Impact of Foreign Sector Aggregates on Poverty Reduction in Nigeria

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Abstract

The study analysed the effect of foreign sector aggregates on poverty reduction in Nigeria between the period of 1987 and 2022. Annual times series data on poverty headcount (POV), exchange rate (EXR), foreign direct investment inflows (FDI), official development assistance received (ODA), and external debt (XDT) were subjected to Augmented Dickey-Fuller (ADF) Unit Root test, auto-regressive distributive lag (ARDL) estimation and diagnostic tests. The result of the study indicated that at 5 percent level, EXR, FDI, ODA, and XDT significantly influenced the level of poverty in Nigeria in the short run. Further, EXR, FDI, and XDT significantly reduced poverty in Nigeria in the long run. On the other hand, there was no statistical evidence that ODA significantly influenced poverty level in the long run. The result of the diagnostic test showed that the model had structural stability and was free from the problems of serial correlation, heteroscedasticity, and misspecification error. However, the study suggested that government and policymakers in Nigeria should strategize and enact guidelines that will correct the positive effect foreign direct investment and external debt have on the level of poverty in the short term.

Keywords: Poverty reduction, External sector, Nigerian economy, ARDL

1.   Introduction

Nigeria continues to be among the world's poorest nations, even though the government has received significant income from the export of petroleum resources for more than 50 years. Indeed, the country's social infrastructure is in disrepair and Nigerians are now poorer (Ochalibe, Awoderu, & Onyia, 2017). Macroeconomic analysts and policymakers have expressed alarm about Nigeria's growing poverty rate. Poor and inconsistent macroeconomic policies, a lack of diversification of the productive base, significant economic mismanagement, weak inter-sectoral linkages, the continued existence of structural bottlenecks in the economy, high reliance on imports, and a heavy reliance on crude oil exports are some of the factors that have been blamed for the latter. Among these include low levels of human capital development, a lack of health and sanitation facilities, unemployment, the poor's inability to access assets like land and capital, and poor roads and communication networks that prevent them from accessing markets. Nigerian poverty is widespread as a result of both material and non-material deprivation (Omojimite & Oriavwote, 2012). Poverty rates rose from 27.2% in 1980 to 46.3% in 1985, then to 65.6% in 1996 before skyrocketing to 69% in 2010 and 72.0 in 2012 (CBN, 2013). Furthermore, the characteristics of

poverty in Nigeria also demonstrate that, while not as severe as poverty in rural regions, poverty in urban areas is more severe. According to NBS (2010), rural poverty climbed from 28.3% in 1980 to 73.2% in 2010, whereas urban poverty increased from 17.2% in 1980 to 73.2% in 2010.

Experts have highlighted several ways to tackle the looming problem in Nigeria; according to the United Nations Conference on Trade and Development (UNCTAD, 2012) report, foreign direct investment can promote positive economic development and growth, it can help lower poverty in emerging and developing nations. UNDP (2005) cited by N'dri (2017) added that international aid is still one of the most effective tools in the fight against poverty. Bakare (2011) argues that foreign aid and grants increases the capital available for investment and growth which are needed to reduce poverty and raise living standards. He further stressed that it can provide resources for enhanced efficiency of resource use, employment generation and increased citizen participation in development programmes. Further, external debts used to augment domestic savings have been viewed traditionally as a promoter of economic advancement thus reducing poverty (Joshua, Adedoyin & Sarkodie, 2020). These views suggest that the external sector may have an enormous role to play in the fight against poverty. Regrettably, not much literature exist that evaluates the importance of the external sector in reducing poverty thus, it became important to investigate the effect of external sector on poverty reduction in Nigeria. Specifically, the study's aim was to determine the effect of exchange rate, foreign direct investment inflows, official development assistance received, and external debt on poverty head count from 1987 to 2022.

2 Literature Review

2.1 Theoretical Framework

Dependency Theory

Researchers in Latin America first established the dependency theory in the 1950s (Ferraro, 2008) as a theoretical foundation and explanation for the region's lack of economic progress and the domination of wealthy nations and other third-world countries. Precisely, Prebisch (1950) proposed the dependency theory, which holds that the underdevelopment of developing economies is caused by economic activity in rich nations. As asserted by modernization theorists, the thesis argued that the globalization promoted by rich economies does not always translate into economic prosperity in underdeveloped nations. According to the argument, countries should look inside themselves for solutions by making effective use of their own resources rather than going outside, which typically makes economic issues worse. Khobai *et al*. (2017) cited by Joshua *et al* (2017) looked into the dependency hypothesis for Ghana and Nigeria empirically. The results showed that trade liberalization hurts Nigeria.

