



Foreign Capital Inflows and Poverty Reduction in Nigeria: Implication for Sustainable Development

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Abstract: This study aims at examining the contributions of the different components of foreign capital inflows in driving one of the key goals of sustainable development-poverty reduction in Nigeria. In achieving the objective of this study, annual data between 1990 and 2019 were utilized with the application of FMOLS and Granger causality technique of estimation. The findings of this research work are as follows; firstly, foreign capital inflows and poverty reduction have a long run equilibrium relationship in Nigeria. Furthermore, there is a unidirectional causality flowing from poverty reduction to foreign direct investment. Poverty reduction Granger causes foreign portfolio investment. Also, feedback relationship exists between poverty reduction and remittances. This implies that poverty reduction is a strong factor causing the inflows of foreign capital such as FDI, FPI and remittances in Nigeria. Moreover, the majority of the components of foreign capital inflows such as FDI, FPI and remittances contributed immensely to the reduction of poverty in Nigeria. This implies that foreign capital inflows have the capacity to propel the achievement of Sustainable Development Goal one - poverty reduction in Nigeria. Therefore, this study makes the following recommendations for the policymakers in Nigeria and by extension Africa that, any time these policymakers set to achieve Sustainable Development Goal one i.e poverty reduction, foreign capital inflows such as remittances, foreign portfolio investment, FDI and external debt should be given priority in their country. And such, the policy that facilitates the sporadic inflows of these variables should be embarked upon by the Nigerian policymakers in particular and African policymakers in general.

Keywords; FDI; FPI; ODA; Remittances; External Debt; Poverty Reduction and SDGs

JEL Classification: F2; 047; C100

1. Introduction

In this era of globalization, inflows of capital across the countries of the world cannot be undermined in the recent times. Strategic factors such as the presence of investment opportunities alongside with the better returns on the investments facilitate the flow of capital from advanced economies to developing economies (Lucas, 1988). Developing countries are usually capital deficient due to a wide gap between available capital and the required capital to drive the economy to a sustainable growth. Therefore, inflows of foreign capital become an indispensable variable to bridge these deficiencies in the domestic economy (Sy & Rakotondrazaka, 2015; UNCTAD, 2015; Chea, 2011; Ellahi, 2011).

However, poverty is a major issue confronting Nigeria in the recent times. Available evidence shows

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that poverty is endemic in Nigeria in such a way that the majority of its populace could not afford basic necessity of life such as food, quality education and the host of others (World Poverty Clock, 2018; Adebayo, 2018; Aderemi *et al.*, 2020:a). In the light of the above, combating poverty in Nigeria becomes a continuous assignment in tandem with the advocacy of the sustainable development goal one – poverty reduction. Meanwhile, achieving poverty reduction in any economy like Nigeria where the actual savings and investments could not metamorphose to the desire investment requires viable means of augmenting the investment gap in the economy. One of the viable means of bridging the investment gap created by deficient locally mobilized savings and net export earnings is to open up the economy to the inflows of foreign capital (Adeola, 2017; Okafor, Ogochukwu & Chijundu, 2016; Abidemi, Adegboye, Ogbebor & Egharvba, 2014).

Consequently, various components of foreign capital inflows like foreign direct investment, foreign portfolio investment, official development assistance, remittances and external debts have become an integral part of the Nigerian economy in the past few decades (CBN, 2017; NBS, 2017; UNCTAD, 2015). This implies that Nigeria has benefited from global allocation of foreign capital. Meanwhile, the early studies have argued in favour of strategic roles of international financial integration in driving the domestic economy (Alfaro, Kalemli-Ozcan & Volosovych, 2007; Obstfeld & Rogoff, 2000). Against this backdrop, various empirical studies started investigating the impact of different components of foreign capital inflows on the performance of the Nigerian economy. It is instructive to note that the focus of the majority of the recent empirical studies has been on the impact of foreign capital inflows on economic growth (Balogun, Okafor & Ihayere, 2019; Adekunle, 2018; Chigbu, Ubah & Chigbu, 2015; Okafor, Ugochukwu & Ajide, 2014). While neglecting the impact it could have on poverty reduction. As a departure from the existing past studies, this study examined foreign capital inflows and poverty reduction nexus in Nigeria, using methodology in which majority of past studies on this subject matter have ignored in most recent times.

