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ILLICIT FINANCIAL FLOWS AND ECONOMIC GROWTH OF NIGERIA: AN ANALYTICAL PERSPECTIVE

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Abstract

This paper examines Illicit Financial Flows (IFFs) and Economic Growth of Nigeria in an Analytical Perspective. Illicit financial flows have been a damaging factor to Nigeria's economic progress as funds for development are being transferred out illegally. The study covered a period of 20 years, 1999-2018. Secondary data were collected from partnership for African social and governance research (PASGR), 2018 and CBN statistical bulletin 2018. Data collected were analyzed using OLS multiple regression, descriptive statistics and normality test. The results showed foreign exchange rate, hot money and trade mis-invoicing having effects on GDP, indicated by the positive signs of the coefficients, a1,3,4 which are 461,2.07 and 2.44 and more than 0. Foreign exchange rate is positive and significant, others are insignificant. The Durbin-wats of 1.33 presents no serial correlation. The R^2 explained about 90% of the total variation in the dependent variable. The adjusted R^2 is 87% it implies; changes in economic growth can be explained by illicit financial flows in Nigeria. The F-statistic is 32.67 and P-F statistic is 0.00000 which is less than 5% level of significance, by this it means the model is statistically significant and has a goodness of fit. Government should initiate enduring monetary policy of reducing interest and exchange rate differential and also harmonies the political structure to discourage both human and financial outflow as antidote to IFFs and means of attracting back the funds that have been transferred out illegally back to the economy.
Keywords: Illicit funds, Mis-invoicing, Capital flight, Economic Progress.

Introduction

Illicit financial flows out of Nigeria constitute an impediment to economic progress, growth and unemployment. According to Partnership for African Social & Governance Research (PASGR) (2018) report, the existing data for the period 1970 to 2014 shows that Nigeria is one of the foremost countries where illicit financial transfers are being carried out in Africa. The report confirmed that available evidence for the period 1980 to 2009 showed that Nigeria is a major source country for illicit financial transfers out of Africa. The Global

Financial Integrity Report (2010) was the agency that draws the global attention to the volume of Illicit Financial Flows out of Nigeria.

The Report by the High-Level Panel (HLP) on Illicit Financial Flows from Africa showed that Nigeria accounted for 30.5% of illicit financial outflows from Africa and lost $217.7 billion to illicit financial flows during the period 1970-2008 and supported by 2015 report of the African Union's High-Level Panel on Illicit Financial Flows from Africa. The sums of $597 billion – $1.4 trillion have left Africa via Illicit Financial Flows as the main driver of net resource transfers out of Africa. In terms of volume, Nigeria, Egypt and South Africa led the regional outflows. Studies by Ndikumana and Boyce (2008, 2010, 2014) analyzing capital flows in and out of African countries show that African countries have experienced massive capital outflows towards Western financial countries According to Ndikumana (2017), Afrcan Economic Outlook, (2017), as of 2010, Africa continent was a net creditor to the world to the tune of US$1.4 trillion. The PASGR (2018) commissioned an all-round-case studies of four African countries – Egypt, Kenya, Nigeria, and South Africa – which mapped and synthesize available literature/information on illicit transfers and tax reforms for key stakeholders for policy making.

Kar and Cartwright-Smith (2014) examined all African countries and fifteen of the top twenty countries with cumulative illicit outflows were identified, the study showed that Nigeria has the highest cumulative illicit outflows for the period 1970- 2004. However, the recent figures from the Global Financial Integrity for the ten years period covered 2004-2013 confirmed that Nigeria surpassed South Africa as the country with the largest average illicit financial outflows in Africa and that from the analysis of Illicit Financial Flows from Developing Countries for the years 2004-2013, evidence showed that Nigeria ranks tenth among the top source countries for illicit transfers (Kar and Spanjers, 2015).

Studies by IFFs have revealed that oil-exporting countries like Nigeria are vulnerable to illicit financial transfers while findings from study by UNCTAD (2016) on trade mis-invoicing of primary commodities showed that export mis-invoicing is another major channel of capital transfers out of Nigeria as imports under-invoicing suggests under-valuation of imports or smuggling of oil into the country,(Maya, 2018).

