

# Impact of Capital Flight on Economic Development in Nigeria

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Article DOI: 10.48028/ijprds/ijormsse.v8.i1.02

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## Abstract

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Capital flight has continued to generate debate across the world. Most developing countries Nigeria in particular are having their own share of the problem. This are burning issues regarding its actual measurement and direction of flow. This study is set to examine the effect of capital flight on economic development in Nigeria from 1980 to 2020. Due to the stochastic nature of time series data, diagnostic tests were conducted to ascertain the behavior of the series. The Augmented Dickey Fuller (ADF) and Philips Perron (PP) test results are reported. Based on these tests, all the variables in the model became stationary after first differencing, that is, they are integrated of order one I(1). Because of this order of integration, the Johansen co-integration test was conducted to check for possible long run relationship. Due to the absence of long-run relationship, unrestricted Vector Autoregressive (VAR) model was specified and used for the estimation. Results from the VAR estimation reveal that Poverty is an increasing function of poverty. There is a negative impact of capital flight on economic development in Nigeria over the period of study. External debt is detrimental to economic development if mismanaged. Floating exchange rate where multiple rates are charged in different markets is detrimental to economic development in Nigeria over the period of study. This paper recommended that training in skill acquisition should be encouraged in Nigeria in order to alleviate poverty. Capital flight should be checked with serious penalties on the perpetrators. In addition, external debt should be channel to economic uses. And finally floating exchange rates where different rates are charged in different markets is should be abolished in Nigeria.

**Keywords:** *Capital Flight, Economic Development, VAR, Nigeria*

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## **Background to the Study**

The issue of capital flight has continued to generate debate and concern in Africa. Scholars around the world have developed interest over the years in trying to define and conceptualize capital flight. Every country both developed and developing require capital for economic progress. Both the classical and neo-classical economics emphasized the importance of capital in economic development. Due to weak political and economic institutions in developing countries, capital moves freely and unaccounted for. African economies exhibit a stunning paradox whereby the acceleration of foreign capital inflows and economic growth have occurred simultaneously with an equally rapid increase in unrecorded capital outflows or capital flight (Ndikumana, Boyce, and Ndiaye, 2015).

According to Gantier and Luc (2020), Capital movement from developed to developing countries has been the trend up to the early 1970s. During this period, capital inflows have been favorable to investment in many sectors of the economy. This movement is however changed in the early 1980s, leading to capital outflow from developing countries to developed countries in the form of capital flight.

Capital is needed in Nigeria to provide employment opportunities, build good schools and hospital, build goods roads and markets, and to compensate for other infrastructural deficits within the country. Nigerian economy has faced huge financial hemorrhage in 2014 as individuals, corporate bodies and foreign investors were moving their funds massively out of the country as well as converting it from Naira to dollar. A total of \$22.1billion went out of the country in five weeks, an average of \$4.5 billion a week. Outflow of foreign exchange rose to about \$5.35billion for the week ending November 30th 2014 (Omoh, 2015). The bulk of the outflow went through the wholesale at the Dutch auction market. A study by Ndikumana and Boyce (2018) found that oil-rich countries are the most exposed to capital flight. Nigeria for instance, lost 340 billion US dollars, followed by Angola with 61 billion US dollars and Cameroun with 43 billion US dollars.

The capital that is needed in Nigeria to provide employment opportunities, build good schools and hospital, build goods roads and markets, and to compensate for other infrastructural deficiencies within the country has been lost to capital flight. A large chunk of capital that is supposed to be used for infrastructural and human development are kept idle in foreign countries. There is diversion of funds away from domestic investments. Against this backdrop, this study is aimed at examining the impact of capital flight on economic development in Nigeria. This paper is divided into five (5) sections as follows: section one is the introduction, section two is literature review and theoretical framework, section three is the methodology, section four is the results and discussions and section five is the conclusion and recommendation(s).

## **Literature Review**

### **Conceptual Literature**

#### **Capital Flight**

There is no agreement among scholars on the actual meaning of capital flight due to some reasons advanced such as the direction of the movement of capital (from developed to developing country or otherwise). Ndikumana and Boyce (2018) defined capital flight as a

phenomenon that originates from corrupt leaders who, take advantage of their privileged positions to build personal fortunes held abroad such as foreign savings that are beyond the reach of local investors and national governments and seeking foreign protection against sociopolitical instability and bad governance, or against deterrent economic measures. It is also defined as the illegal movement of capital across territorial borders either for the fear of uncertainties or seeking investment opportunities.

