

E-ISSN: 2469-4339

Management and Economics Research Journal, Vol. 6, Iss. 2, Pgs. 10, 2020

Original Research Article

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Capital Flight and Economic Development: Evidence from Nigeria

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Received: Dec 02, 2019; Accepted: Feb 14, 2020

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Citation: Akinwale SO. 2020. Capital flight and economic development: Evidence from Nigeria. Management and Economics Research Journal, 6(2): 964791. <https://doi.org/10.18639/MERJ.2020.964791>

Abstract

This study examined the nexus between capital flight and economic development in Nigeria. The null hypothesis was that capital flight has no significant relationship with economic development in Nigeria. The study used the auto regressive distributed lag (ARDL) method on data obtained from the Central Bank of Nigeria and the World Bank, for the period 1986–2018, to examine the relationship between capital flight and economic development in Nigeria. The study examined the unit root problem and cointegrating properties of the data. The unit root problem was tested for by using the augmented Dickey–Fuller (ADF) and Phillips–Perron (PP) tests. Findings from ARDL showed an inverse relationship exists between capital flight, real exchange rate, and economic development. This implies that the variables contributed significantly to reduce economic development within the study period. However, a positive relationship existed between economic development and adult literacy rate in Nigeria. By implication, improvements made in providing quality and affordable education tend to have a positive impact on economic development in Nigeria. The study concluded that economic development is strongly influenced by capital flight, real exchange, and adult literacy rates in Nigeria. The study, therefore, recommends that government policies to curb capital flight should be introduced and monitored so as to lead to economic development in Nigeria.

Keywords: Capital flight; economic development; auto regressive distributed lag.

1. INTRODUCTION

It is worrisome in Africa that a major portion of the available capital is clandestinely transferred to developed economies, and this has generated interest among many researchers and academics across countries. The extent of capital flight or capital outflow occurring from developing to developed countries has necessitated efforts to regulate capital flow from developing countries, where it affects the scarce capital adversely. This phenomenon has resulted in a deficiency of developmental resources and hindered economic development in such host countries. For instance, the United Nations (2015) report showed that former Libyan president Muammar Gaddafi stashed over \$20 billion in four banks in South Africa. In the same way, former Tunisian president Ben Ali stole and sent about \$20 billion to an unknown country between 1987 and 2016. Paradoxically, the issue of capital flight is not uncommon in Nigeria.

Nigeria is faced with capital flight; it is therefore a paradoxical phenomenon that capital from Nigeria exits to developed countries that are capital-surplus. Capital is needed in Nigeria for investment, providing employment opportunities, addressing infrastructural deficits, fighting insecurity challenges and poverty, providing an enabling environment for businesses to thrive, improving the socioeconomic conditions of domestic residents, and driving development generally among others. For example, Transparency International (2015) revealed that capital that flowed out of Nigeria amounted to \$4 billion between 1993 and 1998. Furthermore, the Economic and Financial Crimes Commission (EFCC) reported that capital flight from Nigeria to the United Kingdom, the United States of America, and South Africa was worth \$250 million between 1999 and 2007.

Thus, the extent of capital flight occurring in Nigeria has greatly affected economic growth and development as examined by many factors. The factors include socioeconomic and political reasons, political instability, economic power, weak financial institutions, and corruption, among others. Capital flight may be in the form of an illegal movement of capital from one country to another. It is indeed worrisome that this abnormal flow of capital has significant effects on the host countries. The studies by Schneider (2003) and Ajayi (2005) conclude that the level of capital flight in the country has led to political instability, hate speeches, agitations, increased crime rates, militancy, terrorism, and banditry over the years, and all these have become a serious problem in Nigeria. Thus, capital flight has resulted in wastage of economic resources over the past three decades. Economic resources lost through this medium are thus not available for the enhancement of domestic activities or the social welfare of residents. Therefore the lost resources would have otherwise been vital for sustaining economic growth and development as well as served as capital investments in such an economy. Investments in a particular country have a strong connection with the economic development of that country. Nevertheless, in countries with poor capital organization or poor investment policies by the government, capital absconds, thus endangering such countries to social hardship, high poverty, high crime rates, and poor status of financial institutions (Otene and Edeme, 2012).

