

# Effect of Illegal Financial Movements on Economic Growth in Nigeria

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## Abstract

*The study seeks to examine illicit financial flow and economic growth in Nigeria. Both the exploratory and ex-post facto designs were adopted in this study. The study population consist of 14 (2008 – 2021) years period given the number of years the data was collected. Using a consensus sampling method, the 12 years are used as sample size. The study used the ordinary least square regression technique, specifically the Vector Autoregressive model for testing the hypotheses stated. The first findings revealed that, illicit financial flow from corruption has a positive insignificant effect on change gross domestic product of Nigeria. While, the second hypotheses tested revealed that, illicit financial flow from illegal-commercial activities has a negative insignificant effect on change gross domestic product of Nigeria. As a result, it is recommended that, Nigerian government should put forward policies that discourage corruption. This can be done through ensuring financial transparency in the public sector via Treasury Single Account and Integrated Personnel Payroll Information System implementation. The government through the recent financial intelligence Act should ensure that funds from illegal business activities are curbed and the proceeds collected from such acts be invested back into the Nigerian economy to burst production and GDP.*

**Keywords:** *Illicit financial flows, Economic Development, Illegal Commercial Activities, Multinational Corporation*

## 1.1 Introduction

Nigeria as a nation is endowed with one of the most valuable and widely demanded liquid natural resources, the black gold (crude oil). The exploration, drilling and production have been on for decades and because of high tech requirements of the oil sector, activities in this sector are dominated by Multinational Corporations owned by developed. Through the exportation and production of crude oil, Nigeria has earned hard currencies via foreign exchange earnings amounting to trillions of dollars in the past five decades. It should be recalled that as reported by Asagunla (2018), in the past fifty years, the country's oil subsector has grown phenomenally. Both production and exports have increased a great deal since commercial production in 1958. Take for instance, oil revenue in Nigeria fluctuated and peaked at roughly 40.7 billion U.S. dollars in 2013. In 2019, Nigeria earned \$34.22 billion from oil and gas according to Nigeria Extractive Industries Transparency Initiative (NEITI). Nigeria Extractive Industries Transparency Initiative (NEITI) (2021), reported that Nigeria's crude oil earnings hit N 12.4 trillion in 2021.

Despite the huge amount that has been generated over the decades, the country still remains poor in almost all ramifications. Every sector is relatively sick ranging from education,

electricity, manufacturing, agriculture, no security, poor to worn out medical equipment and facilities.

Corruption, fraud and other related crimes are responsible for mismanagement and misappropriation of the huge fund generated as has been widely reported by organizations and researchers. Transparency International (2019) revealed that Joint Task Force (JTF) comprising personnel from the Nigerian Army, Air Force, Navy and Police, has been deployed in the Niger Delta region since the early 2000s. The JTF is tasked with tackling the militant threat in the region and protecting its oil from theft. However, there have been indications that some JTF members are complicit in, and often benefit from, precisely the pursuit they are mandated to eradicate: the illicit oil industry. Existing research suggests that members of the Nigerian armed forces have enabled and benefitted from the illegal trade in a number of ways. Often this benefit

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However, there is another mysterious means through which Nigeria loses huge resources financially and otherwise that appears not popular among average Nigerians. It is through what is referred to as capital flight perpetrated by developed countries through their Multinational Corporations (MNCs). The impact of this is enormous. Capital flight is aided and abated by Nigeria corruption politician and foreigners who have the monopoly of the technology to tap these natural resources. The MNCs carry out these acts via tax evasion, tax avoidance, transfer pricing and involvement in banking secrecy. It appears that corruption and fraud among the political class have distracted attention from capital flight to the extent that majority of Nigerians, even among the scholars report less on the dangers it portends to the nation.

