FOREIGN INFLOWS AND INFLATION RATE IN NIGERIA (1999 -2023): A GRANGER CAUSALITY APPROACH

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Abstract
This study examined the impact of foreign inflows on the inflation rate in Nigeria. Data were collected from the World Development indicators for the period 1999 to 2023. Using the Granger causality test it shows that none of the variable granger cause the other (i.e. no direction). From the ordinary least square technique, the result F-statistic, that is the overall estimation for all the variables in the model, shows that foreign inflows was positively insignificant (probability = 0.108581 and coefficient = 2.193544). Hence, the study concludes that the independent variables foreign inflows have no significant impact on the inflation rate in Nigeria. The study, therefore, recommends that the government should encourage inflows of FDI and properly direct funds to meaningful investment in the critical sectors of the economy for the adequate production of goods and services for both export and domestic consumption to improve our balance of payments. Also, DRE should be improved upon and funds directed to capital investment and less on purchases of foreign or imported goods and luxury items that are not meant for further production of goods and services. Again, the government should put into use ODA's funds; a proper matching concept should be adopted instead of diversion of funds to other uses.

Keywords: *Diaspora remittance, Foreign direct investment, Granger causality, Inflation rate, Official development assistance.*

Introduction

In Nigeria today, there are a large number of foreign inflows in form of Foreign Direct Investment (FDI), Foreign Portfolio Investment (FPI), Diaspora Remittance (DRE) Foreign Aid (FA), Foreign Loan (FL), Foreign Private Investment, International Bond Offering, and Official Development Assistance (ODA) etc. These large foreign inflows are a result of the need for capital to argument the local capital formation. Perhaps, this is the reason for the drive for foreign capital especially in the emerging economies of Africa. Hence, foreign inflows have been identified as a vital mechanism for the supporting the supply of funds needed for local investments (Fosu & Magnus, 2006 as cited in Orji, Uche & Ilori, 2014).

The amount of foreign inflows to emerging economies especially Nigeria has been on the increase. In the first quarter of 2023 the total capital imported into Nigeria stood at US$1,132.65 million, although, this is lower than US$1,573.14 million recorded in the first quarter of 2022, indicating a decrease of 28% (National Bureau of Statistics, 2023). On the other hand, inflation in the first quarter of 2023 stood at 21.82% compared the first quarter of 2022 that stood at 15.60% (National Bureau of Statistics, 2023).

The inflationary has become so worrisome in Nigeria that both experts in the fiscal and monetary fields are curious to delve into research on what factors are responsible for the alarming state of the rising inflation. In Nigeria for instance, in 2019, 2020, 2021, 2022 and 2023 inflation rates in Nigeria stood at 9.00 percent, 15.67 percent, 16.52 percent, 12.09 percent and 11.39 percent respectively. These high inflationary figures show that Nigeria economy is affected by some macro-economic variables which require empirical research and government policy attention. In view of this, it is pertinent to study what inflation is actually sensitive to within the Nigeria context. FDI, FPI, DRE, ODA etc inflows are part of the common foreign inflows that can meet the investment gap in most emerging economies of the world. The impact of these inflows could be felt in two directions. The first direction is to promote economic growth and development while the second is an influx of the duo variables that could cause excess supply of fund into an economy and consequently cause inflation if not properly managed. The DI and FPI are seen as an investment-smoothening possibility and can reduce the negative effect of inflation if they meet the supply side of the economy.

Looking at the figures above, the situation seems to connote that the higher the capital inflows, the higher the inflationary rate in Nigeria. However, this is not supposed to be so. The capital inflows are meant for further production of goods and services locally for domestic consumption and to some extent export. Exportation of the goods and services will boost the country's balance of payment position and increase foreign reserve.

It is because of this the context of inflation has come at the front burner of our fiscal and monetary discourse in Nigeria. Many views have come up in the literature as to what are the real determinants of inflation as Nigeria experiences rising inflation rate. Nigerians have witness rising inflationary rate in the past two decades (Fabayo & Ajilore, 2006 cited in Olabode, 2021). Is as a result of this growing trend that the study of macro-economic determinants of inflation has emerge as a research area for many researchers considering its importance in the proper management of macro-economic function in the Nigerian economy (Narayan, Narayan & Mishra, 2011; Adeleye, Ogundipe, Ogundipe, Ogunrinola & Adediran, 2019).