Despite the lack of endorsement from Western classical economic researchers, the theory has been successfully used to explain the interdependent links between industrialized and developing nations. Agbedi and Virtanen (2017) tried to explain the interdependent relationship between China and African nations through the lens of dependency theory in a recent study and came to the conclusion that the theory is appropriate and helpful in describing some aspects of the relationship. Nevertheless, the authors (Agbedi and Virtanen, 2017) contend that other economic

theories need to be applied to explain the complexities of such a relationship. Similarly, Balcilar, Kutan, and Yaya (2017) tested and established the existence of dependency theory in trade relationships between Greece and Turkey as patrons, on one hand, and Republic of Cyprus and Turkish Republic of Northern Cyprus as peripheries, on the other. However, Agbedi and Virtanen (2017) argued that other economic theories must be used to explain the intricacies of such a relationship. Similarly, Balcilar *et al.* (2017) investigated and proved the validity of dependency theory in the context of trade ties between the Republic of Cyprus and Turkish Republic of Northern Cyprus as peripheries and Greece and Turkey as patrons.

2.2.   Empirical Review

Omojimite and Oriavwote (2012) investigated the influence of the real exchange rate on poverty within the framework of a dependent economy model. Using data covering 1980 to 2010, the result of a Vector Error Correction model (VECM) showed that the volatility of the real exchange rate had significant influence on the level of poverty in Nigeria. Thus, government policies that targets real exchange rate could play significant role in reducing the level of poverty in Nigeria, particularly if supported by basic institutions, such as those of human capital development.

Tsaurai (2018) evaluated the impact of foreign direct investment on poverty reduction efforts in Africa using panel data analysis (fixed effects, random effects, pooled ordinary least squares, dynamic generalised methods of moments) with data spanning from 2002 to 2012. Three measures of poverty were used in the current study, namely life expectancy at birth, total (years), household consumption expenditure as a ratio of gross national product and mortality rate and infant (per 1 000 live births). Generally, all the four panel data analysis methods produced similar finding: the interaction between FDI and natural resources reduced poverty levels in African countries studied. Southern and Western African nations are therefore urged to implement FDI enhancement policies which attract foreign investors into the natural resources extraction sector if they want to sustainably reduce poverty. Future studies should investigate other macroeconomic factors that must be available in the host country before FDI reduce poverty in all its forms.

N''dri (2017) studied the effect of Official Development Assistance (ODA) on Poverty in the Economic Community of West African States (ECOWAS). The transmission channel extends from ODA to Poverty alleviation through economic growth. Using panel data from 1980 to 2014 and a four-equation simultaneous model, the results show that ODA contributes to reducing poverty, measured by the infant mortality rate. However, its effect on economic growth was found to be harmful. Therefore, was concluded that ODA is pro-poor, but not growth enhancing in West African countries. A policy implication of this study is that ECOWAS member countries should adopt strategies and policies in order to use the foreign aid to achieve both objectives, which consist of promoting economic growth and reducing poverty.

Ewubare and Okpoi (2018) evaluated the impact of international remittances on poverty reduction in Nigeria. Using time series data on poverty incidence, inward and outward remittances, ODA and technical cooperation grants in Nigeria and applying the ARDL method in analyzing the data, the result indicated that: inward and outward remittances had diverse effects on poverty reduction

in Nigeria in the short run. Also in the short run, inward remittances impact was significant while outward remittance was not. ODA and technical cooperation grants also had conflicting effects on poverty in the short run. In the long run, inward remittances intensified poverty while outward remittances, ODA and technical cooperation grants all reduced poverty incidence in Nigeria given their negative coefficients. All the explanatory variables were insignificant in the long run. Based on this result, the study recommended for investment in foreign countries in order to diversify the income source of the economy, create conducive atmosphere for inflow of grants and reduce bottlenecks that hinder inflows of foreign funds as possible ways of reducing poverty in Nigeria.