The Illicit Financial Flow out of African counties especially Nigeria to the western developed countries has been a stopping-block in the wheel of progress, growth and development. The speed at which funds are illegally being transferred out of African is an indication of another form of economic colonialization which demand urgent attention, otherwise Nigeria and the other third world countries will remain underdeveloped as Nigeria is suffering irreparable damages from this new form of imperialism organized by Nigerians in collaboration with foreign partners. This bleeding of Nigeria through money laundry, tax evasion, illicit waste transfer and safe heaven leads to closure of about 226 manufacturing companies, millions unemployment, infrastructural deficiency and others. Money for developing Nigerian economy has been illegally transferred out. (Chinwe, 2018, Onogwu, 2018).

Consequently, the cross-border illicit financial flows (IFFs) mean concealing illegal activities and with the growing globalization of financial markets, the economic and political significance of these illegal activities have grown (GFI, 2013 in Ogbonnaya and Ogechuckwu, 2017, Chinwe, 2018).

The issue of illicit financial flows ranks top on the international agenda as it is affecting the developing countries including Nigeria, heighten inflation, drain foreign

reserves, reduces investments and funds for securities, education and infrastructure have been rob off through illicit flows according to Ogbonnaya and Ogechuckwu, (2017).

The Nigerian government has put in place the Economic and Financial Crime Commission (EFCC) and the Independent Corrupt Practices and other Related Offences Commission (ICPC), charged with the responsibilities of tracking and prosecuting offenders of IFFs. Still, the activities have not reduced due to political structure and inter-regional problems. Nigeria is still poverty ridden with political crisis not unconnected with illicit financial flows. Therefore, this paper examines the effect of illicit financial flows on economic growth of Nigeria in an analytical perspective.

Literature Review

The term illicit financial flow is seen by some as being vague and imprecise and the content controversial. The term is characterized by lack of terminological precision which sometimes limits emergence of effective policy options (Ritter, 2015). Chowla and Falcao (2016) also stated that there is yet no firm agreement on conceptual and definitional issues related to the term illicit financial flows, making it difficult to come up with methodologies for monitoring and evaluating progress. There is disagreement and disappointments with method of estimating the volume of IFFs in literatures due to lack of conceptual precision.

Since it is not all finances leaving a country is illicit, in this study, illicit financial flow is defined as that portion of illicit finance that crosses borders or is transferred out of a country.

Thus, policies to address domestic illicit finance differ from policies to address international illicit financial flows. Acknowledging globalization with the ease of transferring money across borders (electronic transfers), illicit financial flows have continued to grow rapidly. The definition of illicit financial flows is looked at from various points as it differs from capital flight. Capital flight according to Akanbi (2015) refers to the movement of money or financial assets from investments in one country to another in order to avoid country specific risk; political, economic, currency devaluation or imposition of capital controls, and it may be legal or illegal.

An illicit financial flow is defined by various international agencies: UN (2017), OECD (2015) and the World Bank (2016). The AU/ ECA High Level Panel's Report (2016) adopted the definition of Global Financial Integrity and defined illicit financial flows as "money illegally earned, transferred or used". However, the AU/ECA HLP Report (2015, p.23) broadened its definition and described illicit financial flows as comprising activities "that while not strictly illegal in all cases, go against established rules and norms, including legal obligations to pay tax". It therefore includes not only actions that are illegal, but also those which are not necessarily unlawful, but are not acceptable in view of unwritten customs, ethics and rules.. This definition covers all flows whether legal or illegal.

IFF is defined as money illegally earned, transferred or used. Illicit finance is national and cross border financing of illicit activities. United Nations define Illicit Financial Flows" UN 2016 (1), as, "all cross-border financial transfers, which contravene national or international laws". The World Bank (2016) defined IFFs: "as cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned transferred or used that crosses borders."

It is the cross-border movement of money that is illegally obtained, transferred, or used. The Council for International Development (2014) defined illicit financial flows as the transfer of illegally earned assets or the hiding of legally earned assets to facilitate illegal tax

evasion (OECD, 2015, Ogbonnaya and Ogechuckwu, 2017). Global Financial Integrity (2013) says IFFs are activities that involve the transfer of money collected through corruption, bribery, tax evasion, criminal activities and transactions involving contraband goods. IFFs are funds that are illegally earned, transferred or utilized, and cover all unrecorded private financial assets by a resident in contravention of applicable laws and regulatory frameworks.

The term IFFs are the proceeds from criminal activities, transferred and or used across borders, It includes Illicit "Hot money" outflows, money laundering, abusive transfer pricing, trade mispricing, mis-invoicing of services and intangibles and using unequal contracts for purposes of tax evasion, aggressive tax avoidance and illegal export of foreign exchange" (Onogwu,2018).