The structure of this study is done as follows; besides introduction that sets the foundation for this work, section two provides the detailed review of literature. Whereas, section three provides methodology, analysis of results and policy recommendation of the results.

2. Review of Literature

Foreign capital inflows and macroeconomic variables nexus has been well has been prominently pronounced in the literature. Monogbe, Okereke and Ifionu (2020) examined nexus between foreign capital flows and economic development in Nigeria from 1986 to 2018 using error correction model and granger causality techniques. The authors submitted that foreign capital inflows such as foreign portfolio investment, official development assistance and bilateral loan caused a significant contribution to the Nigerian economic development. But FDI and multilateral loan led to a negative contribution to the Nigerian economic development Adekunle (2018) conducted a research about the linkage between foreign capital inflows and economic growth in Nigeria from 1986 to 2015 using ARDL technique. It was discovered from the study that net FDI inflows led to a direct impact on economic growth in the short run, but net foreign remittances and net portfolio flows led to an inverse impact on economic growth in the short-run. Gabriel, John and Baryl (2019) investigated how capital flows contributed to economic growth in Nigeria between 1981 and 2016 with the application of ARDL and ECM. The study argued that the contribution of capital inflow was significant in growing the Nigerian economy. In another related study, Aderemi *et al.* (2020: b) used different panel techniques to assess how inflows of FDI led to poverty alleviation among 16 countries in ECOWAS sub region from 1990 to 2017. The authors posited that the inflows of FDI caused a significant impact in achieving poverty alleviation within ECOWAS sub region and FDI projects led to an aggressive rate of poverty alleviation within the economic bloc.

Meanwhile, Ogunleye *et al.* (2020) utilized Cointegration, DOLS and Granger Causality technique to estimate the long run equilibrium relationship that exists between poverty alleviation and official development assistance between 1981 and 2017. It was submitted from the study that official development assistance had a significant negative relationship with poverty alleviation in the country. There existed a bidirectional feedback between official development assistance and poverty alleviation in Nigeria. While utilizing GARCH-BEKK model, Guglielmo, Faek, and Nicola (2013) examined the relationship between exchange rate uncertainty and portfolio flows in economies such as Australia, Japan, UK, Canada and Sweden from 1988 to 2011. It was argued from the study that the relationship between volatility in exchange rate and portfolio investment was negative in some countries, while reverse was the case in other countries. Similarly, Teddy (2015) carried out a study in Zambia with application of GARCH model, Johansen cointegration test and error correction model in investigating the nexus between volatility in exchange rate and inflows of private capital in Zambia. The author concluded that volatility in the nominal exchange rate and foreign portfolio investment flow had a significant inverse relationship in the country.

Furthermore, Obiechina and Ukeje (2013) employed the Engle-Granger technique in investigating the linkage between capital flows and the Nigerian economic growth between 1970 and 2010. The study asserted that FDI led to a weak contribution to the Nigerian economic growth in the short run. In another related study, Abidemi, Adegboye, Ogbekor and Egharvba, (2014) used a vector error correction mechanism to estimate the relationship between capital flows and economic growth in Nigeria from 1981 to 2012. It was revealed from the paper that the major components of capital flows such as FDI, portfolio investment and external debt orchestrated a significant contribution to economic growth in the country. In a study focusing on 13 countries in ECOWAS sub region, Modou and Liu (2017) researched how Both FDI and trade contributed to economic growth in the sub regional economic bloc between 1985 and 2015. The authors concluded that both trade and FDI exacted a significant contribution to economic growth in the sub region and there existed both unidirectional and bidirectional feedback relationship between FDI and trade on economic growth of the sub region. Saibu and Keke (2014) applied principal components analysis alongside with ARDL in assessing how capital inflow and economic growth are linked in Nigeria. It was discovered from the study that the interaction of capital inflow and trade openness resulted in a significant contribution to economic growth.

In conclusion, it could be deduced from the above empirical studies that various components foreign capital inflows have resulted into a mixed impact economic growth, while neglecting its impact it could have on poverty reduction in the economy. Hence, the relevance of this study.