The High-Level-Level Panel and Global Financial Integrity (GFI) in their study divided IFFs into three categories based on the source of the flow and that is captured in a study by Service Centre for Development Cooperation (2010) as follows: a. Corruption: This was the focus of a wide-range of talk during the 1990s, which accounts only for 3-5% of all these money/illicit outflows. b. International Crime: This includes drug and human trafficking, money laundering et cetera which accounts for about 30%.c. Illegal commercial capital flight

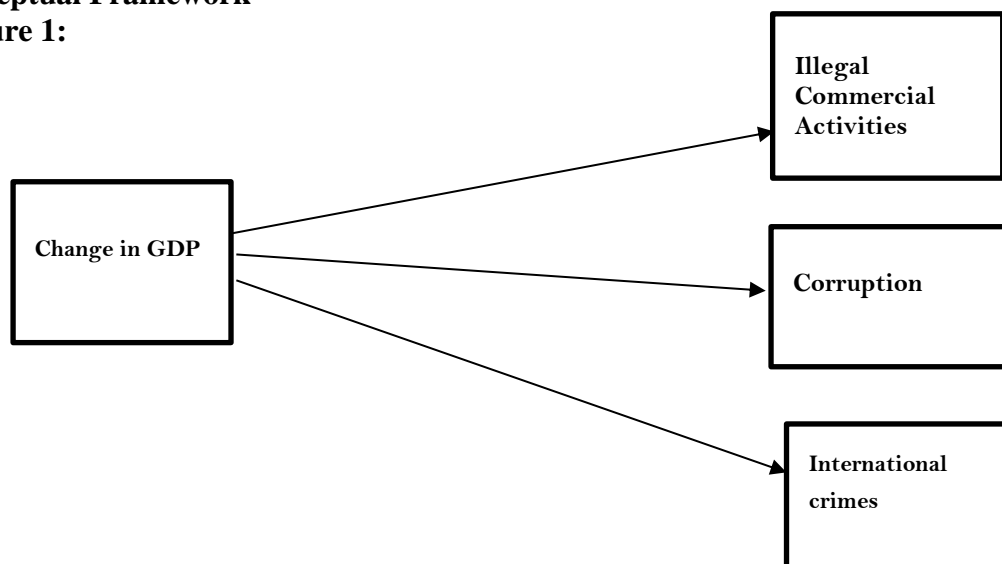
via tax evasion by multinational companies is clearly of greatest significance. This accounts for about 64% of capital flight repatriation/illicit outflows. The financial figures that would be derived as the worth of illicit financial flows/capital flight for a period of the study would be divided according to the subdivision of illicit financial flows percentage wise. That is, illegal commercial activities 64%; International Crime 30%; Corruption 3% - 5% (average 4%).

Therefore, this study would be critically examining the effect of illicit financial movements on economic growth in Nigeria, putting into consideration the three basic subdivisions of illicit financial flows; that is, illicit financial flows via corruption, international crime and illegal commercial activities thus filling a gap created in prior studies that have not looked into the effect of independent variables in this case illicit financial flows via corruption, international crime and illegal commercial activities and dependent variable in this case Change in Economic Growth. It is based on the classification of illicit financial flows by Global Financial Integrity (2007) in Service Centre for Development Cooperation (2010) that this study aims to ascertain the effect of illicit financial flows via illegal commercial activities, corruption and international crime on economic growth in Nigeria.

## Literature Review

### Conceptual Framework

Figure 1:



### Illicit Financial movement

Illicit outflows can be seen as illicit wealth that is earned, transferred or used in contravention of a country's laws. It can be referred to as wealth whose origin is connected with illegal activity, such as corruption, the illicit manufacture of goods, other varying forms of crime; it includes concealing a company's wealth from a country's tax authorities. The definition is used here of illicit or illegal financial flows (or illegal capital flight) comes from the Global Financial Integrity studies, whose figures have been used by many different development policy organisations, including the World Bank. In practice, the majority of unrecorded financial flows break the laws of one country or another, which is why it is reasonable to speak of illegal capital flight.

