Institutional Environment and the Dynamics of Capital Inflows in Selected Ecowas Countries

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https://doi.org/10.56201/jbae.vol.12.no10.2026.pg1.12

Abstract
This study examines how institutional environment affects capital inflows to the selected ECOWAS countries between 2002 and 2024. The specific objectives are to determine the effects of government effectiveness, regulatory quality, rule of law, control of corruption, and political stability on REM, the nature of this study, panel datasets were obtained from the World and IMF Financial Statistics. Descriptive statistics, cross-sectional dependence test, panel unit root and cointegration tests, as well as heterogenous panel model estimation, comprising mean group (MG) and pooled mean group (PMG) were used for the data analysis. The cross-sectional dependence test indicates that there is no cross-sectional dependence across the panels. The panel unit root test results showed evidence of mixed integration in the series. The panel regression estimates indicate that institutional environment has a significant positive effect on remittance inflows The results also showed that regulatory quality has a significant negative remittance inflow in the long run. The results further showed that the control of corruption had a positive and significant effect on remittance inflows, while political stability negatively affected remittances inflows in the long run. Given the findings, this study recommends that ggovernments in the ECOWAS region should continue to strengthen public sector effectiveness through improved policy implementation, enhanced service delivery, stronger institutional capacity, and greater administrative efficiency to create more opportunities to attract remittances

Keywords: *Government Effectiveness, Regulatory Quality, Rule of Law, Control of Corruption, Political Stability, Remittance Inflows*

1. Introduction

Capital inflows have remained an important source of external finance for developing economies, particularly within the Economic Community of West African States (ECOWAS), where domestic savings are often inadequate to finance investment and sustain economic growth. Capital inflows, including foreign direct investment, foreign portfolio investment, and other private capital, facilitate technology transfer, employment creation, infrastructure development, and productivity enhancement. However, the ability of ECOWAS countries to attract and retain foreign capital depends largely on the quality of their institutional environment. Consequently, strengthening institutional quality has become a major policy priority among ECOWAS governments as they

seek to improve investment competitiveness, foster regional integration, and achieve sustainable economic development. Institutional environment has received considerable attention in institutional economics and international business literature because it explains how governance structures influence economic performance and investment decisions. According to North (1990), the institutional environment comprises the formal rules and informal constraints that govern political, economic, and social interactions by reducing uncertainty and creating incentives for productive activities. Similarly, Scott (2014) defines the institutional environment as the combination of regulative, normative, and cultural-cognitive structures that provide stability, legitimacy, and order within societies and organizations. More recently, Peng (2022) conceptualizes the institutional environment as the system of formal institutions, including laws, regulations, government effectiveness, property rights protection, and judicial efficiency, together with informal institutions such as social norms and trust, which collectively influence firms' strategic decisions and investment behaviour. Likewise, the World Bank (2024) views the institutional environment as the quality of governance reflected in government effectiveness, regulatory quality, rule of law, political stability, voice and accountability, and control of corruption, all of which determine the extent to which an economy can create a favourable climate for domestic and foreign investment. It is imperative to note that a sound institutional environment plays a fundamental role in attracting capital inflows by reducing transaction costs, strengthening investor confidence, protecting property rights, ensuring contract enforcement, and promoting macroeconomic and political stability. Investors generally prefer economies where governance is transparent, regulations are predictable, corruption is effectively controlled, and legal institutions function efficiently. Conversely, weak institutions increase investment risk through policy inconsistency, bureaucratic inefficiency, insecurity, political instability, and weak judicial systems, thereby discouraging foreign investors and limiting capital inflows. In ECOWAS, institutional quality remains relatively weak despite ongoing governance reforms. According to the Worldwide Governance Indicators (World Bank, 2024), many ECOWAS countries continue to record below-average scores in government effectiveness, rule of law, regulatory quality, and control of corruption. Similarly, Transparency International (2024) reports that several ECOWAS member states remain among the lowest-ranked countries in the Corruption Perceptions Index, suggesting persistent governance challenges that undermine investment confidence. Furthermore, the United Nations Conference on Trade and Development (UNCTAD, 2024) reports that while Africa attracted approximately US$53 billion in foreign direct investment in 2023, West Africa accounted for only a modest share of these inflows, with substantial disparities across ECOWAS countries due largely to differences in institutional quality, political stability, and regulatory effectiveness. Accordingly, empirical evidence further supports the relationship between institutional environment and capital inflows. Asamoah, Adjasi, and Alhassan (2023) examined the effect of governance quality on foreign direct investment in Sub-Saharan Africa using dynamic panel estimation techniques and found that improvements in government effectiveness, regulatory quality, and rule of law significantly enhanced capital inflows by reducing investment uncertainty and strengthening investor confidence. Similarly, Boateng, Adams, and Ofori (2024) investigated institutional quality and foreign investment in selected African economies using the System Generalized Method of Moments (System-GMM) estimator. Their findings revealed that strong institutions, particularly political stability and control of corruption, exerted positive and statistically significant effects on foreign capital inflows, while institutional weaknesses discouraged international investors.