3. Methodology and Materials

The adoption of an ex-post facto research design is appropriate in this work due to its main interest which explored the viable relationship, and as well described how foreign capital inflows predict variation in poverty reduction in Nigeria. Similarly, secondary data from 1990 to 2019 were extracted mainly from the World Bank Development Indicators to run the analysis of this study.

3.1. Model Specification

Various components of foreign capital inflows have been submitted in the literature to be the drivers of economic growth and consequently result in poverty reduction in developing economies. And as such, this study draws insight in adapting model from studies like Ogunleye *et al.* (2020); Aderemi *et al.* (2020) and Umoh *et al.* (2012). The focus of this study necessitates the adjustment of variables in the adapted model to capture the objective of this study as follows;

$$POVT = F (FCAP) \tag{1}$$

$$POVT_t = \phi + \alpha FDI_t + \beta_1 FPI_t + \beta_2 ODA_t + \beta_3 REM_t + \beta_4 EXD_t + \beta_5 EXCH_t + \beta_6 Inf_t + \mu_t \quad (2)$$

If the natural log is introduced to equation 2, it transforms the model as thus;

$$POVT_t = \phi + \beta_0 LnFDI_t + \beta_1 LnFPI_t + \beta_2 LnODA_t + \beta_3 LnREM_t + \beta_4 LnEXD_t + \beta_5 LnEXCH_t + \beta_6 TOP_t + \beta_7 Inf_t + \mu_t \quad (3)$$

Estimating the Granger causality between the components of foreign capital inflows and poverty reduction requires the utilization of pairwise granger causality equations as stated below;

$$POVT_t = \alpha_0 + \sum_{i=0}^p \alpha_1 POVT_{t-1} + \sum_{i=0}^p \alpha_2 FDI_{t-1} + \sum_{i=0}^p \alpha_3 FPI_{t-1} + \sum_{i=0}^p \alpha_4 ODA_{t-1} + \sum_{i=0}^p \alpha_5 REM_{t-1} + \sum_{i=0}^p \alpha_6 EXD_{t-1} + \varepsilon_{1t} \quad (4)$$

$$FDI_t = \beta_0 + \sum_{i=0}^p \beta_1 FDI_{t-1} + \sum_{i=0}^p \beta_2 FPI_{t-1} + \sum_{i=0}^p \beta_3 POVT_{t-1} + \sum_{i=0}^p \beta_4 EXD_{t-1} + \sum_{i=0}^p \beta_5 ODA_{t-1} + \sum_{i=0}^p \beta_6 REM_{t-1} + \varepsilon_{2t} \quad (5)$$

$$ODA_t = \gamma_0 + \sum_{i=0}^p \gamma_1 ODA_{t-1} + \sum_{i=0}^p \gamma_2 FDI_{t-1} + \sum_{i=0}^p \gamma_3 EXD_{t-1} + \sum_{i=0}^p \gamma_4 FPI_{t-1} + \sum_{i=0}^p \gamma_5 POVT_{t-1} + \sum_{i=0}^p \gamma_6 REM_{t-1} + \varepsilon_{3t} \quad (6)$$

$$REM_t = \gamma_{10} + \sum_{i=0}^p \gamma_{11} REM_{t-1} + \sum_{i=0}^p \gamma_{12} FDI_{t-1} + \sum_{i=0}^p \gamma_{13} EXD_{t-1} + \sum_{i=0}^p \gamma_{14} FPI_{t-1} + \sum_{i=0}^p \gamma_{15} POVT_{t-1} + \sum_{i=0}^p \gamma_{16} ODA_{t-1} + \varepsilon_{4t} \quad (7)$$

$$EXD_t = \gamma_{20} + \sum_{i=0}^p \gamma_{21} EXD_{t-1} + \sum_{i=0}^p \gamma_{22} FDI_{t-1} + \sum_{i=0}^p \gamma_{23} ODA_{t-1} + \sum_{i=0}^p \gamma_{24} FPI_{t-1} + \sum_{i=0}^p \gamma_{25} POVT_{t-1} + \sum_{i=0}^p \gamma_{26} REM_{t-1} + \varepsilon_{5t} \quad (8)$$

$$FPI_t = \gamma_{30} + \sum_{i=0}^p \gamma_{31} FPI_{t-1} + \sum_{i=0}^p \gamma_{32} EXD_{t-1} + \sum_{i=0}^p \gamma_{33} FDI_{t-1} + \sum_{i=0}^p \gamma_{34} POVT_{t-1} + \sum_{i=0}^p \gamma_{35} REM_{t-1} + \sum_{i=0}^p \gamma_{36} ODA_{t-1} + \varepsilon_{6t} \quad (9)$$