However, this paper adapted the definition by Kahn and Hague (1987) which defines capital flight as all transactions that include private and public capital outflows from developing countries. This definition considers all private and public capital outflows from developing countries, whether short-term or long-term, equity investments or portfolio could be seen as capital flight. The reason is that developing countries are generally considered to be in capital deficit and should therefore be net borrowers in the development process to supplement domestic savings with external finance.

### **Economic Development**

Economic development, in addition to rise in per capita income, implies fundamental changes in the structure of the economy. Economic development implies a change in the capital structure, institutional framework, as well as infrastructure in order that the majority of the population can achieve a high standard of living at the goal. Development therefore calls for changes in the structure of capital goods, as this is basic for the transformation of primary producing economies, using labor-intensive techniques in general, with large scale unemployment and poverty, to a fully employed and developed economy using the latest capital-intensive methods of production.

### **Theoretical Framework**

#### **Dependency Theory**

The dependency theory is a popular theory within the social sciences to explain economic development of states. The theory developed during the late 1950s and over the following two decades, principally under liberal reformer Raúl Prebisch, director of the United Nations Economic Commission for Latin America (UNECLA), and development economist Hans Singer. There are three main salient issues in the dependency theory. First, the international system is seen as the sum of two sets of states: dominant and dependent. Second, dependency theory holds that external forces are critical in terms of economic activity of dependent states. Third, relationships, based on strongly historical patterns and dynamics (i.e., internationalization of capitalism), between dominant and dependent states are a vibrant process, with exchanges taking place between the states playing a considerable role in the reinforcement of patterns of inequality.

Dependency theory can be seen as a critique based on the following question or problem: Why do some countries become rich while others remain poor? This question is posed against the previously held conception that economic development was beneficial to every country within the international system. Economic prosperity in particular countries, however, often resulted in deep problems in terms of underdevelopment. Dependency theory holds expected outcomes for peripheral countries: (a) economically,

the outcome of development is continued underdevelopment; (b) socially, the outcome is inequality and conflict; (c) politically, the outcome is the reinforcement of authoritarian government. This study is anchored on this theory because of its power in explaining the impediments to development.

### **Empirical Review**

Idirs (2021), studied the impact of capital flight in developing countries using time series data. The autoregressive distributed lag (ARDL) technique was used and it was found that capital flight has a negative and significant impact on economic growth in the long-run period.

Okafor, and Ede (2021) investigated the relationship between kidnapping rate and capital flight in developing countries. Panel data on 67 developing countries was collected. The generalized method of moment (GMM) technique was used. The result shows that kidnapping rate has a positive impact on capital flight.

Orji, Ogbuabor, Kama and Anthony-Orji (2020) examined the impact of capital flight on economic growth in Nigeria using time series data. The autoregressive distributed lag (ARDL) technique was deployed for analysis. The result shows that capital flight significantly decrease economic growth over the years of study.

Gantier and Luc (2020) conducted a comparative study on the effects of capital flight on economic growth in ECCAS, ECOWAS, and SADC. Panel data was used. The pooled mean groups (PMG) regression was deployed and the results show that capital flight has a negative impact on economic growth in the SADC. Conversely, capital flight have positive impacts on the economies of ECCAS and ECOWAS.

Alejo, Aremu, Mathew, Awolabi, Okorie and Osabuohien (2020), investigated the relationship between capital flight and poverty reduction in Nigeria. The dynamic ordinary least square (DOLS) technique was used and the result shows that an increase in poverty level in the country is accompanied by rising capital flight coupled with increasing dependence ratio and decline in economic growth rate over the period of study. Okonkwo, Ojima, and Manasseh (2020) examined the impact of capital flight on economic growth in Nigeria using time series data. The ordinary least square (OLS) and the Error correction mechanism (ECM) were deployed for the analysis. The result shows that capital flight has a negative impact on economic growth in Nigeria over the period of study.

Ayomitunde, Olubunmi, Olaronke and Pereowei (2020), investigated the relationship between capital flight and poverty levels in Nigeria. Using the dynamic ordinary least square (DOLS) technique and granger causality, the study reveal that external debt service payments, exchange rate and openness of the economy have a negative relationship with consumption per capita.

Oriomolode and Olusola (2020) studied the impact of capital flight on the Nigerian economy using time series data. Autoregressive Distributed lag (ARDL) model was used

to estimate the data. The result shows that there is a long-run negative relationship between capital flight and economic growth in Nigeria over the period of study.