Furthermore, capital transferred abroad from a host country cannot in any way contribute to domestic investment and other productive activities. It is still unknown whether the significantly lower levels of investment with corresponding multiplier consequences on other aspects of the economy, including the growing rate of unemployment, social unrest, hunger and starvation, and general economic recession in the country, are mainly a result of capital flight (Nelson, et al., 2018).

Despite the great attention given to capital flight, it still remains a serious problem in Nigeria. For the past three decades, Nigeria has been experiencing this unresolved and disturbing occurrence of capital flight with corresponding adverse consequences over the years. Studies have revealed that a total value of \$107 billion of Nigerian assets was reported to have flown out of the country in the period from 1970 to 2001 (Lawanson, 2007; Collier, et al., 2003). Similarly, the Central Bank of Nigeria (CBN, 2015) showed the sum of \$1.1 trillion and \$8.8 trillion in net capital flight flows in 1999 and 2011, respectively, in Nigeria, while the International Monetary Fund (IMF, 2015) reported that offshore-held assets amounted to \$11.6 trillion and income from such assets was \$866 billion to other countries. As a result, about \$255 billion is lost in tax revenue regularly by countries suffering from capital flight, the statistics being proof of the effect and the challenge of capital flight.

Many studies have been conducted on the relationship between capital flight and macroeconomic variables. Studies such as those by Brada (2011) and Hoa and Lin (2016) found a negative relationship between capital flight and macroeconomic variables, while Aderoju (2017), Saheed and Ayodeji (2012), and Uguru et al., (2014) found a positive relationship. Although most of the reviewed studies focused on the impact of capital flight on economic growth, the effects of capital flight on economic development have not been considered. This study will add to the existing literature by looking at the effects of capital flight on economic development in Nigeria. Furthermore, most studies revealed information spanning the period from 1980 to 2016 (Aderoju, 2017). Hence, this study was guided by the following objective: to investigate the relationship between capital flight and economic development in Nigeria from 1980 to 2018. Following this introduction, the rest of the paper entails the following: Section two covers the literature review and theoretical underpinnings. Section three presents the methodology of the study. Data analysis and interpretation of the result are dealt with in section four, while section five deals with the conclusion and recommendations.

1.1. The Trend Analysis of Capital Flight and Economic Development in Nigeria

The study attempted to examine the trend of capital flight and economic development proxied by poverty index, income inequality, and unemployment in Nigeria for the period 1986–2018. The trend is presented as follows:

Figure 1 shows the trend of capital flight between 1986 and 2018 in Nigeria. It is seen that between 1986 and 2012, capital flight increased steadily, but in the period between 2012 and 2013, capital flight drastically reduced; between 2014 and 2018, the trend of capital flight experienced an upward slope in Nigeria. The study thus reveals that capital flight increased steadily from one period to the other. This trend has seriously affected economic development negatively in Nigeria within the period of study.

Figure 1. Trend of Capital Flight in Nigeria, 1986–2018.