Where:

POVT is poverty reduction and is measured by GDP per capita. FDI is foreign direct investment and is measured by net inflows of FDI in the reporting economy. FPI is foreign portfolio investment. ODA is official development assistance. REM is remittances. EXTD is external debt. EXCH is exchange rate. Inf is inflation rate and TOP is trade openness. u is error term. t is the period of the analysis.

It is expected that β_0 to $\beta_6 > 0$ whereas $\beta_7 < 0$.

4. Results and Discussion

Table 1. Descriptive Statistics of Variables

Descriptive Statistics	POVT	LnFDI	LnFPI	LnODA	LnREM	LnEXTD	TOP	Inf	LnEXCH
Mean	1751.00	21.9626	26.3845	21.0681	22.7297	7.32808	37.4127	13.2886	167.601
Median	1930.00	22.0964	26.7504	21.3846	23.6561	7.52620	37.1450	11.8350	141.190
Maximum	3223.00	22.9110	31.2379	23.1596	24.1091	8.95665	53.2800	44.5900	387.000
Minimum	477.000	20.8691	20.7430	18.8393	17.8408	4.71438	20.7200	5.38000	17.2984
Std. Deviation	875.251	0.67972	2.23264	1.16687	1.65127	1.07631	8.84573	7.92014	91.6658
Skewness	0.12742	0.26984	0.33569	0.55355	0.42621	-0.52187	-0.08120	0.89189	0.27046
Kurtosis	1.77287	1.77977	3.59306	2.47075	4.32894	2.61727	2.37747	12.3170	3.92680
Jarque-Bera	1.43989	1.63187	0.73561	1.38030	9.07728	1.13289	0.37942	110.238	6.70571
Probability	0.48677	0.44222	0.69224	0.50149	0.01068	0.56753	0.82719	0.00000	0.03498
Sum	38522.0	483.178	580.460	463.498	500.054	161.217	823.080	292.350	3687.24
Sum. Sq. Deviation	160873	9.70261	104.678	28.5934	57.2607	24.3277	1643.18	1317.30	176455.

Observatio	29	29	29	29	29	29	29	29	29
n									

Source: Authors' Computation (2021)

An attempt to test the normal distribution of the employed data, descriptive statistics of the various data in this study was estimated in which its results were presented in the above table. The importance of this test lies in the fact that econometric analysis is built on the assumption of the normal distribution of the dataset. Meanwhile, the values of the mean and median of all the relevant variables are very close. This justifies the assertion of Karmel and Polasek (1980) who argued that normal distribution of data occurs the moment the mean, modal and median values of such data converged. In the same vein, all the variables except Ln EXTD have positive skewness with kurtosis values that are not far from 3.

Table 2. Unit Root Test

Variables	ADF Test				Remark
	Level	Probability	1 st Diff	Probability	
LnFDI	-2.981038***	0.4785	-2.971853***	0.0000	I(1)
LnFPI	-2.986225***	0.1139	-2.991878***	0.0016	I(1)
POVT	-2.967767***	0.8435	-2.971853***	0.0133	I(1)
LnEXCH	-2.967767***	0.9993	-2.971853***	0.0141	I(1)
LnEXTD	-2.967767***	0.1570	-2.971853***	0.2365	I(2)
LnREMM	-2.967767***	0.0703			I(0)
LnODA	-2.967767***	0.1758	-2.971853***	0.0000	I(1)
OPEN	-2.967767***	0.0385			I(0)
Inf	-2.967767***	0.2733	-2.971853***	0.0019	I(1)
Variables	PP Test				Remark
	Level	Probability	1 st Diff	Probability	
LnFDI	-2.967767***	0.3827	-2.971853***	0.0000	I(1)
LnFPI	-2.967767***	0.0001			I(0)
POVT	-2.967767***	0.8159	-2.971853***	0.0156	I(1)
LnEXCH	-2.967767***	0.9984	-2.971853***	0.0146	I(1)
LnEXTD	-2.967767***	0.1389	-2.971853***	0.4121	I(2)
LnREMM	-2.967767***	0.0703			I(0)
LnODA	-2.967767***	0.2081	-2.971853***	0.0001	I(1)
OPEN	-2.967767***	0.0385			I(0)
Infl	-2.967767***	0.1810	-2.971853***	0.0020	I(1)