It is evidence that when inflation is on the rise, the economy of a country tends to be badly affected and cannot easily be solved by mere economic summit discussions. It requires an empirical study of the macro-economic variables that are responsible so that the needed fiscal and monetary policies are put in place. Hence, the exogenous and endogenous factors assumed to cause this unnecessary rise in inflation rate are empirically investigated.
Thus, the influence of exogenous factors such as capital inflows variables remains silence in the previous studies. For the time being, the question as to whether foreign inflows in form of FDI, FPI, DRE, and ODA etc are responsible for the rise in inflationary rate in the emerging economies of Africa, especially Nigeria is true if they are not well managed.

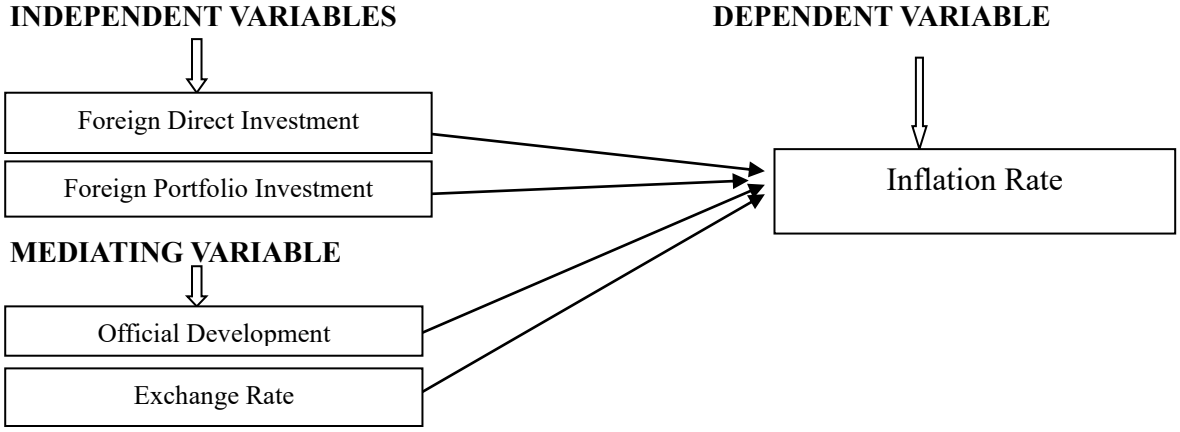
To further extend and fill the lacuna in the previous studies, this study attempts to provide empirical evidences on the main objective of the study "do foreign inflows in form of FDI, DRE, and ODA responsible for the rise in inflation rate in Nigeria?" The specific objectives are: to examine the impact of FDI on the inflation rate in Nigeria; to identify the impact of DRE on the inflation rate in Nigeria; to evaluate the impact of ODA on the inflation rate in Nigeria.

The study is divided into five sections for easy of the understanding of the readers. The first section is the introduction, the second section is the literature review, and the third section dwells on the methods and materials, while the fourth section presents the data analysis and discussion of results, and lastly is the fifth section for the conclusion and recommendations.

Literature Review
This section presents the review o related literature. The related literature consists of conceptual framework, theoretical framework and the empirical review.

Conceptual Framework
The conceptual framework of this study consists of the independent variable of foreign inflows measured by FDI, DRE, and ODA with the dependent variable of inflation rate. On the other hand, is mediating variable of exchange rate is introduced. As such, these variables will be look at in turn.

Figure 2.1: Conceptual model of foreign inflows and inflation rate in Nigeria



Source: Researchers' conceptual model 2024.

Theoretical Framework

Basically, there are several theories that provide foundations for the understanding of the complexities of the causality between foreign inflows and the inflation rate. However, the study, due to pagination constraints, will only mention some of these theories in the literature and underpin the study to one. The theories are: new Keynesian Phillips curve; international finance theory; open economy macroeconomics; absorption approach; Dutch disease theory; portfolio balance theory; balance of payments theory; supply-side theory; demand-pull theory; and monetary approach.