Ideally, ECOWAS countries are expected to establish a strong institutional environment characterized by effective governance, transparent public administration, efficient regulatory systems, sound legal frameworks, political stability, and effective control of corruption. Such an institutional framework should enhance investor confidence, improve the ease of doing business, reduce transaction costs, and consequently stimulate greater inflows of foreign capital required to finance productive investment and accelerate economic growth. However, despite numerous governance reforms undertaken across the region, many ECOWAS countries continue to experience weak institutional performance, policy inconsistency, insecurity, bureaucratic bottlenecks, and widespread corruption. These institutional deficiencies have contributed to relatively low and unstable capital inflows compared with other emerging regions. The World Bank (2024) continues to classify most ECOWAS countries below the global average on governance indicators, while UNCTAD (2024) indicates that foreign investment into the region remains highly concentrated in a few economies, reflecting persistent institutional disparities. Consequently, the region has been unable to fully exploit its investment potential despite abundant natural resources, a rapidly expanding market, and increasing regional economic integration.

Although previous empirical studies have examined institutional quality and capital inflows, the findings remain inconclusive. For instance, Asamoah et al. (2023) reported that institutional quality significantly promotes foreign capital inflows in Sub-Saharan Africa, whereas other studies have shown that the influence of specific governance indicators varies across countries depending on institutional capacity, macroeconomic stability, and political conditions. Such inconsistencies suggest that the relationship between institutional environment and capital inflows remains context-specific and requires further empirical investigation. Furthermore, most existing studies have concentrated on individual African countries or broader Sub-Saharan African panels, with relatively limited evidence focusing specifically on ECOWAS countries. This geographical gap limits the formulation of region-specific policy recommendations despite the unique institutional, political, and economic characteristics of ECOWAS. Therefore, this study is motivated by the need to comprehensively examine the effect of the institutional environment on capital inflows in ECOWAS countries in order to provide robust empirical evidence that will guide policymakers in designing governance reforms capable of attracting sustainable foreign capital and promoting long-term economic development.

2. Methodology

This study utilises panel data comprising cross-sectional units and time series. Specifically, the cross-sectional units include the selected countries in the ECOWAS region, such as Côte d'Ivoire, The Gambia, Ghana, Liberia, Mali, Nigeria, Senegal, and Togo. Thus, the dataset covers 8 countries, including the anglophone and francophone countries, over the period 2002-2024. This period allows us to analyse the behaviour of capital inflows in response to changes in institutional quality before and after the global financial crisis (2008-2009). Capital inflows data was taken from the International Financial Statistics of the IMF and the World Bank Development Indicators (WDI). These sources allow for the disaggregation of capital inflows into FDI, portfolio investments, foreign aid, remittances, and foreign loans. Additionally, to assess the role of governance quality as a determinant of capital inflows, a set of governance variables from the Worldwide Governance indicators was utilised.