Nanfa, Ajang, Timnan, Azi, Diemsan, Magit, and Salami (2023) examined the effect of public debt on poverty reduction in Nigeria; assessed the effect of external, domestic, and debt servicing in Nigeria. Secondary time series data spanning the period of Twenty-one years (2000– 2021) was gathered in the study. The data used in the study was estimated using descriptive statistics, correlational matrix, and Error Correction Mechanism (ECM). Discoveries from the result revealed that external debt exerts a positive and significant effect on poverty alleviation in Nigeria, while domestic debt and debt servicing had an inverse and significant relationship with poverty reduction in Nigeria as well. The empirical evidence reveals that there is a co-integration between public debt and poverty alleviation in Nigeria. Based on these findings, the paper recommends that; to achieve a significant reduction in poverty in Nigeria, the government should examine and review current policies and incentives of external borrowing in Nigeria and the current administration needs to mobilize domestic savings efforts to tackle the nuisance of poverty in Nigeria.

3.   Methodology

3.1.   Data and Sources

The data for this study were sourced from the World Bank's World Development Indicators (WDI. The data covered the period 1987 to 2022. The study adopted Hemmer and Phuong Hoa (2002) approach, but with some adjustment. This study differs from Hemmer and Phuong Hoa (2002) in the area of variables, types of data, and place. To measure poverty, this study followed Hemmer and Phuong Hoa (2002) by using the headcount index, which measures the percentage of the population living on less than US$ 1.90 per day at 2011 PPP term.

3.2.   Model Specification
In capturing the effect foreign sector aggregates on poverty reduction in Nigeria, the study adopts the Autoregressive Distributed Lags (ARDL) method.
The functional form of the model is:
POV = (EXR, FDI, ODA, XDT)   (1)
Stated in linear form gives;
$POV = a_0 + a_1 EXR + a_2 FDI + a_3 ODA + a_4 XDT + \mu$
(2)
A priori expectations: $a_1 > 0$, $a_2 < 0$, $a_3 < 0$, $a_4 < 0$
Formulating the Autoregressive Distributed Lag (ARDL) long-run model gives;

$\Delta(\text{POV})t = a_\circ + a_1(\text{POV})t + a_2(\text{EXR})t + a_3(\text{FDI})t + a_4(\text{ODA}) + a_5(\text{XDT}) + \sum_{i=1}^{n}\Delta a_1(\text{POV})_{t-1} + \sum_{i=1}^{n}\Delta a_2(\text{EXR})_{t-1} + \sum_{i=1}^{n}\Delta a_3(\text{FDI})_{t-1} + \sum_{i=1}^{n}\Delta a_4(\text{ODA})_{t-1} + \sum_{i=1}^{n}\Delta a_5(\text{XDT})_{t-1} + \mu_{1t}$ (3)

The short-run Error Correction Model derived from the ARDL model would be;

$\Delta(\text{POV})t = \lambda_\circ + \lambda_1(\text{POV})t + \lambda_2(\text{EXR})t + \lambda_3(\text{FDI})t + \lambda_4(\text{ODA})t + \lambda_5(\text{XDT})t + \sum_{i=1}^{n}\Delta\lambda_1(\text{POV})_{t-1} + \sum_{i=1}^{n}\Delta\lambda_2(\text{EXR})_{t-1} + \sum_{i=1}^{n}\Delta\lambda_3(\text{FDI})_{t-1} + \sum_{i=1}^{n}\Delta\lambda_4(\text{ODA})_{t-1} + \sum_{i=1}^{n}\Delta\lambda_5(\text{XDT})_{t-1} + \Pi ECM + \mu_{2t}$ (4)

Where;
POV = Poverty headcount
EXR = Exchange rate
FDI = Foreign direct investment inflows
ODA = Official development assistance received
XDT = External debt
$a_0 = Respective\ intercept\ of\ the\ models$
$a_1 - a_4 = Slopes\ of\ the\ models\ respectively$ and or
$a_1 - a_5 = Long-run\ dynamic\ coefficients.$
$\lambda_1 - \lambda_5 = Short-run\ dynamic\ coefficients.$
$\mu_{1t} - \mu_{2t} = Disturbance\ or\ error\ term$
$\Delta = First\ difference\ operator.$
$n = Maximum\ lag\ lenght.$
$\Pi = Error\ correction\ coefficient.$
ECM = $Error\ correction\ term\ with\ one\ period\ lag.$
$f = Functional\ Notaton$

4.1. Unit Root Test

The result of the unit root test utilizing the Augmented Dickey Fuller (ADF) method is presented Table 1.