Akinwale (2020), examine the impact of capital flight on economic development in Nigeria using time series data. Autoregressive distributed lag (ARDL) technique was used and the results show that there is an inverse relationship between capital flight, real exchange rate and economic development. The implication is that capital flight reduce economic development over the period of study.

Anetor (2019) examine the macroeconomic determinants of flight in Sub-Saharan African (SSA) countries. The panel autoregressive distributed lag (ARDL) model was used for analysis and it was found that economic rate and external debt constitute the macroeconomic fundamentals that influence the rate of capital flight from Sub-Saharan African countries.

Igwemma, Egbulonu, and Assumpta (2018) investigated the impact of capital flight on the Nigerian economy. Secondary data was collected on gross domestic product, capital flight, political instability, amount of looted funds, interest rate differentials, and expenses on foreign medical services, education abroad, and domestic investment. Autoregressive distributed lag (ARDL) technique was used to analyse the data. The result shows that capital flight has a negative impact on economic growth in Nigeria. In a similar study, Bredino, Fiderikumo and Adesuji (2018) investigated the impact of capital flight on economic growth in Nigeria using time series data. The Ordinary least square (OLS) and Error Correction Mechanism (ECM) techniques were used to analyse the data. The result shows that capital flight has adverse impact on the growth of the Nigerian economy.

Lawal, Kazi, Adeoti, Osuma, Akinmulegun and Ilo (2017) examined the impact of capital flight on economic growth in Nigeria. Time series data was collected on current account balance, capital flight, foreign direct investment, foreign reserve, inflation rate, external debt and real gross domestic product. Autoregressive distributed lag (ARDL) model was used to analyse the data. It was found that capital flight has a negative impact on the growth of Nigeria over the period of study.

Clement and Ayodele (2016), did an empirical analysis of the impact of capital flight on the Nigerian economy using secondary data. The ordinary least square (OLS) technique was used and the result shows that capital flight has a positive and significant impact on the Nigerian economy.

Olawale and Ifeodayo (2015), studied the impact of capital flight on economic growth in Nigeria. The ordinary least square (OLS) regression and the Error Correction Mechanism (ECM) techniques were deployed on time series data. It was found that capital flight has a negative impact on the Nigerian economy. Usman and Arene (2014), studied the effects of capital flight and its macroeconomic determinants on agricultural growth in Nigeria. Using the Ordinary least squares (OLS) and the Error Correction Mechanism (ECM) techniques, it was found capital flight has no direct impact on agricultural growth.



Najimdeen, Durrani and Tauhidi (2014), studied human capital flight in Pakistan using time series data. The ordinary least square (OLS) technique was used to analyse the data and it found that workers' foreign remittances positively and significantly affected economic growth in Pakistan. From the literature reviewed, there are good number of researches on the impact of capital flight on economic growth in Nigeria. Less attention is given to the impact of capital flight on economic development. Moreover, to the best of our knowledge, none of the literature have used the VAR model. This study has taking a step to fill these gaps.

## Methodology

### Data

The data for this study were obtained from Central Bank (CBN) statistical bulletin 2020 and World Development Index (WDI). The data is collected from 1980 to 2020. The variables for which data were collected are defined as follows:

**Poverty index (LPOV)** used as the proxy for development is a continues variable

**Capital flight (LCF)** measured using the World Bank residual approach (1985) as follows:

$$KCF = \Delta ED + FDI - CAD - \Delta FR \dots\dots\dots (1)$$

Where:

KCF is capital flight

FDI is Net Foreign Investment Inflows

ED is stock of external Debt

CAD is Current Account Balance

FR is the stock of Foreign Reserves

**Stock of External Debt (LEDB)** is a continues variable

**Exchange Rate (LEXR)** is a continues variable

### Model Specification

This study adapted the linear regression model by Bredino, Fiderikumo and Adesuji (2018). The functional form of the model is specified as follows:

$$LPOV = f(LCF, LEDB, LEXR) \dots\dots\dots(2)$$

The econometric Vector Autoregressive (VAR) model is specified as follows:

$$LPOV_t = \alpha_0 + \sum \alpha_{1i} LPOV_{t-1} + \sum \alpha_{2i} LCF_{t-1} + \sum \alpha_{3i} LEDB_{t-1} + \sum \alpha_{4i} LEXR_{t-1} + \mu_{1i} \dots\dots\dots (3)$$