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Crime: This includes drug and human trafficking; money laundering et cetera which accounts for about 30%.c. Illegal commercial capital flight via tax evasion by multinational companies is clearly of greatest significance. This accounts for about 64% of capital flight repatriation/illicit outflows. Illegal commercial means that funds are transferred from a company to subsidiaries sited in a number of tax havens at exceedingly high or low prices. By investments in tax haven companies, the investors can conceal their true identity. For example, allowing them to enjoy the benefit from special treatment targeted to overseas investors. A similar process can be used for laundering money. For example, in the case of China it is estimated that as much as a quarter of capital illegally taken out of the country returns as foreign investments. China is famous as a country of origin of huge illicit financial flows. It is estimated that up to €80 billion of taxable income evaporates from China each year. Some multinational companies engaging in illegal capital flight are situated and do business in emerging economies. Unfortunately, about 80–90% of illegally taken capital leaves developing countries permanently through these MNCs that claim they attract development.

Also when foreign investors make extensive use of offshore companies, shell companies, and tax havens, they weaken disclosure standards and undermine the efforts of reformers in Africa to promote transparency. Such practices also facilitate tax evasion and, in some countries, corruption, draining Africa of revenues that should be deployed to fight poverty and vulnerability” (Kofi Annan African Progress Report, 2013). MNCs are very selfish in their business dealings in developing nations such as Nigeria, taking a look at these developments. Some foreign companies operating in Nigeria are the conduit pipes for this act. Some of these foreign investors do business in those areas that require huge capital outlay and are also technology-driven. Take for instance; reported that the Airline Operators of Nigeria has called on the Federal Government to support domestic carriers, saying that foreign airlines had dominated the country’s airspace resulting in about \$3bn capital flight, annually.

Paul *et al.* (2015) noted that the high value of world-wide estimate of capital flight of \$539 billion to \$829 billion every year is worrisome and incapacitates development intentions of the developing countries. The capital flight in countries represents a significant proportion of their gross domestic product (GDP). For instance, South Africa lost 9.2% of her GDP (US \$ 13 billion) in 2000, China 10.2% of GDP (US \$ 109 billion) in 1999; Chile 6.1% of GDP (US 4.7%) in 1998 and Indonesia 6.7% of GDP (US \$14 billion) in 1997. In addition, between 1990 and 1995, Russia is estimated to have lost about \$400 billion. Nigeria and other sub-Saharan African countries are estimated to have lost over 100% of their GDP (\$230 billion) since 1970. It is inimical to the economic growth of Nigeria that such resources are lost to even richer and developed nations via capital/illicit flows.

### **Channels for Illicit Financial movements in Nigeria**

They include tax haven practices by MNCs, tax evasion and avoidance, corruption, organized crime, fraud in international trade through mis-invoicing, illegal exploitation of natural resources and diversion of public fund from priorities. Other forms through which illicit outflows occur include illegal logging, fishing and mineral extraction.

The consequence of these is the impoverishment of the citizenry and country at large.

## Consequences of Illicit Financial Flows (IFF)

They include political and economic security challenges around the world especially in developing countries. Poverty, economic retardation, poor standard of living and general underdevelopment in all ramifications have become the norm in developing world. IFFs reduce domestic resources and tax revenue needed to fund poverty reducing programmes and infrastructure in developing countries. It goes further to erode resources thereby constraining poverty reduction and shared prosperity (World Bank, 2015) Nigeria has fallen victim of capital flight perpetrated by developed nations mostly through their agents, that is, multinational corporations. Though these multinational companies are welcome by their host developing countries with a view to speeding up development and increasing FDI, studies have shown that unknowingly to these developing countries, huge sum of capital/resources are illegally transferred to the countries of origin or parent companies of these MNCs abroad through their subsidiaries abroad in order to avoid/avert filling in their tax return to their host governments thereby robbing these developing nations of their resources through various tax havens practices and other illegal cross border practices. These developments have negatively affected the citizenry and economy of Nigeria.