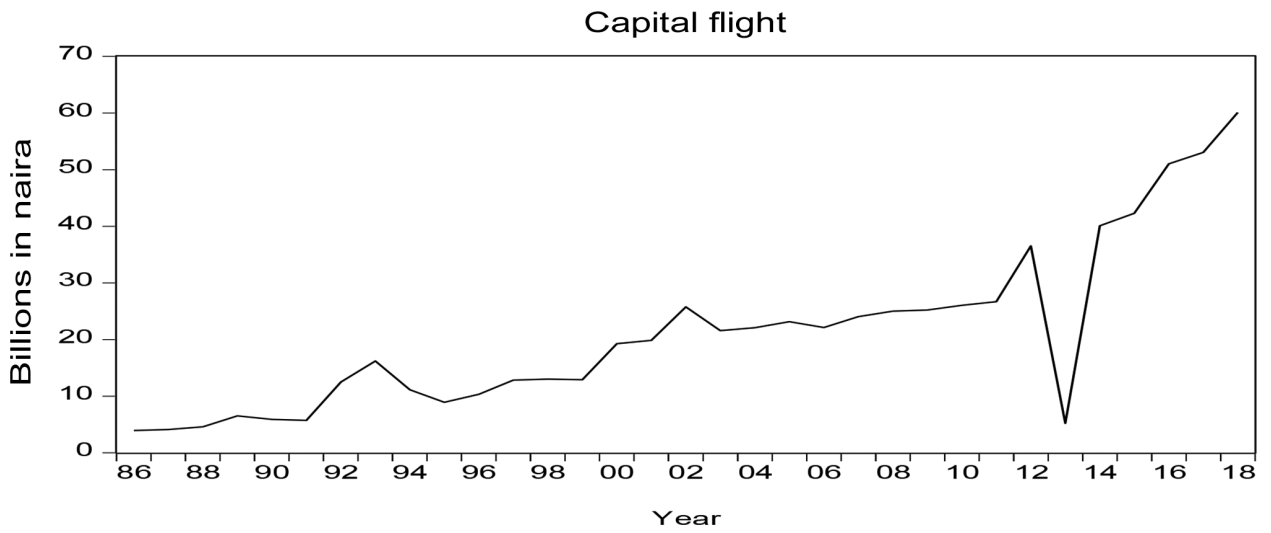


Figure 2. Trend of Economic Development in Nigeria, 1986–2018.

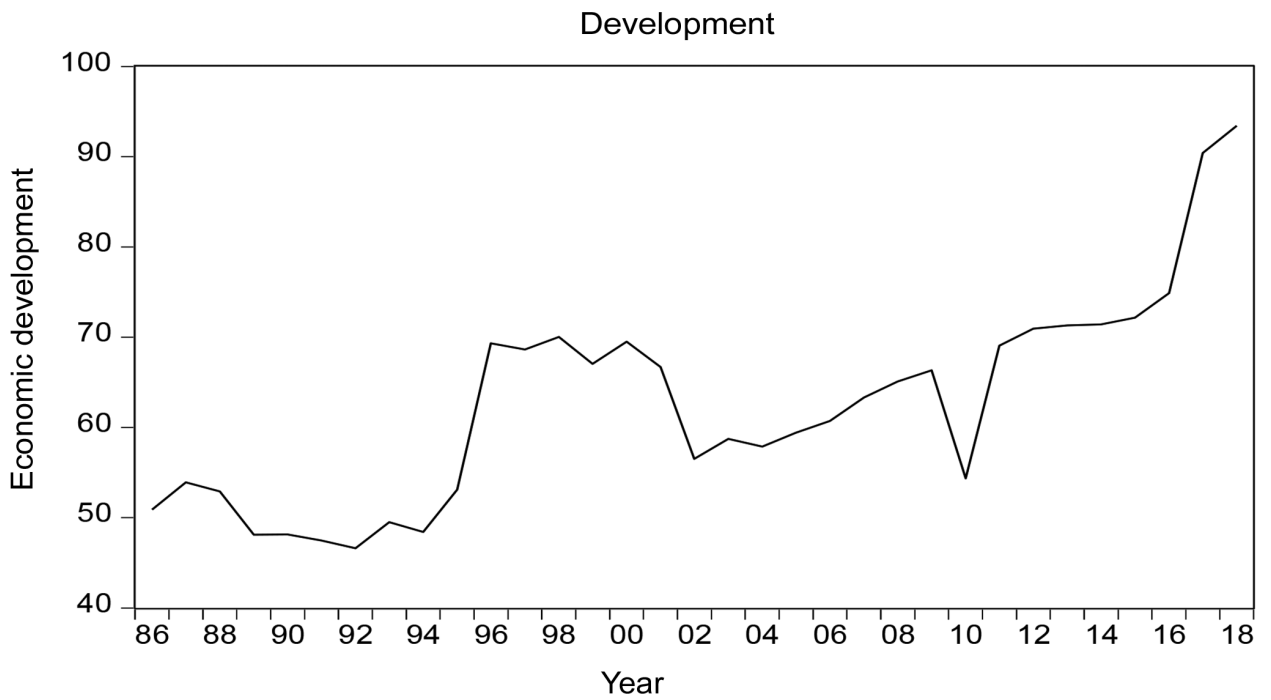


Figure 2 shows the trend of economic development. Between 1986 and 2018, there was an up-down slope, which implies that economic development was poor almost throughout the period under investigation in Nigeria.