$$LCF_t = \beta_0 + \sum \beta_{1i} LPOV_{t-1} + \sum \beta_{2i} LCF_{t-1} + \sum \beta_{3i} LEDB_{t-1} + \sum \beta_{4i} LEXR_{t-1} + \mu_{2i} \dots\dots\dots (4)$$

$$LEDB_t = \gamma_0 + \sum \gamma_{1i} LPOV_{t-1} + \sum \gamma_{2i} LCF_{t-1} + \sum \gamma_{3i} LEDB_{t-1} + \sum \gamma_{4i} LEXR_{t-1} + \mu_{3i} \dots\dots\dots (5)$$

$$LEXR_t = \theta_0 + \sum \theta_{1i} LPOV_{t-1} + \sum \theta_{2i} LCF_{t-1} + \sum \theta_{3i} LEDB_{t-1} + \sum \theta_{4i} LEXR_{t-1} + \mu_{4i} \dots\dots\dots (6)$$

Where,

LPOV represents poverty index used as the proxy for development is a continues variable

LCF represents capital flight

LEDB represents external debt

EXR represents exchange rate  
 We expect  $\alpha_1, \alpha_2, \alpha_3,$  and  $\alpha_4 < 0$

**Results and Discussion**

Time series data exhibits trend. Time is deterministic and developed what is called momentum. This momentum is what causes noise in time series. The idea of unit root is to tackle the noise and to determine the behaviour of the data set. This result is summarized in table 1.

**Table 1:** Summary of Unit Root Test Results

Variable	Augmented Dickey Fuller (ADF)		Philip Perron (PP)		Decision
	Level	First Diff.	Level	First Diff.	
LPOV	-2.8734	-9.0090*	-2.7369	-9.1042*	I(1)
LCF	-3.0277	-8.2504*	-3.1521	-8.6161*	I(1)
LEDB	-2.5070	-5.0725*	-2.0486	-5.0471*	I(1)
LEXR	-1.3303	-5.9925*	-1.3575	-5.9905*	I(1)
<b>Critical Values</b>					
1%*	-3.7122	-3.8222	-3.7132	-3.812	
5%**	-3.5266	-3.5298	-3.5266	-3.5298	
10%***	-2.9824	-2.6321	-2.6142	-2.7418	

**Source:** Author's Computation Using EVIEWS 10, 2021

Table 1 shows the summary of the unit root test results. Both the ADF and PP tests show that all the variables became stationary at first difference, that is, they are integrated of order I(1). This implies that there could be long-run relationship among the variables. Thus, there is need to conduct co-integraion test.

Table 2 shows the lag length selection criteria which is needed in the estimation. Base on the results, the Akaike Information Criteria (AIC) which has the lowest value choses lag 2. This implies that lag 2 is the recommended lag.

**Table 2:** Optimal Lag Length Selection

lag	Logl	LR	FPE	AIC	SIC	HQ
0	-44.05	NA	0.0486	5.4903	5.6376	5.5294
1	77.42	80.451*	0.0018	2.2177	2.8068*	2.3740
2	-108.53	15.463	0.0016*	2.0581*	3.0889	2.3316*
3	5.179	10.357	0.0018	2.0683	3.5409	2.4590

**Source:** Author's Computation Using EVIEWS 10, 2021

Table 3 represents the Johansen co-integration results. As demonstrated by the trace statistic and the Max-Eigen statistics, we do not reject the null hypothesis of no co-integration. This implies that even though all the variables are I(1), there is no evidence of long-run relationship. This is because the trace statistic and Max-Eigen statistic are both

less than the 5% critical values. Therefore, the suitable model for estimation is the unrestricted Vector autoregressive (VAR) technique.

**Table 3:** Summary of Johansen Co-integration Test Result

Unrestricted Co-integration Rank Test (Trace)				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None	0.420481	30.81703	40.17493	0.3132
At most 1	0.185212	10.08585	24.27596	0.8480
At most 2	0.051118	2.302389	12.32090	0.9248
At most 3	0.008086	0.308499	4.129906	0.6403

Trace test indicates no co-integration at the 0.05 level

\* denotes rejection of the hypothesis at the 0.05 level

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

Unrestricted Co-integration Rank Test (Maximum Eigenvalue)				
Hypothesized		Max-Eigen	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None	0.420481	20.73117	24.15921	0.1362
At most 1	0.185212	7.783462	17.79730	0.7297
At most 2	0.051118	1.993890	11.22480	0.9236
At most 3	0.008086	0.308499	4.129906	0.6403