GDP as used in the Study: The make-up of GDP includes personal consumption expenditures plus business investment plus government spending plus (export minus imports). Economic growth looks the expansion of a country's economy. It is most popularly measured by increasing gross domestic product, or GDP. This indicator estimates the value added in a country which is the total value of all goods and services produced in a country minus the value of the goods and services needed to produce them. It is common to divide this indicator by a country's population to better gauge how productive and developed an economy is, that is, the GDP per capita.

$$\text{Change in GDP} = \frac{\text{Final GDP} - \text{Initial GDP}}{\text{Initial GDP}}$$

In recent times, Change in GDP has been found to be a reliable proxy for economic growth and therefore adopted in this study as the proxy for economic growth. It is possible to have economic growth without economic development in the short or even medium term (Feldman *et al.*, 2016). On the other hand, there could be an increase in GDP without any increase in standard of living of people in a state.

As distinguished from other forms of international investment, FDI is made to create a lasting interest in or effective and efficient management control over a firm in another country.

## Theoretical Framework

There are different views on how capital flight /illicit cash outflows affect economic and social aspects of society or any nation especially developing nation. The theoretical overview or background is discussed hereunder. There are five views on the possible effect of MNCs and FDI on the direction the world economy is going. These are termed „the Race to the Bottom“, „the Climb to the Top“, „Neo-liberal Convergence“, „Uneven Development“, and „Much Ado about Nothing“. The study settled with „the Race to the Bottom“ view. According to this view, capital will more and more be able to compensate workers, communities and nations off against one another, while it will threaten to run away once there is demand for tax and when the need for regulatory and wage concessions are not forthcoming.

In this perspective, increased capital mobility benefits corporations, while workers and communities lose (Bluestone and Harrison, 1982; Barnet and Cavanagh, 1995; Greider, 1997). For the purpose of this study we adopt „the race to the bottom“ view because it has relationship with the reason MNCs and foreign investors indulge in activities that encourage illegal capital leading to huge losses by their host communities and countries to their own advantage.

### **Review of Prior Empirical Studies**

Orimolade and Olusola (2018) studied the nexus between capital flight and the growth of Nigerian economy and discovered that there is a long run negative nexus between GDP and all the capital flight variables as used in the study.

Rabah *et al.* (2014) in their own study on the relationship between natural resources and capital flight in the form of tax avoidance from multinational corporations, it noted spill over effects in terms of tax revenue mobilization and stock market development from the thin capitalization rule, a policy instrument aimed at limiting firm tax avoidance through setting limits on a firm's foreign indebtedness. The study exploited the plausibly exogenous within-country variations of data on oil discoveries for a group of countries during the period 1970–2012. It was discovered that oil discoveries significantly boost both tax revenue mobilization and stock market development, but only when thin capitalizations rule is in place. The study therefore concluded that through, capital flight perpetrated by MNCs, tax evasion is entrenched in developing nations hence the loss of capital in such countries and this brings about erosion of domestic tax base.

Global Reporting Initiative (2006) in a study/report to determine the rate of capital flight in developing countries, discovered that capital flight with the intention to evade tax returns are of various forms such illegal commercial capital flight by MNCs amounting to 64%, international crime estimated at 30% and corruption between 3-5%. Some multinational companies engaging in illegal capital flight are domiciled and operating in emerging economies, but nevertheless, about 80–90 percent of illegally taken capital leaves developing countries permanently.

### **Research Methodology**

Research design adopted in this study is *ex post facto* design. This study is limited to secondary data obtained from the data bases of Global Financial Integrity and UNCTAD, FDI/MNE database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)) including published researched works by Global Financial Integrity, IMF, the World Bank (The World Development Indicators), Kar and Devon (2009). Others include OECD reports, textbooks and other materials in existence adopted in explaining the researched variables. The period of study is 16 years covering 2005 – 2021. These sources made available data that were used to measure the illicit financial movements (independent variable) and economic growth (dependent variable).

