) value of 3.38 and lower bound value of 2.39. This is a sufficient condition to estimate the conventional ARDL error correction model (ECM). This result justify use of ARDL-ECM is presented in Table4.4 below.

ARDL Estimates of the Long Run Regression for Model

The results of the ARDL estimates of the long run relationship in the model are presented in tables 4.4 below.

Table 4.4 ARDL Long Run Regression Estimates for the Model

D(DINV): dependent Variable

Levels Equation				
Case 2: Restricted Constant and No Trend				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
CF	3.01E-07	1.98E-07	1.516668	0.1501
INTR	-1.176863	68.20245	-0.017255	0.9865
EXR	37.61769	10.97297	3.428214	0.0037
FDI	4.39E-07	4.04E-07	1.086158	0.2946
EXD	-1.199682	0.487666	-2.460051	0.0265
C	7230.128	1039.420	6.955928	0.0000

$$EC = DINV - (0.0000*CF - 1.1769*INTR + 37.6177*EXR + 0.0000*FDI - 1.1997*EXD + 7230.1276)$$

Source: Author's own computation using E View 12

The results revealed that a positive coefficient of capital flight indicates that capital formation has a positive but very small impact on domestic investment. For each unit increase in CF, domestic investment increases by approximately 0.00000301 units. This indicates a very weak long-term relationship between capital formation and domestic investment. The p-value of 0.1501 indicates that the coefficient of capital flight is not statistically significant at the 5% level in determining domestic investment.

Interest rate has negative impact on domestic investment with a coefficient of -1.18 units implies that an increase in the interest rate leads to a decrease in domestic investment. Specifically, for every one-unit increase in the interest rate, domestic investment decreases by approximately 1.18 units. This aligns with economic theory, which posits that higher interest rates make borrowing more expensive, reducing the likelihood of investment. The result further revealed a p-value of 0.9865, the coefficient of interest rate is far from statistically significant. The effect of interest rate on domestic investment is likely insignificant in the long run.

The empirical result show that exchange rate is positively related to domestic investment indicating that an increase in the exchange rate (depreciation of the domestic currency) leads to a large increase in domestic investment. For each one-unit increase in the exchange rate, domestic investment increases by approximately 37.62 units. A depreciated exchange rate might make domestic production more competitive internationally, thus boosting investment. The p-value of 0.0037 is highly significant at the 5% level, indicating that the exchange rate has a statistically significant positive impact on domestic investment. This means that changes in the exchange rate reliably influence domestic investment in the long run.

The result indicate that foreign direct investment is also positively related to domestic investment in Nigeria. The coefficient of FDI is very, indicating that foreign direct investment has a minimal positive long-run impact on domestic investment. For each unit increase in FDI, domestic investment increases by 0.00000439 units, suggesting a negligible direct influence of FDI on domestic investment in the long run. The p-value of 0.2946 suggests that the coefficient of foreign direct investment is not statistically significant at conventional levels (5% or even 10%). This reinforces the interpretation that FDI has a minimal and statistically insignificant effect on domestic investment.

Finally, external debt has a negative impact on domestic investment which indicates that an increase in external debt reduces domestic investment. For every one-unit increase in external debt, domestic investment decreases by approximately 1.2 units. This suggests that higher external debt may crowd out domestic investment, possibly due to the need to allocate resources to debt servicing. The p-value of 0.0265 is statistically significant at the 5% level, implying that external debt has a meaningful negative impact on domestic investment in the long run. This suggests that external debt crowds out domestic investment in a statistically significant way.

The long-run ARDL results show that the exchange rate and external debt have statistically significant effects on domestic investment, with the exchange rate having a strong positive impact and external debt having a significant negative impact. The other variables, such as capital flight, interest rate, and foreign direct investment, do not have statistically significant long-run effects on domestic investment. This indicates that domestic investment is more responsive to external factors like the exchange rate and external debt than to domestic policy variables like interest rates or capital flight. In policy terms, focusing on exchange rate stabilization and managing external debt could be crucial for promoting domestic investment in the long run.

ARDL-ECM Test for Short Run

Since the results of the ARDL Bound test of the model indicated that a long-run cointegration relationship existed between the dependent and explanatory variables, the ARDL-ECM test was carried out to adjust for the short run. The results obtained are presented in tables 4.5.

Table 4.5 ARDL-ECM Test for the Model for model 1

ARDL Error Correction Regression

Dependent Variable: D(DINV)

Selected Model: ARDL(4, 4, 0, 4, 1, 4)

Case 2: Restricted Constant and No Trend

Date: 09/15/24 Time: 07:01

Sample: 1981 2022

Included observations: 38

ECM Regression				
Case 2: Restricted Constant and No Trend				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(DINV(-1))	-0.085295	0.092120	-0.925907	0.3692
D(DINV(-2))	-0.122803	0.081632	-1.504342	0.1533
D(DINV(-3))	0.534969	0.076763	6.969078	0.0000
D(CF)	1.85E-09	1.09E-08	0.170236	0.8671
D(CF(-1))	-2.26E-07	2.95E-08	-7.654127	0.0000
D(CF(-2))	-1.85E-07	2.47E-08	-7.493594	0.0000
D(CF(-3))	-1.26E-07	1.86E-08	-6.744952	0.0000
D(EXR)	-11.32423	7.977338	-1.419551	0.1762
D(EXR(-1))	-12.72393	8.031841	-1.584186	0.1340
D(EXR(-2))	-46.05684	8.568614	-5.375062	0.0001
D(EXR(-3))	-34.26039	9.299019	-3.684302	0.0022
D(FDI)	4.42E-08	9.77E-08	0.452074	0.6577
D(EXD)	0.392644	0.230461	1.703734	0.1091
D(EXD(-1))	0.683624	0.234526	2.914915	0.0107
D(EXD(-2))	0.929543	0.311430	2.984759	0.0093
D(EXD(-3))	0.875317	0.200117	4.374023	0.0005
CoIntEq(-1)*	-0.714958	0.107963	-6.622237	0.0000
R-squared	0.882973	Mean dependent var		90.40421
Adjusted R-squared	0.793809	S.D. dependent var		1010.993
S.E. of regression	459.0740	Akaike info criterion		15.39797
Sum squared resid	4425728.	Schwarz criterion		16.13058
Log likelihood	-275.5615	Hannan-Quinn criter.		15.65863
Durbin-Watson stat	1.639254			