Table 1: Result of the Test of Unit Root

Variable	ADF Test Stat.	5% Critical Value	P-value	Order of Integration	Test Option	Remark
POV	-7.182710	-3.548490	0.0000	I(1)	Trend & Intercept	Integrated of order 1
EXR	-4.535098	-3.548490	0.0050	I(1)	Trend & Intercept	Integrated of order 1
FDI	-3.621633	-2.948404	0.0103	I(0)	Intercept	Integrated of order 0
ODA	-4.224781	-3.548490	0.0107	I(0)	Trend & Intercept	Integrated of order 0

					Trend &	Integrated of order
XDT	-4.492636	-3.548490	0.0055	I(1)	Intercept	1

Source: Author's computation from Eviews software, 2024

Table 1 shows that FDI and ODA were integrated of order zero, that is, they were stationary at level. This is because, at 5 percent significance level, the ADF test statistic value of FDI and ODA of -3.621633 and -4.224781 respectively are more negative than their respective critical values of -2.948404 and -3.548490. All other variables (POV, EXR, XDT) were not stationary at level. However, after taking the first difference the series became stationary, indicating they were integrated of order one I(1). The outcome of the unit root test shows that the model of the study is comprised of variables with mixed order of integration, thus given credence to the use of ARDL method of estimation.

4.2.   Cointegration Test
The ARDL bounds cointegration test was conducted at 5 percent level of significance and the result is presented in Table 2.

Table 2: Result of Bounds Cointegration Test

Test Statistic	Value	Signif.	I(0)	I(1)	Decision
F-statistic	4.747531	10%	2.2	3.09	
K	4	5%	2.56	3.49	Cointegrated
		2.50%	2.88	3.87	
		1%	3.29	4.37	

Note: K denotes number of explanatory variables
Source: Author's computation from Eviews software, 2024

The result of the bounds test for cointegration shown in Table 2., indicates that the F-statistic (4.747531) for the test equation is greater than the upper-bound critical value (3.49) at the 5 percent level of significance. This result implies that long run relationship exists between POV and the independent variables.

4.3.   Model Estimation
This study relied on the ARDL method for estimating the models. The result is presented in Table 3.

Table 3: Estimated Short Run and Long Run Coefficients

Dependent Variable: POV

Short run results				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(POV(-1))	-0.313821	0.143982	-2.179591	0.0543
D(POV(-2))	-0.388298	0.155551	-2.496275	0.0316
D(EXR)	-0.089978	0.045339	-1.984562	0.0753
D(EXR(-1))	0.138497	0.056418	2.454849	0.0340
D(EXR(-2))	0.096282	0.048861	1.970530	0.0771
D(EXR(-3))	-0.087959	0.034361	-2.559855	0.0284
D(FDI)	0.809857	0.904729	0.895137	0.3918
D(FDI(-1))	6.260198	1.428658	4.381873	0.0014
D(FDI(-2))	2.318189	0.860601	2.693685	0.0226
D(ODA)	-1.385367	0.663025	-2.089463	0.0632
D(ODA(-1))	-1.818182	0.581827	-3.124953	0.0108
D(ODA(-2))	-1.573568	0.626812	-2.510430	0.0309
D(XDT)	-0.081214	0.084788	-0.957845	0.3607
D(XDT(-1))	-0.167412	0.119009	-1.406719	0.1898
D(XDT(-2))	0.038855	0.111220	0.349355	0.7341
D(XDT(-3))	0.532465	0.099974	5.326049	0.0003
CointEq(-1)*	-1.012950	0.156846	-6.458258	0.0001
Long run results				
EXR	-0.054996	0.014618	-3.762163	0.0037
FDI	-6.886630	1.920035	-3.586720	0.0050
ODA	0.348728	1.754165	0.198800	0.8464
XDT	-0.177740	0.058564	-3.034955	0.0126
R-squared	0.827773			
Adjusted R-squared	0.644065			
Durbin-Watson stat	2.003786			

Source: Author's computation from Eviews software, 2024

The short run result in Table 3 indicates that in the current period, EXR did not exert any significant influence on POV at 5 percent level. The second lag period of the short run also witnessed a case of lack of significant influence on POV. However, EXR showed evidence of significant effect on POV in the previous year and three years back. This was due to the fact that the associated probability values in the first and third lag periods of 0.0340 and 0.0284 are greater than 0.05. The coefficient of 0.138497 for the first lag period would suggest that for every 1 unit rise in EXR, POV will increase by 0.138497 unit. This result shows that past changes in exchange rate have influence on the level of poverty in Nigeria. In the long run, EXR showed evidence of significant

negative effect on POV as the probability value (0.0037) associated with the coefficient of -0.054996 is less than 0.05.