The geographical scope of this study is Nigeria, representing both the study's population and sample size. The time frame is sixteen years (2005-2021) and the reason for chosen the numbers of year is to make it possible to have robust and comprehensive data for effective analysis and results. This period is considered appropriate because it helps to establish consistency and effectiveness.

## Data and Method of Data Analysis

This study used the Ordinary Least Square analysis (OLS) to examine the effect of illicit financial flows (independent variable) and economic growth in Nigeria proxied by Change in GDP (CGDP) (dependent variable). This study was designed to cover a period of 16 years (2005-2021).

### Specification of Model

This study adopts a linear model written thus:

$$CGDP = f(IFFC, IFFINTC, IFFICA) \text{ ----- (i)}$$

By turning the Equation (i) into econometric model:

$$CGDP = \beta_0 + \beta_1 IFFC_t + \beta_2 IFFICA_t + \beta_3 IFFINTC_t + \mu_t \text{ ----- (ii)}$$

### Where

$\beta_0, \beta_1, \beta_2, \beta_3$  in Equation (ii) are the parameters.

CGDP = Change in Gross Domestic Product.

IFFICA = Illicit Financial Flows via Illegal Commercial Activities

IFFC = Illicit Financial Flows via Corruption

$\mu_t$  = Stochastic disturbance

## Data Presentation and Analysis

### Descriptive Statistics

The descriptive statistics for both the dependent and independent variables are presented in table 1 below:

**Table 1: Descriptive Statistic Table**

Variable	Obs.	Min	Max	Mean	Std. Dev.	Skewness
CGDP	14	10.277	12.028	10.886	.46633	0.15
IFFICA	14	3.7836	4.9050	4.3913	.30515	0.96
IFFC	14	4.5003	5.6217	5.1119	.31051	0.92

**Source: Stata 13**

Table 1 presents the descriptive statistics of all the variables. The number of observations for the study is 14. From the table above, the following information is distilled. The result reveals that, Change in Gross Domestic Product (CGDP) reveals a mean of 10.88686 with a deviation of 0.4663386. CGDP further reveals maximum and minimum values of 12.02897 and 10.2771 respectively. Illicit Financial Flow from Illegal-Commercial Activities (IFFICA) has a mean of 4.391309 with a deviation of 0.3051577. Also, IFFC records a maximum and minimum value of 5.621765 and 4.500323.

Illicit Financial Flows from Commercial Activities (IFFC) has a mean of 5.111977 with a deviation of 0.3105169

To test for normality of data, the skewness statistics is used. For CGDP, the data set reveal a skewness value of 0.1530, while data for IFFCA and IFFIC reveal skewness values of 0.9610 and 0.9200 respectively. This means the data values are normally skewed within the stipulated region of -2 and +2. The result of the descriptive statistics in respect to the study variables shows the level of fluctuation that occurs as a result of economic uncertainties, as well as change in government policies. This is noted in the respective deviation values of the variables.

### Stationarity Test

In order to ensure that the results are robust, several diagnostic tests are conducted to enhance the validity of data and model specified for analyses. As such, data diagnostic test such as; the Unit root test and the Co-integration test are computed.

### Unit root

To avoid running a spurious regression, unit root test is carried out to ensure that the variables employed in this study are mean reverting i.e. stationary. For this purpose, the Augmented Dickey Fuller (ADF) test is employed to test for stationary of data. The result of the test is presented in the table below.