\* denotes rejection of the hypothesis at the 0.05 level

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

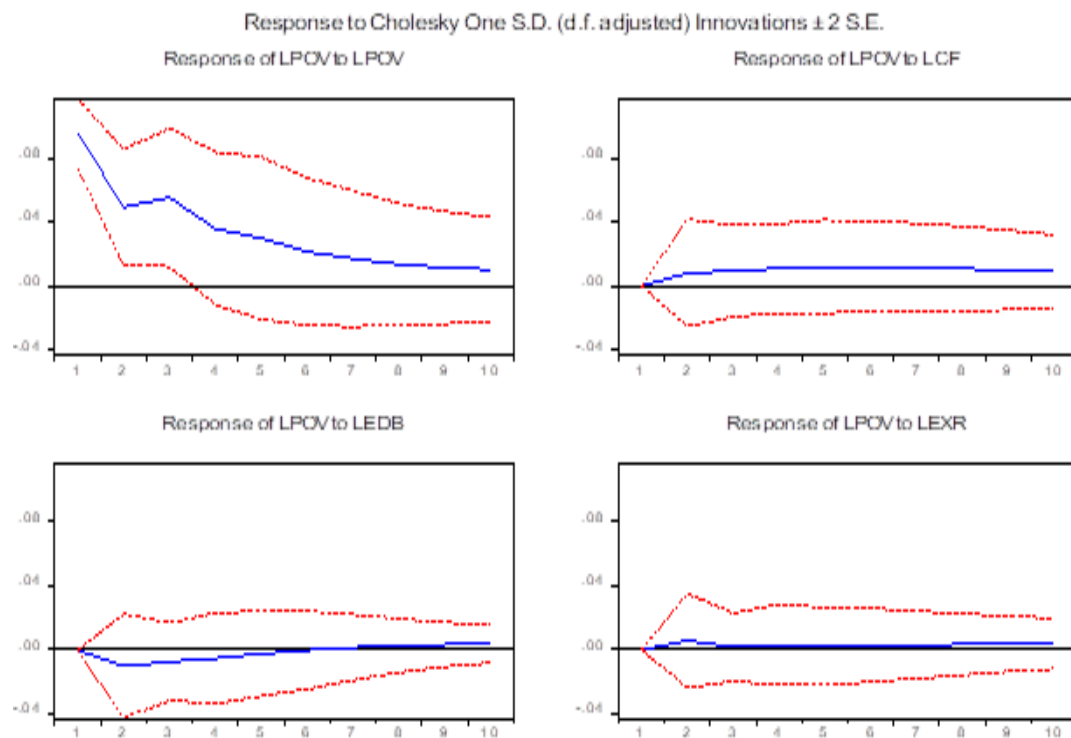
**Source:** Author's Computation Using EViews 10, 2021

Figure 1 presents the dynamic response of LPOV to generalize one standard deviation (SD) shock or innovation of LPOV, LCF, LEDB and LEXR within a horizon of 10 periods. Own shock remains positive with a little drop between horizon 1 and 2, stabilize between horizon 2 and 3, drop steadily from horizon 4 to 10. Meaning that poverty increase steadily and has a long-run positive relationship with its own shock. This is expected because a poor person remains poor unless something is done to reverse his condition. In the same vein, for unit shock(increase)in capital flight, poverty level responds to the shock by rising a little above zero between horizon 1 and 2, remain above zero and positive throughout to period 10. This implies that poverty responds positively to shock in capital flight and has a long-run impact over the period of study. As capital flight increases, poverty level increase, resulting to a decrease in economic development. This is expected because an increase in capital flight is expected to impoverish more people in Nigeria. On the other hand, the response of poverty to a unit shock from external debt shows a little drop from zero and remain negative from horizon 1 to 5, rise a little to zero from horizon 5 to 7, and again rise a little above zero and remain positive through horizon



10. This is also expected because external borrowing puts the economy on the path of depression if the funds are not used for developmental purposes. The rise from negative to positive trend could be attributed to the anti-graft war in Nigeria over the period of study. More so, the response of poverty a unit shock in exchange rate rise a bit above zero and remain steady and positive from horizon 1 to 10. This implies that exchange rate increase in Nigeria has a direct and increasing impact on poverty. This is equally expected in Nigeria because of the floating exchange rate.