2. LITERATURE REVIEW

Capital flight occurs through the transfer of a substantial portion of domestic private savings abroad, the persistence of which can lead to a serious deleterious effect on domestic savings, thereby restricting banks' ability to provide credit to domestic investors capable of promoting and enhancing economic growth and development (Aderoju, 2017). Capital flight is devoid of a precise and universally accepted definition partly because of the way the term is used by developed and developing countries. Some researchers believe that capital outflows from developed countries are foreign investments, while capital outflows from developing countries are referred to as capital flight (Williamson, 1987). The outflow of capital becomes capital flight when the gross domestic product (GDP) of the country of origin increases at a lower rate than capital outflow. Corroborating this, Ajayi (2000) stressed further that capital shift out of developed countries is regarded as capital outflows because the investors from developed countries are responding to investment opportunities, while those from developing countries are said to be escaping from huge risks perceived at home.

According to Dooley (1988), normal capital outflows are defined as legal capital outflows, while capital outflows based on the desire to place assets beyond the control of domestic authorities are labeled capital flight. Ojo (1992) and Forgha (2008) argue that separating capital flight from normal portfolio diversification and trade transactions is fraught with challenges and could involve some elements of value judgment, which explains, in part, the variations in the definitions of capital flight.

On the other hand, economic development implies that achieving sustained rates of growth of income per capita enables a nation to expand its output at a rate faster than the growth rate of its population. Meanwhile, an increasing number of economists and policy makers clamor for more direct efforts to lower widespread absolute poverty, increasingly inequitable income distributions, and rising unemployment. In short, during the 1970s, economic development came to be redefined in terms of the reduction or elimination of poverty, inequality, and unemployment within the context of a growing economy. Seers (1970) posed a basic question about the meaning of economic development: the questions to ask about a country's development are therefore, What has been happening to the economic development of a nation? He opined that if all the three of these have declined from high levels, then beyond reasonable doubt, there is economic development in the country concerned. He argues that a number of developing countries experienced a relatively high rate of per capita income during the 1980s and 2000s but showed little or no improvement or even an actual decline in employment, equality, and the real incomes of the bottom 40% of their population. Given the view of Seers, economic development depends on the three indicators, which this study sought to examine, and their relationships with capital flight. Thus, this study views economic development by the three indicators aforementioned by Seers.

Capital flight and economic growth have generated a number of contradictions in economic thinking. Some studies opined that capital flight reduces economic growth, whereas others argued that capital flight enhances economic growth. Some even argue that capital flight has no significant effect on economic growth. The study by Lawal *et al.* (2017) examined the impact of capital flight and its determinants on the Nigerian economy between 1981 and 2015, using the auto regressive distributed lag (ARDL) model. Findings revealed that there is existence of a long-run relationship between the variables. Furthermore, the result indicates that capital flight has a negative impact on the economic growth of Nigeria. Again, Akinwale and Obagunwa (2017) sought to find out the short-run and long-run implications of capital flight on economic growth in Nigeria from 1986 to 2015, employing augmented Dickey-Fuller (ADF), bound test, and ARDL. It was found that capital flight has reduced the development resources of the nation, thereby leading to embarking on foreign debt in the economy. However, Ajayi (2012) found a positive relationship between capital flight and economic growth. In the same vein, Liew *et al.* (2016) used the residual approach by World Bank to assess capital flight in Malaysia within the period of 1975–2013. The results showed that there was an existence of a positive and significant relationship between political risk and outflow of capital. Similarly, Lan *et al.* (2010) conducted a research in China using yearly data span from 1992 to 2007, using the ARDL model. It was discovered that changes in the domestic economy and political environment affect capital flow. These included political instability such as social disorder and change in economic policies. Also, Cheung and Qian (2010) studied the empirical determinants of China's capital flow by utilizing

quarterly data from 1999 (Q1) to 2008 (Q2). The result showed that political structure affects capital outflow in China.