Ogbonnaya and Ogechuckwu, (2017) reviewed the 2016 report of United Nations Economic Commission for Africa (UNECA, 2016), an Ethiopian-based UN agency whose mandate is to foster intra-regional integration and promote Africa's development, classifies illicit financial flows in the following broad categories: (i) tax invasion (ii) proceed from corruption (iii) revenues from illegal resources (iv) trade mispricing or mis-invoicing.
Some components of illicit financial transfers according to (AU/ECA/2016) are:

Corruption: the proceeds of bribery and embezzlement of national wealth or abuse of entrusted power by government officials.

Criminal Activities: the proceeds of criminal activities such as drug trading, human trafficking, racketeering, counterfeiting, contraband, and terrorist financing.

Commercial Activities: proceeds of activities intended to hide wealth, avoid taxes, and dodge customs duties and levies. They include the proceeds of tax evasion and laundered commercial activities such as: abusive transfer pricing, trade mispricing, mis-invoicing of services and intangibles, and unequal contracts.

Causes of IFF outflows include corruption, lack of political leadership, poor institutions, lack of development cooperation and global partnership to stop it. The reasons for high level of IFFs in Nigeria is connected with weak institutions and governance, helping public officials to divert funds to other economy instead of saving it in Nigeria bank account, and the consequence of the IFFs is the obstruction to sustainable development such as; reduction in private savings and investment, reduction tax collections due to tax evasion and tax avoidance, emergence of speculator on assets coupled with unfair competition destroys domestic industries and employment, and it also damages investors' confidence.
Illicit financial flows have negative effects on development (Nkurunziza, 2012; UNECA, 2017).

Despite the fact that Nigeria earned billions of dollars revenue since the discovery of oil in 1956, the pace of socio-economic developments has been slow and has excluded majority of citizens as large portion of these revenues have been lost to illicit financial transfers. About 29 Nigerians and Nigerian businesses registered their private jets in South Africa to hide their loot and avoid paying tax thereby defrauding the Nigerian government of tax revenue (Vanguard editorial, November 3, 2017). The problem of illicit financial flow has stayed with us for so long and it is still not abating. There is need therefore to continue studying and analyzing this problem in other to find lasting solution to at least reduce its impact on the economic growth of the country. This study is an attempt in this direction.

Theoretical Framework

The theory that underpins this study on illicit financial flows is the Dependency Theory Dependency theory, developed by Raul Prebisch in 1950, was of the notion that resources flow from a periphery of poor and underdeveloped countries to a "core" of wealthy countries, enriching the later at expense of the former. It attempts to explain the persistent underdeveloped state of many nations in the world by examining the patterns of interactions among nations and by arguing that inequality among nations are intrinsic part of those interactions. The resources of under developed countries are channeled to develop the developed countries via illicit financial flows. The Marxist theory of imperialism is self-liquidating, while the dependent relationship is self-perpetuating. This theory argues the persistent poverty in the developing nations is a consequence of capitalist exploitation, which a new body of thought called the "world system approach".

It is further argued that the poverty was a direct consequence of the evolution of the international political economy into fairly rigid division of labour which favoured the rich and penalized the poor countries. This theory is the dynamic motives for the pursuit of profit, involving the investment of money or any financial asset outside ones country with the objective of increasing the initial monetary value as financial return whether in the form of profit, rent, interest or/and capital gains. The quest for capital gains necessitates illicit financial flows in, which African countries are suffering. Hot money hypothesis posits the continuous shifting of capital from low interest rates region to higher interest rates regions either legitimately or not, in order to make quick money, negatively affecting exchange rate and impact significantly on a country's balance of payments. As long as interest rate differentials exist between countries, funds transfer will continue to damage the concerned weaker African economies, and particularly Nigeria..

Empirical Review

Onogwu (2019) carried out a study on illicit financial flows and economic development of Nigeria. The study finds that illicit Financial Flows had drained Nigeria of billions of Naira of potential development funds and contributed seriously to underdevelopment over time.

Ogbonnaya and Ogechukwu (2017) studied the impact of IFFs on Economic Growth and Development: Evidences from Nigeria. Secondary data collected from CBN and analyzed by ADF and Johansen co-integration was used. The results showed that there is stable and long run relationship between the variables and IFFs negatively affects the growth and development of Nigeria.