**Figure 1:** The Impulse Response Function of the Vector Autoregressive (VAR) Model



**Source:** Author's Computation Using EViews 10, 2021

### Diagnostic Tests of the Model

Diagnostic checks of the VAR model were done to ensure that it is robust and free from problems that may render the obtained results spurious.

Table 4 shows the test for serial correlation or serial independence among the variables in the model. Given that the probability values are greater than 0.05, the null hypothesis of no serial correlation is maintained. Thus, the model is free from serial correlation.

**Table 4:** VAR Residual Serial Correlation LM**Tests**

Included observations: 39

Lag	LRE* stat	df	Prob.	Rao F-stat	df	Prob.
1	17.05207	16	0.3822	1.084339	(16, 70.9)	0.3859
2	9.099474	16	0.9093	0.549057	(16, 70.9)	0.9103

Lag	LRE* stat	df	Prob.	Rao F-stat	df	Prob.
1	17.05207	16	0.3822	1.084339	(16, 70.9)	0.3859
2	28.05104	32	0.6668	0.855935	(32, 71.7)	0.6812

\*Edgeworth expansion corrected likelihood ratio statistic.

**Source:** Author's Computation Using EVIEWS 10, 2021

Table 5 shows the test for heteroskedasticity among the variables in the model. Given that the probability value is not statistically significant, there is absence of heteroskedasticity. Thus, the model is homoskedastic.

**Table 5:** VAR Residual Heteroskedasticity Tests (Levels and Squares)

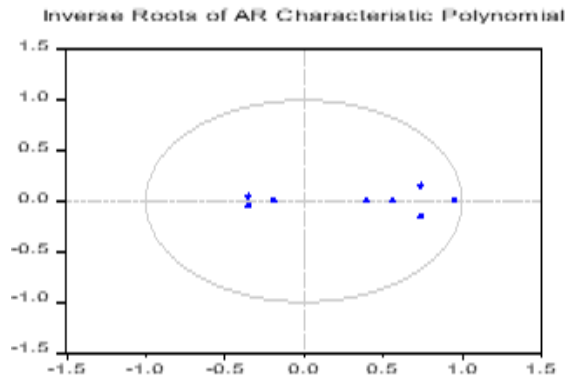
Included observations: 39

Joint test:					
Chi-sq	df	Prob.			
121.7306	160	0.9631			
Individual components:					
Dependent	R-squared	F(16,22)	Prob.	Chi-sq(16)	Prob.
res1*res1	0.251082	0.460982	0.9417	9.792193	0.8773
res2*res2	0.600179	2.064038	0.0575	23.40698	0.1033
res3*res3	0.428008	1.028881	0.4661	16.69232	0.4058
res4*res4	0.279193	0.532583	0.9001	10.88852	0.8163
res2*res1	0.623157	2.273732	0.0373	24.30312	0.0831
res3*res1	0.466699	1.203281	0.3375	18.20126	0.3122
res3*res2	0.549720	1.678655	0.1285	21.43908	0.1622
res4*res1	0.548635	1.671314	0.1305	21.39676	0.1638
res4*res2	0.734842	3.810581	0.0021	28.65882	0.0263
res4*res3	0.282034	0.540133	0.8950	10.99933	0.8095

**Source:** Author's Computation Using EVIEWS 10, 2021

Figure 2 shows the inverse roots of AR polynomial. Thus, the VAR model has satisfied the stability condition because all the Eigen values of the residuals lay within the unit circle. Hence, the model is stable and suitable for policy.

**Figure 2:** Stability Test



**Source:** Author's Computation Using EVIEWS 10, 2021

### **Conclusion and Recommendation(s)**

This paper examined the impact of capital flight on economic development in Nigeria between 1980 to 2020. A good number of literatures were reviewed in order to have an insight and to contribute in the ongoing debate in the area. This paper finds the following: Poverty is an increasing function of poverty. There is a long-run negative impact of capital flight on economic development in Nigeria over the period of study. External debt is detrimental to economic development if mismanaged. Floating exchange rate where multiple rates are charged in different markets is detrimental to economic development in Nigeria over the period of study. All these findings are in tandem with the findings of Alejo, Aremu, Mathew, Awolabi, Okorie and Osabuohien (2020); Akinwale (2020).

Based on these findings, this paper recommended that training and skill acquisition should be encouraged in Nigeria in order to alleviate poverty. Capital flight should be checked with serious penalties on the perpetrators. In addition, external debt should be channel to economic uses. And finally, multiple exchange rate regimes should be abolished in Nigeria.

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