Again, Musibau (2017) carried out a research on the causes of capital flight from Nigeria between 1980 and 2014, using the vector error correction mechanism (VECM) on variables such as interest rate, capital flight, political instability, and GDP. Findings revealed a negative relationship between capital flight and economic growth. Also, there exists a positive relationship between capital flight and interest rate. Furthermore, unidirectional causality exists between economic growth and capital flight. However, Onyele and Nwokocha (2016) analyzed the effect of capital flight on poverty in Nigeria using the VECM between 1986 and 2014 on macroeconomic variables such as GDP, discomfort index, capital flight, adult literacy, and exchange rate. The result showed that there exists a positive relationship between capital flight and discomfort index (a proxy for poverty). Uguru and Ugwuanyi (2010) analyzed the influence of capital flight as a multidisciplinary phenomenon on foreign direct investment between 1997 and 2004 in Nigeria, using ordinary least squares (OLS) techniques. The study found that capital flight has a negative and significant influence on foreign direct investment in Nigeria. Similarly, Busari (2010) examined the impact of capital flight on some economic recession indicators whereby capital flight was regressed against GDP, inflation, interest rate, unemployment, and exchange rate in Nigeria using the OLS model. The findings showed that capital flight has a negative effect on GDP, inflation, interest rate, and unemployment. Also, Aderoju (2017) investigated the impact of capital flight on domestic investment in Nigeria between 1980 and 2015 using OLS techniques on macroeconomic variables such as gross domestic investment (GDI), capital flight, exchange rate, and inflation. It was found that capital flight has a positive relationship with GDI. Also, a positive relationship exists between exchange rate and GDI.

Furthermore, Nelson *et al.* (2018) examined the impact of capital flight on exchange rate in Nigeria from 1990 to 2014 using OLS techniques on the following variables: capital flight, real exchange rate, foreign direct investment, current balance, foreign borrowing, and external reserves. Results revealed that there is a negative relationship between capital flight and exchange rate. On the contrary, Uguru *et al.* (2014) examined capital and exchange rate volatility in Nigeria from 1970 to 2007 using OLS techniques. It was discovered that a positive relationship exists between exchange rate and capital flight.

Many empirical studies have examined the nexus between capital flight and economic growth across countries (Lawal *et al.*, 2017; Akinwale and Obagunwa, 2017). Only few studies have examined the relationship between capital flight and economic development (Lan *et al.*, 2010; Liew *et al.*, 2016; Cheung and Qian, 2010). The works of Lan *et al.* (2010), Liew *et al.* (2016), and Cheung and Qian (2010) were conducted in China and Malaysia, respectively, and applying their findings to Nigeria might be very difficult. Most of the studies conducted in Nigeria examined either the capital flight–economic growth nexus, capital flight–poverty nexus, or capital flight–inequality nexus (Lawal, *et al.*, 2017; Ajayi, 2012; Onyele and Nwokocha, 2016; Aderoju, 2017; Raheem and Adeniyi (2015). To the best of knowledge, no known study has investigated the nexus between capital flight and economic development in Nigeria. Most of the previous studies used economic growth as a response variable, which does not take into consideration development component of poverty, inequality and unemployment. It becomes compulsory to view the capital flight effect beyond GDP. Hence, this study sought to examine the nexus between capital flight and economic development. The economic development is proxied by poverty, inequality, and unemployment (Dudley Seers's theory). The inability of previous studies to capture poverty rate, inequality, and unemployment has created an empirical gap, which needs to be explored. Apart from there being few studies in Nigeria, the empirical literature is weakened by not covering the recent economic situation. This study was thus conceived to address these gaps in the literature on the link between capital flight and economic development in Nigeria.

3. METHOD(S)

This study examined the nexus between capital flight and economic development in Nigeria using ARDL in the period 1986–2018. The economic development components used for this study include poverty, inequality, and unemployment, while capital flight is measured by the capital outflows–GDP ratio per annual. Poverty (POV), inequality (GINIC), unemployment rate (UNEMP), real exchange rate (RER), and adult literacy

rate (ADLT) data were sourced from the Central Bank of Nigeria (2017), statistical bulletin, and World Bank indicators (2018). All variables were transformed into logarithms.