**Table 2: Unit root result**

Variable	Test Stat.	5% Critical Value	Difference
CGDP	2.755	-1.950	Level
IFFICA	-2.468	-1.950	1 <sup>st</sup>
IFFC	-2.528	-1.950	1 <sup>st</sup>

**Null: There is serial Unit Root in the data**

*Source: Stata output in appendix ii*

The table above shows the result of the first test required to know the stationarity of the variables. For the individual stationarity test, the Augmented Dickey-Fuller (ADF) unit root test is used. The ADF unit root test result for result for individual stationarity is interpreted using the Test Statistic measured against the critical value to ascertain the level of individual stationarities of the time-series data. The result above shows that, data for the variables were stationary at 1<sup>st</sup> difference (ADF) with a Test Statistics > critical values for all the variables; except data for CGDP which is stationary at level. Since the variables data set are individually stationary at level and 1<sup>st</sup> difference order, there is need for cointegration test to be carried out to ascertain if the data are mean reverting in the long run.

### Co-integration Test

**H<sub>0</sub>:** There is no co-integration



**Table 3: Co-integration result**

Statistic	Rank 0	Lag 1	Lag 2	Lag 3
Trace Stat.	20.4103*	9.2761	0.9235	*
Critical Value	29.68	15.41	3.76	*
<b>Decision</b>	-	-	-	-

*Source: Stata output in appendix ii*

The table above reveal the result of Johansen co-integration test for the time-series data. To ensure the level of cointegration of the data set, the trace statistics values listed in the table above is considered against their respective critical values to ensure a more robust test for cointegration; it is expected that the Ranked trace statistics > critical values.

From the Rank (0) order result, the trace statistics of 20.4103 < 29.68 critical value; it means there is no cointegration at ranked level. Also, the result reveal no cointegration at Lag-1, and Lag-2 with trace statistics of 9.2761 and 0.9235 against critical values of 15.41 and 3.76. This means there is no cointegration if the data is lagged for 2 series. The study is restricted to Lag-1 decisions given the lag selection criteria of 1 in appendix ii of the study, it also means there is need to compare both the VAR and VECM models in analyzing the data for this study.

### Regression of the Estimated Model Summary

This section presents the results produced by the error correction model summaries for further analysis.

**Table 4: VECM/ VAR**

Long-run equilibrium	Coefficient (VECM)	Short-run equilibrium	Coefficient (VAR)
CGDP (-1)	1.000	GDP	-.0924367
IFFCA (-1)	6.451661	IFFCA	2.599501
IFFC (-1)	- 6.473121	IFFC	- 2.378812
Lag Selection	2	Prob.	0.15878

*Source: Stata Output in appendix ii*

Table 4 above presents result of the VAR and VECM for the study model, to test for long run and short run shocks correction as a result of non-cointegration of the data set for Lag-1 and Lag-2 model above. The various coefficient values of the short run equilibrium (VAR) are compared against the long run equilibrium (VECM) to ascertain the level of bounce backs in addressing non long run cointegration issues of the model.

After 1<sup>st</sup> differences, the adjustment coefficient value of -0.0924367 shows that, the previous period deviation from long run equilibrium is corrected in the short run at an adjusted speed of 0.0924367 for CGDP. For IFFCA coefficient, a unit change in IFCA is associated with 2.599501 unit increase in CGDP in the short run *Ceteris Paribus* against the long run coefficient of 6.451661. For IFFC coefficient, a unit change in IFFC is associated with 2.378812 unit decrease in CGDP in the short run *Ceteris Paribus* against the long run

coefficient of -6.473121. Data for IFIC is dropped from the model as a result of collinearity issues.

The VECM Lag-range multiplier test for autocorrelation reveals value of 0.15878. This shows that the set of data after error correction has no presence of autocorrelation, as such, further VAR analysis is permitted.

### Regression of the Estimated Model Summary

This section presents the results produced by the error correction model summaries for further analysis.

**Table 5: GDP VAR Regression**

VAR Variable	Coefficient	R-Square	Constant	Prob.
CGDP		0.7211	1.723724	0.0000
IFFCA	2.599501			0.614
IFFC	-2.378812			0.638
Lagrange (1)	Probability	0.37943		

*Source: Stata output in appendix ii*

For model fitness, the  $R^2$  value is used to establish the level of overall fluctuation the study independent variables (IFFCA & IFFC) can cause CGDP as the dependent variables to change.