The current period of the short run shows that FDI did not significantly determine changes in POV under the evaluation period at 5 percent level. However, in the first and second lags, the Nigerian economy witnessed a significant positive impact of FDI on POV. This was on the basis that, their corresponding probability values of 0.0014 and 0.0226 are less than 0.05. The coefficient of FDI in these lagged periods were 6.260198 and 2.318189 respectively. This suggests that for every 1 unit increase in FDI in the first and second lag periods, POV will rise by 6.260198 unit and 2.318189 unit respectively. The long run result also witnessed a significant impact of FDI on POV at 5 percent level even though the effect was negative. Further, in the short run, the lagged values of ODA and EXT significantly influenced poverty level in Nigeria under the study period. The result in Table 3 infers that past changes in Nigeria external sector significantly influence current changes in the level of POV. In the long run, while XDT had evidence of significant negative impact on POV, ODA failed to exert any long run effect on POV at 5 percent level of significance.

The coefficient (-1.012950) of the error correction term, denoted as CointEq(-1) is negative and significant at 5 percent level. This coefficient indicates that a deviation from the long-run equilibrium as a result of a short-run shock is adjusted at a speed of approximately 101 percent each year. Further, the value (0.644065) of the adjusted R-squared is indicative of the fitness of the model in explaining the relationships; showing that approximately 66.41 percent of the variations in POV performance is explained by the independent variables engaged in the estimated model. The Durbin–Watson statistic of 2.003786 is within its threshold of two (2) and would imply that the model is free from spurious regression and serial correlation problems.

4.4. Post-estimation Tests

4.5.1. Serial Correlation LM test, Heteroskedasticity Test, and Ramsey RESET
Table 4 presents the Serial Correlation LM test, Heteroskedasticity Test, and Ramsey RESET test results.

Table 4: Result of Serial Correlation LM Test, Heteroskedasticity, and Ramsey RESET Test

Breusch-Godfrey serial correlation LM test	F-statistic	0.264935	Prob. F(2,8)	0.7737
	Obs*R-squared	1.987818	Prob. Chi-Square(2)	0.3701
Breusch-Pagan-Godfrey Heteroskedasticity	F-statistic	0.922437	Prob. F(21,10)	0.5838
	Obs*R-squared	21.10496	Prob. Chi-Square(21)	0.4526
Ramsey RESET	t-statistic	0.946535	Prob. Value	0.3686

| F-statistic | 0.895929 | Prob. Value | 0.3686 |

Source: Author's computation from Eviews software, 2024

Table 4 shows that under Breusch-Godfrey serial correlation LM test, the probability value of the Obs*R-squared is greater than 0.05, depicting that the model is free from the problem of serial correlation. The findings from the Heteroskedasticity test show that the probability value (0.4526) of Obs*R-squared for the employed model surpasses 0.05. Consequently, this implies the absence of heteroscedasticity issue in the employed model. In reference to the result of the Ramsey RESET test provided in Table 4, the probability value linked to the F-statistic of 0.3686 in the employed model for this study surpasses 0.05 and as such, it indicates that the model is free from misspecification errors.

4.5.2.   The Cumulative Sum Recursive Plot

The result of the CUSUM which provides clear evidence of the models' stability is presented in Figure 1.
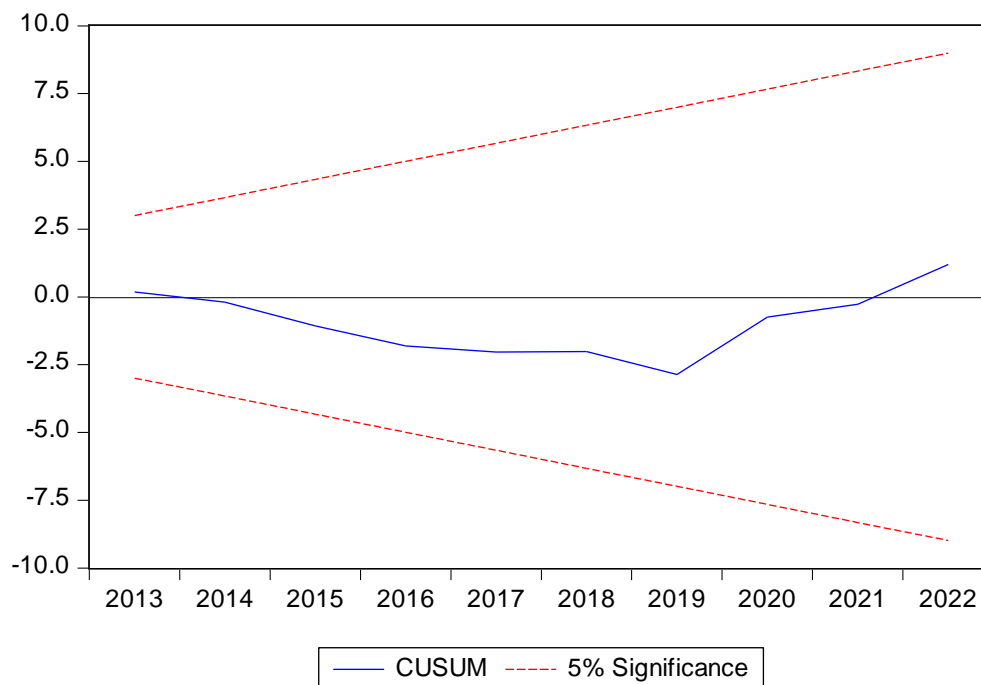