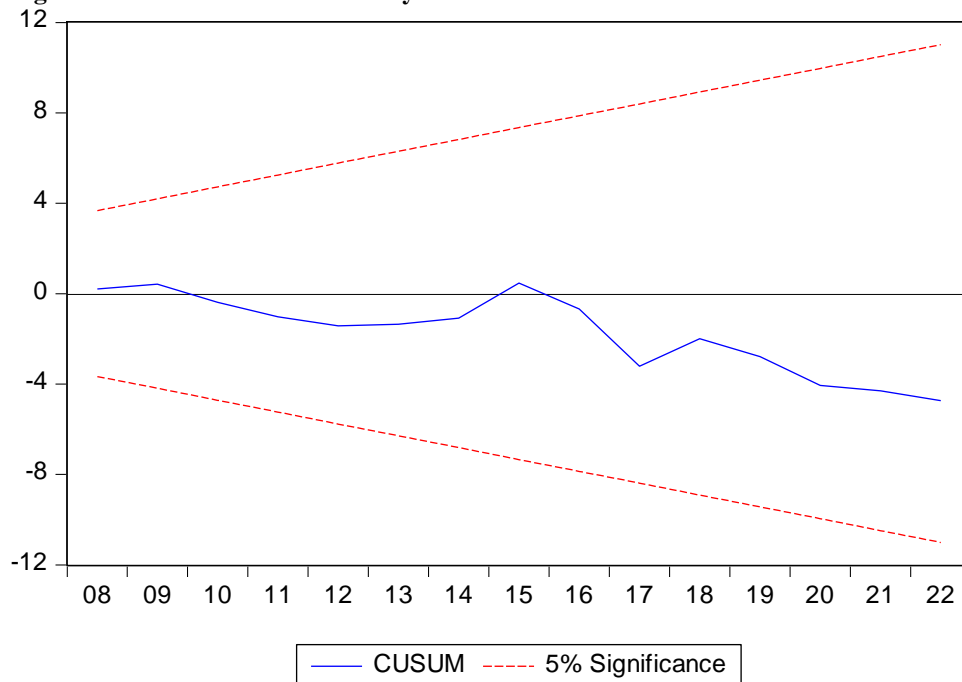
* p-value incompatible with t-Bounds distribution.

Source: Author's own computation using E View 12.

The short run relationship between the explanatory variables (CF, INTR, EXR, FDI and EXD) and the dependent variable (DINV) is explained by estimating the ARDL Error Correction Model for model. Table 4.5 explained the short run effects of changes in the explanatory variables on domestic investment measured by gross fixed capital formation in the model. The model exhibits an high explanatory ability of 0.882973, implying that 88 percent of change in domestic investment is explained by capital outflow, interest rate, exchange rate, foreign direct investment and external debt stock. The error correction factor (ECM) integrates the short run dynamics with that of the long run equilibrium. The error correction term ECM_{t-1} indicates the speed of adjustment from a short run deviation to the long run equilibrium. The coefficient of the ECM_{t-1} is negative (-0.714958) which is high and significant at 5% level, supporting the ARDL bounds test result of cointegration. It indicates that about 71 percent of the previous year's deviation from the long run equilibrium will be restored within a year. Furthermore, the result revealed that the Durbin-Watson (DW)-statistic of 1.639254 indicates that there is presence of serial correlation in the model.

Diagnostic Test for Stability

Figure 4.1 CUSUM test for stability



The CUSUM test result revealed that the model is stable and is statistically significant at 5% level of significance.

V. CONCLUSION AND RECOMMENDATIONS

The ARDL long-run regression results show that capital flight has a limited direct impact on domestic investment in Nigeria. While capital flight (CF) has a positive but statistically insignificant effect on domestic investment, external factors such as the exchange rate and external debt play more critical roles. The exchange rate shows a significant positive relationship with domestic investment, suggesting that exchange rate stability could enhance investment. Conversely, external debt has a significant negative impact, indicating that high levels of debt may crowd out domestic investment. Interest rates and foreign direct investment (FDI) are statistically insignificant, suggesting that their long-run effects on domestic investment are minimal.

Based on the empirical findings, the following recommendations were made for policy formulation.

1. Given the significant positive impact of exchange rates on domestic investment, the government should focus on stabilizing the exchange rate. A stable exchange rate will improve investor confidence and encourage domestic investment by reducing uncertainties related to currency depreciation.
2. Although the coefficient of capital flight is not statistically significant, the positive relationship suggests that reducing capital flight could potentially support domestic investment. The government should implement stricter regulations and tracking mechanisms to limit illicit financial outflows, thereby retaining more funds for domestic use.
3. Since external debt has a statistically significant negative impact on domestic investment, policymakers should adopt prudent debt management strategies. Reducing reliance on external borrowing and improving debt servicing frameworks could free up resources for productive domestic investment.
4. Interest rates and FDI were found to have minimal impacts on domestic investment in the long run. The financial sector should be reformed to ensure that lower interest rates and more attractive investment conditions are available, encouraging both domestic and foreign investors to contribute more significantly to Nigeria's economy.

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