To achieve the stated objective, the study adopted the Raheem and Adeniyi (2015) model with little modification. The model of Raheem and Adeniji states that poverty is influenced by capital flight, real exchange rate, and adult literacy rate in Nigeria, and this model is specified in the functional form as:

$$\text{POV} = f(\text{CAPF}, \text{RER}, \text{ADLT}) \quad (1)$$

The model of Raheem and Adeniji is modified such that economic development is proxied by poverty, inequality, and unemployment. These factors were incorporated into the model as part of the essential components of economic development in Nigeria. Hence, the model was modified in order to suit the study, and this is specified as follows:

$$\text{DEV} = (\text{CAPF}, \text{RER}, \text{ADLT}) \quad (2)$$

where DEV represents economic development, which is proxied by poverty, inequality, and unemployment. Development refers to the multidimensional process involving major changes in social structure, popular attitudes, and government institutions. It also includes accelerators of economic growth, reduction of unemployment and income inequality, and eradication of poverty. According to Seers (1970), the questions to ask about a country's development is: What has been happening to poverty, income inequality, and unemployment? If all these three have declined from high levels, then beyond doubt, there is development in the country concerned. This study therefore adopted the theory of Seers by considering poverty, income inequality, and unemployment for analyzing economic development. Thus, following the theory of Seers, Income inequality, poverty and unemployment are summed together to arrived at economic development.

Meanwhile, CAPF, RER, and ADLT represent the capital flight–GDP ratio, real exchange rate, and adult literacy rate and are used as control variables in the model. Hence, the model is specified in econometric linear form as:

$$\text{DEV} = \beta_0 + \beta_1 \text{CAPF} + \beta_2 \text{RER} + \beta_3 \text{ADLT} + U \quad (3)$$

where β_1 to β_3 = the parameters to be estimated and e = the error term.

The theoretical expectation about the signs of the coefficients of the parameters is as follows: β_1, β_2 , and $\beta_3 < 0$

Equation (3) is modified to become the ARDL estimation form, and this is written as:

$$\text{DEV}_t = a_0 + \sum_{i=1}^k a_{1i} \ln \text{DEV}_{t-i} + \sum_{j=k+1}^{d \max} a_{2j} \text{CAPF}_{t-j} + \sum_{j=k+1}^{d \max} a_{3j} \ln \text{RER}_{t-j} + \sum_{i=1}^k \delta_{1i} \ln \text{ADLT}_{t-i} + U_t$$

To know the direction of analysis, the study commenced its empirical analysis by examining the stationarity status of the time series, which is then followed by the cointegration test. If the series are observed to be integrated by different orders, a linear combination of the series may be cointegrated with one another. Furthermore, Engel and Granger (1987) pointed out that a linear combination of two or more nonstationary series may be stationary. If such a stationary linear combination exists, the nonstationary time series are said to be cointegrated. The stationary linear combination is called the cointegrating equation and may be interpreted as both short-run and long-run equilibrium relationships between the variables. Since the variables were stationary at $I(1)$, the study used the ARDL cointegrating estimate to examine the series in the estimated model. Based on the evidence from the stationarity and ARDL cointegration test, the study applied the ARDL bound test and the short-run and long-run estimate in Nigeria. The basic idea of the ARDL technique is to account for both short-run and long-run estimates unlike OLS and VAR and also test for the determinants of economic development in the estimated model.

4. RESULTS AND DISCUSSION

Test of Unit Root Results

An appropriate test has been developed by augmented Dickey–Fuller (ADF) and Phillips–Perron to consider whether a time series has a unit root.

Table 1 shows the empirical results of ADF and PP tests in the estimated model. The empirical results show that all the series were stationary at first difference, and this implies that there exists a short-run relationship between the data series in the study. Hence, the study concludes that the data series were integrated at 1st difference at a 5% significance level. The study therefore employed short-run estimation to examine the nexus between the variables using ARDL bound testing approach. The method is used to capture both the short and long run within the estimated model. In most cases, the critical value of the ARDL bound testing is a function of selected lag length; for the purpose of this study, the optimal lag (p) is determined empirically by employing the Akaike’s Information Critical (AIC).