Source: Authors' Computation (2021) *** %5 level

It has been established that time series data usually show non-stationarity behavior (Granger, 1986). This type of behavior is the genesis of spurious results in an empirical analysis. In order to resolve this issue in this study, effort was made to subject the data to stationarity test via the standard Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) techniques. The estimated results presented in table 2 indicate that the variables comprise of different order of integrations. In another words, the majority of the variables are stationary after first differencing, while external debt data in log form is stationary after second differencing, foreign portfolio investment and remittances in log form are stationary in their native form.

Table 3. Johansen Cointegration Test (Trace Statistic)

Hypothesized Number of CEs	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob**
None*	0.998535	243.1650	95.75366	0.0059
At most 1	0.888928	119.1707	69.81889	0.0531
At most 2	0.826522	77.41679	47.85613	0.0500
At most 3	0.679565	44.13438	29.79707	0.0706
At most 4	0.539433	22.51094	15.49471	0.0537
At most 5	0.336010	7.780283	3.841466	0.0853

Johansen Cointegration Test (Max-Eigen Statistic)

Hypothesized Number of CEs	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob**
None*	0.998535	123.9944	40.07757	0.0000
At most 1	0.888928	41.75388	33.87687	0.0047
At most 2	0.826522	33.28241	27.58434	0.0683
At most 3	0.679565	21.62344	21.13162	0.0426
At most 4	0.539433	14.73066	14.26460	0.0722
At most 5	0.336010	7.780283	3.841466	0.0953

Notes: *denotes rejection of the null hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

Source: Authors' Computation (2021)

It has been discovered in table 2 that the majority of the variables of interest are not stationary at a level. This means that a short run disequilibrium could occur among these variables in the short run, but there is a tendency the short run disequilibrium adjusts to equilibrium in the long run if there is a long run convergence among these variables of interest. Against this backdrop, this study utilized Johansen Cointegration test developed by Johansen and Juselius (1990) to examine the presence or otherwise of a long run convergence among the variables of interest. Consequently, it could be inferred from table 3 that at most 5 cointegrating equations exist among the variables as indicated by both the Trace statistic and the Maximum Eigen Statistic. This implies that foreign capital inflows and poverty reduction have a long run relationship in Nigeria.

Table 4. Pairwise Granger Causality Test between Foreign Capital Inflow and Poverty Reduction in Nigeria

Null hypothesis	F-statistic	Prob.	Decision	Causality
POVT does not Granger Cause Inf	1.25346	0.3043	Accept	
Inf does not Granger Cause Log POVT	0.19113	0.8273	Accept	None
POVT not Granger Cause Ln EXTD	0.56545	0.5758	Accept	
Ln EXTD does not Granger Cause POVT	0.58206	0.5668	Accept	None
POVT does not Granger Cause Ln FDI	0.93519	0.4069	Accept	Unidirectional
Ln FDI does not Granger Cause POVT	4.08039	0.0304	Reject	
POVT does not Granger Cause Ln FPI	3.82723	0.0472	Reject	Unidirectional
Ln FPI does not Granger Cause POVT	0.74198	0.4940	Accept	
POVT does not Granger Cause Ln REM	0.38875	0.6823	Accept	Unidirectional
Ln REM does not Granger Cause POVT	4.31868	0.0256	Reject	None
POVT does not Granger Cause Ln ODA	1.76245	0.1940	Reject	
Ln ODA does not Granger Cause POVT	1.38155	0.2713	Reject	

Source: Authors' Computation (2021)

In table 4, the estimated results of causal relationship among various components of foreign capital and poverty reduction were presented. It is instructive to state that there is a unidirectional causality flowing from poverty reduction to FDI. In the same vein, poverty reduction Granger causes FPI. Also, feedback

relationship exists between poverty reduction and remittances. This implies that poverty reduction is a strong factor causing the inflows of foreign capital such as FDI, FPI and remittances in Nigeria.