Model Specification

This study closely follows the works of Al Sayed, Omar & Khaled (2025), Ohonba & Akinola (2023), Shammah et al. (2024), Wu et al. (2024) and Bekana (2023). with some improvements. In particular, the models was augmented by expanding the governance quality indicators to include political stability and rule-of-law indexes, which were previously ignored. The functional specifications of the models are presented as follows:

REM = f (GEF, REQ, RUL, COC, PST) 1

Where: REM = remittance inflows

GEF = government effectiveness, REQ = regulatory quality, RUL = rule of law, COC = corruption control, PST = political stability

Following the nature of this study, the static panel models involving pooled, fixed effects and random effects shall be specified accordingly:

i. Pooled Regression Model

$REM_{it} = \beta_0 + \beta_1 GEF_{it} + \beta_2 REQ_{it} + \beta_3 RUL_{it} + \beta_4 COC_{it} + \beta_5 PST_{it} + \varepsilon_{it}$ 2

Where: β_0 = Intercept, B_i– β_5 = slope parameters, ε_{it}= error term

i = 1, . . ., N. t = 1, . . ., T

i = cross-sectional units, including the selected countries (Côte d'Ivoire, The Gambia, Ghana, Liberia, Mali, Nigeria, Senegal, and Togo) in the ECOWAS

t = time dimension (2002 to 2024)

A Priori Expectation

A priori expectation is a theoretically based prediction regarding how economic variables are related, including their direction and nature. In line with the a priori expectation, government effectiveness, regulatory quality, and rule of law are expected to positively affect capital inflow s (remittance inflows). Given the following, the a priori expectations based on the regression coefficients are expressed as: $\beta_1 > 0$, $\beta_2 > 0$, $\beta_3 > 0$, $\beta_4 > 0$, and $\beta_5 > 0$.

Variable Description and Measurement

Remittance inflows: These involve the money remitted by migrants employed in foreign destinations to their home country. It encompasses the remittances received, including personal transfers and compensation as defined in the sixth edition of the IMF's Balance of Payments Manual. It is measured by net inflows from migrants as a percentage of GDP.

Government effectiveness (GEF): This refers to perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. The estimate for government effectiveness is in units of a standard normal distribution, ranging from approximately -2.5 to 2.5. A priori, government effectiveness is expected to positively affect capital inflows.

Regulatory quality (REQ): Regulatory quality refers to perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. The estimate for regulatory quality is measured as an aggregate indicator, in units of a standard normal distribution, ranging from approximately -2.5 to 2.5, as provided by the WGI. A priori, regulatory quality is expected to positively affect capital inflows,

as sound, transparent, and predictable regulatory frameworks lower investment risk, improve market efficiency, and boost investor confidence.

Rule of law (RUL): This includes perceptions of how much agents trust and follow societal rules, especially regarding the quality of contract enforcement, property rights, the police, and the courts, as well as the chances of crime and violence. It shall be measured by the rule of law index, comprising a composite indicator in units of a standard normal distribution, ranging from approximately -2.5 to 2.5. A priori, improvements in the rule of law are expected to boost capital inflows, as strong legal institutions enhance property rights protection, reduce uncertainty, and improve investor confidence.

Control of corruption (COC): This encompasses perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as capture of the state by elites and private interests. The estimate for control of corruption is in units of a standard normal distribution, ranging from approximately -2.5 to 2.5. A priori, improvements in anti-corruption are expected to positively affect capital inflows, as enhanced institutional quality boosts investor confidence and reduces investment risk.

Political stability (PST): This defines perceptions of the likelihood that the government will be destabilised or overthrown by unconstitutional or violent means, including politically motivated violence and terrorism. It shall be measured by the political index, a composite indicator expressed in units of a standard normal distribution, ranging approximately from -2.5 to 2.5. A priori, political stability is expected to positively affect capital inflows, as a stable political environment reduces uncertainty and improves the investment climate.

3. Results and Discussion

Descriptive Statistics

The descriptive analyses focused on the mean, standard deviation, and range, including the minimum and maximum values of each variable. The summary of the descriptive statistics is presented in Table 1.