Table 2 reports the computed F -test value in the ARDL bound test, and the test showed that $f F^*$ is greater than the upper critical value bound test at the 1% significance level. This shows that capital flight, real exchange rate, and adult literacy rate have significantly influenced effect on economic development in Nigeria. The ARDL bound test revealed sufficient results for the nexus relationship between capital flight and economic development in Nigeria for the period of investigation.

Table 3 shows the short run result of the ARDL model on the effect of capital flight on economic growth in Nigeria. The adjusted R^2 shows the predictor power of a model and it is derived to be 0.826848. This implies that capital flight, real exchange rate, and adult literacy rate account for 83% of the systematic variation in economic development for the period under investigation in Nigeria, while the random or stochastic term accounts for the remaining 6% variation in economic development in the estimated model. Furthermore, the

Table 1. Results of ADF Unit Root Test.

Variable Level	ADF Test	PP Test	Critical Value at 0.05	Order of Stationary Test
DEV	(5.757119)	(5.757119)	(2.960411)	I(1)*
CAPT	(9.798901)	(10.30504)**	(2.960411)	I(1)*
RER	(3.986219)	(3.938398)	(2.960411)	I(1)*
ADLT	(6.725192)	(10.40107)**	(2.960411)	I(1)*

Source: Author’s computation, 2019.

*I(1) denotes at 5% 1st difference.

**Denotes stationary at 5% 1st difference.

Table 2. The Empirical Result of ARDL Bound Test.

F -test	5.757778	
Critical levels	Critical value for bound test	
Significance(%)	I(0) Bound	I(1) Bound
10	2.72	3.77
5	3.23	4.35
2.5	3.69	4.89
1	4.29	5.61

Source: Author’s computation, 2019.

Table 3. The Empirical Result of ARDL in the Short-Run Estimate.

Dependent variable: Economic development			
Variable	Coefficient	t-test	Prob.
DEV(-1)	-0.588212	-3.566615	0.0026
D(CAPT(-1))	-1.210033	2.749222	0.0143
D(RER(-1))	-0.258425	-3.422706	0.0035
D(ADLT(-1))	3.945655	2.714861	0.0153
Adjusted R^2	0.826848		

Source: Author's computation, 2019.

Table 4. The Empirical Result of ARDL in the Long-Run Estimate.

Variable	Coefficient	t-test	Prob.
CAPT	2.057138	2.147150	0.0475
RER	-0.439340	-2.726370	0.0149
ADLT	6.707879	3.063085	0.0074

Source: Author's computation, 2019.

lagged capital flight (CAPT-1) once showed that capital flight shows an inverse relationship with economic development in Nigeria. The results revealed that any attempt by Nigerian politicians in capital flight tends to reduce the level of economic development. Also, the lagged (-1) one of real exchange rate is found to have a positive and significance effect on economic development at the 5% level. This means that a unit increase in real exchange rate leads to about a 26% decrease in economic development in Nigeria.

Table 4 reveals a long-run relationship between some of the variables in the model. From the result, capital flight, real exchange rate, adult literacy rate, and economic development showed a long-run relationship in the model. Moreover, in the long run, a positive relationship exists between capital and economic development. However, in the long run, real exchange rate revealed an inverse relationship with economic development in the estimated model. Finally, adult literacy rate has positive nexus with economic development. Hence, any government aiming at providing quality and accessible education will have a significant effect on the economic development in the country.

5. CONCLUSION

The issue of capital flight has drawn the attention of both scholars and policy makers due to its effect on the economy. The study assessed the relationship between capital flight and economic development in Nigeria for the period 1986–2018 using the ARDL technique, which provides useful insights for analyzing and forecasting the relationship between the variables in Nigeria. Utilizing the method, the following are the major findings of the study. First, the study found that the variables were stationary and cointegrated in the model. Secondly, the findings show that capital flight, real exchange, and adult literacy rates have significant effects on economic development in Nigeria. The study, therefore, recommends that monetary policies to curb capital flight should be introduced and monitored so as to improve economic development in Nigeria.

Conflict of Interest

None.

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