Table 5. Relationship between Foreign Capital Inflows and Poverty Reduction in Nigeria

Dependent Variable: POVT

Method: FMOLS

Regressors	Coefficient	T-statistics	Prob. Value
LnEXD	85.98436	1.217463	0.2468
LnFDI	172.1984	0.669268	0.5160
LnFPI	210.0416***	2.841690	0.0149
LnREMM	534.8874***	2.662119	0.0207
LnODA	-331.0664*	3.414531	0.0051
Inf	-51.69421***	2.725237	0.0184
LnEXCH	-0.997839	0.842337	0.4161
R-Squared	0.881183		
Adjusted R-squared	0.811874		

Source: Authors' Computation (2021) *Significant at 1% ***significant at 5% **Significant at 10%

Table 5 shows estimated results of the long run nexus between foreign capital inflows and poverty reduction in Nigeria within the framework of the Fully Modified Ordinary Least Square. The power of test shows that the model is relatively good because foreign capital inflow components and other control variables jointly explained about 88% of the systematic variations in dependent variable, poverty reduction as indicated by the result of R-Squared. Similarly, all the variables have the expected signs except LnODA and LnEXCH. External debt and GDP per capita have a positive relationship, though the relationship is not significant. In the same vein, FDI and GDP per capita have an insignificant positive relationship. Meanwhile, foreign portfolio investment and GDP per capita have a positive relationship which is significant at 5% level of significance. A unit change in foreign portfolio investment increases GDP per capita by 2.1%. Furthermore, remittances and GDP per capita have a significant positive relationship. A unit change in remittances leads to an increment in GDP per capita by 5.3%. However, ODA and GDP per capita have a significant inverse relationship with each other. A unit change in ODA causes a reduction in GDP per capita by 3.31%. Inflation rate and GDP per capita have a significant negative relationship. A unit change in inflation rate reduces GDP per capita by 51.7%. Also, exchange rate and GDP per capita have insignificant negative relationship.

By and large, it could be inferred from the above that majority of the components of foreign capital inflows contributed significantly to the expansion of GDP per capita in Nigeria. This implies that foreign capital inflows have contributed significantly to poverty reduction in the last three decades. The finding in this study is in tandem with submissions of Tunde, Okereke and Ifionu (2020), and Aderemi *et al.* (2020: b) in related studies in Nigeria and ECOWAS countries respectively.

5. Conclusion and Recommendation

This paper examined the contributions of the different components of foreign capital inflows in driving one of the key goals of sustainable development-poverty reduction in Nigeria. In achieving the objective of this study, annual data between 1990 and 2019 were utilized with the application of FMOLS and Granger causality technique of estimation. It is instructive to report the findings of this research work as follows; firstly, foreign capital inflows and poverty reduction have a long run equilibrium relationship in Nigeria. Furthermore, there is a unidirectional causality flowing from poverty reduction to FDI. Poverty reduction Granger causes FPI. Also, feedback relationship exists between poverty reduction and



remittances. This implies that poverty reduction is a strong factor causing the inflows of foreign capital such as FDI, FPI and remittances in Nigeria. Moreover, that majority of the components of foreign capital inflows such as FDI, FPI and remittances contributed immensely to the reduction of Poverty in Nigeria. This implies that foreign capital inflows have the capacity to propel the achievement of Sustainable Development Goal one - poverty reduction in Nigeria. Therefore, it is important for this study to make the following recommendations for the policymakers in Nigeria and by extension Africa that, any time these policymakers set to achieve Sustainable Development Goal one i.e poverty reduction, foreign capital inflows such as remittances, foreign portfolio investment, FDI and external debt should be given priority in their country. And such, the policy that facilitates the sporadic inflows of these foreign capital should be embarked upon by the Nigerian policymakers in particular and African policymakers in general.

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