Figure 1: The Cumulative Sum Recursive Plot
Source: Authors estimation, 2024

The result from Figure 1 demonstrates that the plots of CUSUM lie within the critical bounds of 5 percent. This suggests that the model does not suffer from structural instability over the study period.

4.6.   Discussion of Findings

The result of the study shows that EXR had mixed short run effect on POV such that in the first lag period it had a positive relationship and in the third lag period the relationship was negative. This mixed effect can be attributed to the instability of Nigeria's exchange rate. Omojimite and Oriavwote (2012) rightly noted that, the degree of poverty in Nigeria is significantly impacted by fluctuations in exchange rate. The result will suggest that government policies that focus on real exchange could be very effective in reducing or increasing Nigeria's poverty rate. In the long run, the result showed that EXR led to a reduction in POV in Nigeria. This suggests that EXR can be used as an economic tool in taming the growth in the level poverty in Nigeria especially as it affects household per capita consumption expenditure.

Further, the result showed that, FDI in the previous one year and previous two year, had a significant positive impact on POV. This result is surprising as FDI is expected to reduce POV. This finding differs from the a priori expectations. This result suggests that FDI worsens poverty level in Nigeria in the short run. However, in the long run, this inappropriate sign was corrected such that growth in FDI significantly reduced the level of poverty. This result suggests that changes in FDI have significant long-term impact on poverty reduction in Nigeria. This finding is in accordance with theoretical expectations. This result collaborates with the findings of Tsaurai (2018). The result of the impact of ODA on POV indicates that, in the short run, although, in the current period, ODA had an inverse relationship with POV, it was not statistically significant. This result suggests that the level of ODA in the current period is too small to influence the reduction of poverty in Nigeria. However, the result showed that the previous values (lagged values) of ODA significantly influenced reduction in poverty. This result conforms to the a priori expectations and agrees with the work of N'dri (2017).

Furthermore, the result showed that the value of XDT three years ago had a significant positive impact on POV. Which suggests that increase in XDT cumulates to increase in POV. A possible explanation to this result is that external borrowing has not been channelled to highly productive activities that would increase the overall output and stimulate employment which can ultimately reduce poverty. This result agrees with the findings of Nanfa *et al.* (2023) who observed that increase in external debts worsened poverty rate in the short run. However, adjustment was made towards the long run as XDT was found to significantly reduce the level of POV in Nigeria. This could be attributed to the monitoring and provision of strong policy advice by major international financial agencies targeted at improving debt transparency and accountability as well as adhering to international standards and best practices.

5. Conclusion and Recommendations

5.1. Conclusion

The study investigated the effect of external sector on poverty reduction in Nigeria from 1987 to 2022. Using the ARDL estimation method, the study achieved substantial empirical findings which enables it to make the following conclusion that; the past values of Nigeria foreign sector aggregate's variables comprising of exchange rate, foreign direct investment inflows, official development assistance received, and external debt are instrumental in influencing the level of poverty in the economy. Furthermore, exchange rate has mixed effect on poverty rate in the short run, however, in the long run it significantly alleviates poverty. Foreign direct investment and external debt on the other hand, increase the level of poverty in the short run but in the long run, they decrease poverty rate in Nigeria. The study also asserts that official development assistance to Nigeria has no long-term effect on poverty, but in the short term it significantly reduce poverty rate in Nigeria.

5.2 Recommendations

Recommendations are made based on the conclusions drawn by this study that:

i. Government and policymakers in Nigeria should strategize and enact guidelines that will correct the positive effect foreign direct investment and external debt have on the level of poverty in the short term.

ii. Nigeria should search for more official development assistance to support sectors like manufacturing and infrastructure that can lead to the alleviation of poverty.

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