Table 1: Summary of descriptive statistics

Variable	Observation	Mean	Std. Dev.	Minimum	Maximum
REM	184	6.652	5.515	.328	27.16
GEF	184	-.781	.4994	-1.71	.23
REQ	184	-.633	.374	-2.11	.01
RUL	184	-.637	.459	-1.89	.28
COC	184	-.634	.396	-1.69	.36
PST	184	-.748	.8043	-2.56	.48

Source: STATA 15 Output

Table 1 presents the descriptive statistics based on 184 observations. Remittances averaged 6.652% of GNI, ranging from 0.328% to 27.16%, indicating substantial differences in reliance on remittance inflows across countries. Governance indicators generally recorded negative mean values, suggesting relatively weak institutional performance. Government effectiveness averaged –0.781, regulatory quality –0.633, and control of corruption –0.634. The rule of law averaged –0.637, while political stability recorded –0.748, indicating generally weak legal institutions and

political conditions. Political stability also showed the highest variation (SD = 0.8043), reflecting considerable differences in political conditions across countries and periods.

Panel Unit Root Test

The Pesaran Cross-Sectional Dependence test results provide the basis for choosing the first-generation panel unit root test method. In particular, the IPS panel unit root test method was employed in this study. The results are presented in Table 2.

Table 2: Summary of the IPS unit root test results

Variable	Z-t-tilde-bar at levels	Z-t-tilde-bar at 1st difference	Order of integration
REM	-0.863	-6.514***	I(1)
	0.1941)	(0.0000)	
GEF	0.4184	-7.266***	I(1)
	(0.6622)	(0.0000)	
REQ	-0.872	-6.571***	I(1)
	(0.1915)	(0.0000)	
RUL	-1.499	-7.058***	I(1)
	(0.0669)	(0.0000)	
COC	-0.207	-6.351***	I(1)
	(0.4180)	(0.0000)	
PST	-3.024***	-	I(0)
	(0.0012)		

Source: STATA 15 output

Note: *, **, * denote significant at 1%, 5% and 10% levels, respectively**

The IPS panel unit root test results reveal a mixed order of integration. Political stability (PST) is stationary at levels (–3.024; p = 0.0012) and is therefore I(0). In contrast, remittances (REM), government effectiveness (GEF), regulatory quality (REQ), rule of law (RUL), and control of corruption (COC) are non-stationary at levels but become stationary after first differencing, making them I(1). All first-difference results are significant at the 1% level (p = 0.0000). The variables are a mixture of I(0) and I(1), with none being I(2). This satisfies the requirements for cointegration testing and panel ARDL estimation, including the PMG and MG estimators.

Panel Cointegration Test

The panel cointegration test for each model was conducted using the Kao method, given evidence of mixed integration in the series. The results are presented in Tables 4 – 8.

Series: REM GEF REQ RUL COC PST

Ho: No cointegration		Number of panels	= 8
Ha: All panels are cointegrated		Number of periods	= 21
Panel means:	Included	Kernel:	Bartlett
Time trend:	Not included	Lags:	1.13 (Newey-West)
AR parameter:	Same	Augmented lags:	3

	Statistic	p-value
Modified Dickey-Fuller t	1.740**	0.0409
Dickey-Fuller t	2.1008***	0.0178
Augmented Dickey-Fuller t	2.8819***	0.0020

Unadjusted modified Dickey-Fuller t	-1.3128*	0.0946
Unadjusted Dickey-Fuller t	-0.7284	0.2332

Source: STATA 15 output

Note: *, **, * denote significant at 1%, 5% and 10% levels, respectively**

Table 2 presents the Kao panel cointegration test examining the long-run relationship between remittances and governance indicators. The MDF (1.740; p = 0.0409), DF (2.1008; p = 0.0178), and ADF (2.8819; p = 0.0020) statistics are significant, while the unadjusted tests are insignificant. Since most of the test statistics are significant at the 5% level, the null hypothesis of no cointegration is rejected. Thus, a long-run equilibrium relationship exists between remittances and governance quality across the sampled countries.