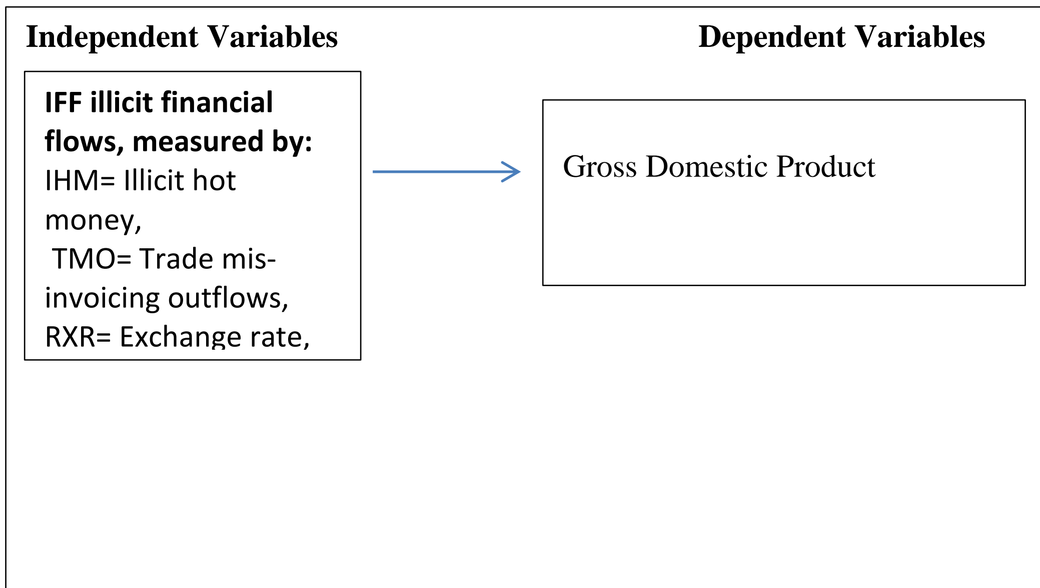
Ndikumana (2017) in an effort to establish the extent to which IFFs inhibiting effect impact on the investment growth, used data from a number of African developing countries to conduct an econometric simulation. The central question of the study is how much additional growth the affected countries might have achieved without illicit financial outflows. The findings are of course plagued by a number of uncertainties; however, the trend is impressive. Ndikumana (2017) concludes that the thirty-nine countries studied over the period from 2000 to 2010 might have been able to achieve on average 3 percent more economic growth had there been a radical stop to all IFFs.

In oil-exporting countries, which are especially prone to illicit financial outflows, that additional growth might even have been 3.9 percent. This problem is being used to re-colonise the developing countries of the world that continue to remain perpetually dependent on the developed economies. Studies and analysis of illicit financial flows will

therefore continue to attract academic attention for as long as the problem remains unabated, particularly in developing countries like Nigeria. Hence the essence of this study.

Conceptual Model

The conceptual model relates the elements of independent variables (Illicit financial flows) to the dependent variable of Gross Domestic Product. The independent variable is proxied on IHM= Illicit hot money, TMO= Trade mis-invoicing outflows, and RXR= Exchange rate.



Source: Researcher 2020

Methodology

This study used secondary data collected from partnership for African social and governance research (PASGR), 2018 and CBN statistical bulletin 2016. .

Model Specification

GDP ƒ(IFF)

IFFs is proxied on IHM= Illicit hot money, TMO= Trade mis-invoicing outflows, and RXR= Exchange rate

Therefore, GDP= ƒ(IHM,TMO,EXR)

$GDP= a0 + a_1IHM +_{a2}TMO + _{a3}EXR + eu$

Where:

GDP = Gross Domestic Product. IFF =illicit financial flows, measured by IHM= Illicit hot money, TMO= Trade mis-invoicing outflows, RXR= Exchange rate, eu = Error term and a1, a2, a3= coefficient of independent parameter.