The R-square values of 0.7211 shows that IFFCA and IFFC cause CGDP to fluctuate at approximately 72%; this means that 28% fluctuation of Nigeria's CGDP is caused by other factors not considered in this study like; FDI and policy reforms.

The constant value of 1.723724 for the model revealed that, given intercept only model, the CGDP value of Nigeria will increase by 1.723724 units. But a unit change in IFFCA will cause CGDP to increase by 2.599501 units and a unit change in IFFC will cause CGDP to decrease by 2.378812 units. The lag-range multiplier value of 0.37943 shows there is no issue of autocorrelation in the VAR model.

### Test of hypotheses

***H<sub>01</sub>: Illicit financial flow from illegal-commercial activities has no significant effect on change in gross domestic product of Nigeria.***

Since the calculated probability (Prob) value for IFFC against CGDP (0.638) is greater than the accepted probability value of 0.05. The null hypothesis is accepted and the alternative rejected. Thus, illicit financial flow from illegal-commercial activities has no significant effect on change in gross domestic product of Nigeria.

***H<sub>01</sub>: Illicit financial flow from corruption has no significant effect on change in gross domestic product of Nigeria.***

Since the calculated probability (Prob) value for IFCA against CGDP (0.614) is greater than the accepted probability value of 0.05. The null hypothesis is accepted and the alternative rejected. Thus, illicit financial flow from corruption has no significant effect on change in gross domestic product of Nigeria.

## **Discussion and Interpretation of Results**

The study hypotheses tested revealed that, both illicit financial flow from corruption and illicit financial flow from illegal commercial activities have no significant effect on change in gross domestic product of Nigeria. The study findings conform to the report by Global Reporting Initiative (2006) that illicit financial movements with the intention to evade tax returns are of various forms such as illegal commercial capital flight by MNCs amounting to 64%, international crime estimated at 30% and corruption between 3-5%. Some multinational companies engaging in illicit capital flows are domiciled and operating in emerging economies, but nevertheless, about 80–90 percent capital illegally leaves developing countries permanently without significant effect on the economy.

## **Summary, Conclusion and Recommendation**

The following are the summary of the major findings of this study arrived at through the test of the research hypotheses earlier formulated in this study. Illicit financial flow from corruption has a positive relationship with change in gross domestic product of Nigeria. But illicit financial flow from corruption has no significant effect on change gross domestic product of Nigeria. Illicit financial flow from illegal-commercial activities has a negative relationship with change in gross domestic product of Nigeria. Also, illicit financial flow from illegal-commercial activities has no significant effect on change gross domestic product of Nigeria.

## **Conclusions**

Based on the findings of this study from the test of the two research hypotheses earlier formulated in the study, the study has therefore come to the following conclusions outlined in respect to each hypothesis. Thus, illicit financial flow from illegal-commercial activities has no significant effect on change in gross domestic product of Nigeria. Thus, illicit financial flow from corruption has no significant effect on change in gross domestic product of Nigeria.

## **Recommendations**

In consonance with this study's findings, the following recommendations become imperative. The Nigerian government should put forward policies that discourage corruption. This can be done through ensuring financial transparency in the public sector via Treasury Single Account and Integrated Personnel Payroll Information System implementation. The government through the recent financial intelligence Act should ensure that funds from illegal business activities are curbed and the proceeds collected from such acts be invested back into the Nigerian economy to burst production and GDP.

## **Area of Further Research**

There is clearly enormous scope for more research that can inform an understanding of the effect of illicit financial activities on economic growth in Nigeria. To develop specific policies and recommendations, this study suggests the following for further research:

- i. More studies can be done to look at specific public sector financial reforms targeted at disrupting the practice of illicit financial flows in Nigeria.
- ii. Further research can be done using qualitative data or the timeframe for the current research can be extended to reflect current happenings.

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