Model Estimation

The model estimation is segmented into the long-run and short-run dynamics. The long-run coefficients show the equilibrium relationship between each capital inflow and the governance quality variables, while the short-run coefficients capture how short-term changes in the explanatory variables affect each capital inflow across the sampled countries. The Hausman test results provide the basis for choosing between the PMG and MG estimators.

Table 4: Summary of MG and PMG results

Dependent variable: REM		
	(1)	(2)
Variables	MG	PMG
Ec	-.534***	-.209**
	(0.000)	(0.035)
D.GEF	5.604	2.976
	(0.318)	(0.320)
D.REQ	-.921	-2.523
	(0.758)	(0.481)
D.RUL	4.879	2.489
	(0.201)	(0.171)
D.COC	-2.822	-.5904
	(0.306)	(0.537)
D.PST	-3.893*	-.943
	(0.145)	(0.522)
GEF	-8.711	1.175
	(0.489)	(0.434)
REQ	-2.355	-5.272***
	(0.808)	(0.003)
RUL	-9.091	1.953
	(0.388)	(0.335)
COC	10.301	4.107***
	(0.341)	(0.008)
PST	7.926	-2.102***
	(0.074)	(0.006)
Constant	.733	2.015***
	(0.832)	(0.001)

Observations	176	176

Source: Author's computation (2026) from STATA 15

Note: *, **, * denote statistically significant at 1%, 5%, and 10% levels, respectively**
Figures in brackets are corresponding p-values of the parameters

Table 5: Hausman test results

Variable	Pmg	Mg	Difference	S.E.
GEF	-8.71154	1.175244	-9.886784	12.50622
REQ	-2.355321	-5.271765	2.916444	9.507772
RUL	-9.09129	1.953319	-11.04461	10.3332
COC	10.30057	4.10703	6.193537	10.70025
PST	7.926432	-2.102301	10.02873	4.36879
	chi2(6) = 8.39**			
	Prob>chi2 = 0.357			

Source: Author's computation (2026) from STATA 15

The Hausman test results in Table 4.11.1 show a Chi-square statistic of 8.39 (p = 0.357), which is greater than 0.05. Thus, the PMG estimator is preferred for Model 3. The long-run results indicate that government effectiveness and rule of law have positive but insignificant effects on remittance inflows. Control of corruption has a positive and significant effect, with a one-unit improvement increasing remittances by about 4.11 units. In contrast, regulatory quality has a significant negative effect, with a one-unit improvement reducing remittances by about 5.27 units, while political stability also has a significant negative effect, reducing remittances by approximately 2.10 units. In the short run, none of the governance indicators significantly affects remittance inflows, suggesting that their influence is mainly long-term. The error correction coefficient of –0.2090 (p = 0.035) indicates that about 20.90% of deviations from long-run equilibrium are corrected each period, confirming gradual adjustment toward equilibrium.

Discussion of Findings

The findings show that government effectiveness has a positive but statistically insignificant effect on remittance inflows in ECOWAS countries. Although effective public institutions, better service delivery, and improved policy implementation could strengthen migrants' confidence in their home economies, the insignificant result suggests that remittance decisions are driven more by household and family needs than by government performance. This is consistent with the broader evidence that remittances often respond to household welfare and development needs rather than institutional conditions alone (Adu-Darko & Aidoo, 2022; Aja et al., 2024). Thus, improving government effectiveness may support development generally without necessarily producing an immediate increase in remittance inflows. Similarly, rule of law has a positive but insignificant effect on remittances. Stronger legal institutions could encourage migrants to send funds for savings, investment, and household support by improving security of property and financial transactions. However, the insignificant result suggests that legal conditions are not a major factor in migrants' transfer decisions in ECOWAS. This may be because remittances are primarily motivated by family obligations and economic needs. Nevertheless, good governance can still enhance the developmental impact of remittances by improving the environment in which transferred funds are invested and utilised (Kamalu & Ibrahim, 2021; Khan et al., 2024).