Results and Discussion of Findings

Table 1. Descriptive Statistics

	GDP	FXR	IHM	T_MO
Mean	3090.327	140.7594	14819.70	2984.400
Median	3179.510	141.1903	16147.50	1844.000

Maximum	4797.450	160.7228	26735.00	13056.00
Minimum	1385.950	118.5669	0.000000	0.000000
Std. Dev.	1207.784	14.62430	9009.762	3977.915
Skewness	-0.077672	-0.089003	-0.255949	1.736521
Kurtosis	1.556877	1.533722	1.971094	5.218930
Jarque-Bera	0.877806	0.909024	0.550287	7.077360
Probability	0.644743	0.634758	0.759463	0.029052
Sum	30903.27	1407.594	148197.0	29844.00
Sum Sq. Dev.	13128672	1924.831	7.31E+08	1.42E+08
Observations	20	20	20	20

Source: Researcher's Computation 2020

The findings from Table 1shows that GDP has averages of 3090.33 and varies from a minimum of 1385.95 to a maximum of 4797.45 Foreign exchange rate (FXR) and Illicit hot money and Trade mis-invoicing has a mean of 14819.7 and 2984.4 and fluctuate from a minimum of 0.000 and 0.00 to a maximum of 26735 and 13056 correspondingly. The probability of Jarque-Bera is above 5% except that of trade mis-invoicings, showing that the residuals of estimated model are normally distributed. The skewness indicates negative values apart from trade mis-invoicing, signifying normal level of distribution.

Unit Roots Test (Phillips Perrons and Augmented Dickey Fuller)

A non stationarity test among the variables was carried by Augmented Dickey Fuller and Phillip Perrons the variables differenced are integrated at order zero 1(0), hence Least square regression was not suitable.

Table 2

Dependent Variable: GDP
Method: Least Squares
Date: 11/07/20 Time: 02:06
Sample: 1999 2018
Included observations: 20

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FOREX	461.3306	69.86623	6.603056	0.0000
IHM	2.071491	1.671534	1.239276	0.2343
TMI	2.439725	1.239852	1.967755	0.0679
C	-35097.20	14141.26	-2.481901	0.0254

R-squared	0.897037	Mean dependent var	51278.55
Adjusted R-squared	0.869580	S.D. dependent var	33576.72
S.E. of regression	12125.78	Akaike info criterion	21.85637
Sum squared resid	2.21E+09	Schwarz criterion	22.10531
Log likelihood	-213.5637	Hannan-Quinn criter.	21.90497
F-statistic	32.67090	Durbin-Watson stat	1.332590
Prob(F-statistic)	0.000000		

Source: Researcher's Computation 2020

The regression model shows that foreign exchange rate, hot money and trade mis-invoicing has effects on GDP, which is indicated by the signs of the coefficients, β1,2,3 which are 461, 2.07 and 2.44 respectively which is more than 0. Foreign exchange rate is positive and significant, other are insignificant. The model has Durbin-wats of 1.33 which did not show the presence of serial correlation. The R^2 is approximately 90%, which showed that the explanatory variables explained about 90% of the total variation in the dependent variable. The adjusted R^2 is about 87%, implying that only 87% of changes in economic growth can be explained by illicit financial flows in Nigeria. The F-statistic is 32.67 and P-F statistic is 0.00000 which is less than 5% level of significance, by this it means that the model is statistically significant and has a goodness of fit.

Table 3

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	1.180800	Prob. F(2,13)	0.3379
Obs*R-squared	3.074679	Prob. Chi-Square(2)	0.2150

Breusch-Godfrey Serial correlation test is a test of serial correlation for time series data. The P-value of our observation and R-squared is .045 which is less than statistical threshold of 5% thus we accept the null hypothesis. The series have evidence of severe serial correlation, meaning the result or figure of one year can be used to predict that of other future years.

Conclusion and Recommendations

This paper examines illicit financial flows and Nigeria economic growth in an analytical perspective. The study covered a period of 20 years, 1999-2018. Secondary data were collected from partnership for African social and governance research (PASGR), 2018 and CBN statistical bulletin, 2018. Data collected were analyzed using multiple regression analysis and descriptive statistics. The results showed that foreign exchange rate has a positive and significant effect on GDP while hot money and trade mis-invoicing have positive but insignificant effect on the GDP which is the dependent variable. The coefficients of the independent variables, a 1, 3, 4, are 461, 2.07 and 2.44 respectively, all greater than 0. The illicit financial flows both in financial and human resources undermine Nigeria's economic progress. The unlawful resources' drain on Nigeria dragged the country to unemployment and infrastructural decay. The interest and exchange rate differentials encourage illicit financial flows.

The government and monetary authority should ensure reduction in the interest and rate differentials.

The political structure and system should be harmonized to discourage both human and financial outflow.

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