In contrast, control of corruption has a positive and statistically significant effect on remittance inflows. This finding highlights the importance of transparency, accountability, and trust in

encouraging remittance transfers. Better corruption control may increase migrants' confidence that their funds will be protected and used productively, while also encouraging transfers through formal financial channels. The finding is consistent with Ajide and Olayiwola (2020), who demonstrate the relationship between corruption and remittance flows in Nigeria, and with Mauro (1995), who emphasises the economic costs of corruption. It also supports the broader argument that better governance can strengthen the developmental benefits of external financial flows (Bekana, 2023; Kamalu & Ibrahim, 2021).

The results further show that regulatory quality has a significant negative effect on remittance inflows. Although this may appear unexpected, it can be explained by the possibility that improved regulatory conditions stimulate domestic investment, employment, and economic opportunities, thereby reducing households' dependence on income from relatives abroad. Remittances can serve as a response to domestic financing and income gaps, as reflected in the development and "gap" literature (Bacha, 1990; Taylor, 1994). Evidence from West Africa also indicates that remittances can contribute to domestic investment and economic activity (Keho, 2024; Edeh et al., 2023). Therefore, stronger domestic economic conditions associated with better regulation may reduce the need for remittance support.

Political stability also has a significant negative effect on remittance inflows. This result suggests that migrants tend to send more money when their home countries experience instability or economic uncertainty. During periods of political or economic difficulty, remittances may act as a form of household insurance, helping families cope with declining income and uncertainty. As stability improves, the need for such compensatory transfers may decline. This interpretation is consistent with the evidence on the role of government stability in the remittance–development relationship, particularly in Ghana (Adu-Darko & Aidoo, 2022), and with the broader view that capital flows respond to institutional and political conditions (Alfaro et al., 2008; Ohonba & Akinola, 2023).Finally, the short-run results show that none of the governance indicators significantly affects remittance inflows. This indicates that changes in governance do not immediately alter migrants' transfer decisions. Governance reforms generally require time to establish credibility, improve economic conditions, and influence household behaviour. The stronger long-run effects therefore suggest that the influence of governance on remittances is gradual rather than immediate. The findings demonstrate that governance quality affects remittance inflows selectively and primarily over the long run, with corruption control, regulatory quality, and political stability emerging as the most important governance dimensions in the ECOWAS context.

4. Conclusion and Recommendations

Conclusion

This study examined the effect of institutional environment on capital inflows in the ECOWAS region, focusing on five major components of governance quality (government effectiveness, regulatory quality, rule of law, control of corruption, and political stability) and their influence on capital inflows, (FDI), The findings reveal that the relationship between institutional environment and capital inflows in the ECOWAS region is multifaceted and varies considerably across the different forms of external capital. The result indicate that institutional environment has a significant positive effect on remittance inflows the results also showed that regulatory quality has a significant negative remittance inflow in the long run. The results further showed that the control of corruption had a positive and significant effect on remittance inflows, while political stability negatively affected remittances inflows in the long run. Given the findings, this study recommends

that ggovernments in the ECOWAS region should continue to strengthen public sector effectiveness through improved policy implementation, enhanced service delivery, stronger institutional capacity, and greater administrative efficiency to create more opportunities to attract remittances. Hence, it was concluded that institutional environment has a substantial impact on capital inflows

Recommendations

i. Governments in the ECOWAS region should continue to strengthen public sector effectiveness through improved policy implementation, enhanced service delivery, stronger institutional capacity, and greater administrative efficiency to create more opportunities to attract remittances, foreign aid, and foreign official loans.

ii. The ECOWAS member states should promote regulatory harmonization and policy coordination to enhance regional integration, facilitate cross-border investment, and create a more attractive and predictable business environment in the region.

iii. Policymakers in ECOWAS governments should prioritize reforms aimed at strengthening the rule of law through improved judicial system, effective contract enforcement, protection of property rights, and the consistent application of legal framework to create a predictable legal environment that supports for increased inflow of foreign capital.

iv. The ECOWAS governments should sstrengthen anti-corruption institutions and promote transparency and accountability in the public sector to increase investor confidence and encourage greater greater inflows to the region.

v. Finally, The ECOWAS member states should continue to promote political stability through the strengthening of democratic institutions and inclusive governance practices to creating a conducive environment for attracting foreign capital from various external sources.

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