Theoretical underpin

The Dutch disease theory is the foundation of this study. "The Economist" developed the theory in 1977 to explain the collapse of the Dutch industrial sector following the 1959 discovery of the substantial Groningen natural gas field (The Economist, 1977). From the conceptual standpoint of foreign inflows, Dutch disease appears when a growing economy's traded goods sector declines due to a shift of purchasing power to it. The most basic examination of this impact takes into account a small, open economy consisting of two sectors: traded and non-traded. The world market sets the price of the composite traded good, making it exogenous. On the other hand, domestic supply and demand govern the price of the non-traded good. Accordingly, a foreign inflow will raise the relative price of non-traded goods and increase the returns to factors in the non-traded sector by increasing national income. Typically, this will lead to an appreciation of the real exchange rate and a decline in the output of the traded goods sector as factors of production shift into the non-traded sector until equilibrium is restored.

Empirical Review

Changaya and Olanrewaju (2020) studied the effect of foreign inflows on real estate investment in Kenya employing Autoregressive Distributed Lag bounds test and the Dynamic Ordinary Least Squares. Their findings revealed that FDI and PI have significant negative effect on real estate investment in Kenya in the short-run but wanes in the long-run. The study also shows that the interaction between financial development and foreign inflows is significantly weak.

Awe (2013) examined the impact of foreign direct investment on economic growth in Nigeria from the year 1976 to 2006 using the two-stage least squares (2SLS) method of simultaneous equation model. The study revealed negative relationship between GDP proxy for economic growth and FDI.

Obi-Nwosu, Ogbonna and Ibenta (2021) looked at the role of FDI on the manufacturing capacity in Nigeria for the period 1984 to 2017. They employed OLS to estimate the variables and found out that FDI and EXR have significant impact on manufacturing capacity while INF did not. Furthermore, the study revealed the presence of a long-run relationship among the variables.

Orji, Uche and Ilori (2014) using the seemingly unrelated regressions estimation (SURE) technique examined implications of four different types of foreign capital inflows (Foreign Direct Investment - FDI, Official Development Assistance - ODA, Foreign Private Investment - FPI, and Remittances - REM) on the growth of the West Africa Monetary Zone (WAMZ) economies for the period 1981 t0 2010. Their result revealed that the foreign capital inflows have differences in the impact on the WAMZ countries. The outcome also demonstrates that Nigeria's output growth was positively impacted by multiple types of capital influx. Once more, we see that FDI promotes more production growth in Nigeria and the Gambia, while ODA positively contributes more to output growth in Ghana and Sierra Leone. In Liberia, remittances make up the largest portion of the total inflows, and ultimately, none of them have had a favourable effect on Guinea's economic growth.

Aliyu, Olalekan and Olusegun (2022) using the estimation model of Dynamic Ordinary Least Square (DOLS) technique examined the long-run nexus between foreign direct investment inflows and exchange rate in Nigeria. The study revealed a negative nexus between the independent and dependent variables – an increase in FDI brings about an appreciation of the Naira and vice versa.

Olabode (2021) investigated the impact of foreign capital inflows on the continuous increase in inflation in Nigeria from the year 1985 to 2019. A forecast Error Variance Decomposition technique was employed to analysis the cause-effect of inflation and foreign capital inflows and was affirmed positive. The outcomes show that the series have a long-term association. The findings also show that variables pertaining to foreign capital inflows, such as net official development assistance received and remittance inflows into Nigeria have an impact on inflation.

Roy and Rahman (2014) empirically assessed whether growing remittances cause an inflation as well as food inflation in Bangladesh using monthly data over the time period July 2003 to July 2013. Applying a Vector Error Correction Model (VECM) technique to estimate the variables' direction, extent and significance relationship, it shows that remittance inflows cause an inflationary pressure.

Afolayan and Jimoh (2019) examined the long-run relationship between FDI inflows and oil exports in Nigeria from 1990 to 2016 using Dynamic Ordinary Least Square (DOLS) and Granger Causality Test. It was determined that there is a strong positive correlation between Nigeria's oil exports and FDI inflows. This demonstrates that crude oil, which accounts for the majority of Nigeria's exports, is what attracts international investors to the country. Similarly, there is a unidirectional causal relationship between Nigeria's oil exports and FDI inflows. This demonstrates even further how the country's oil exports are driven by FDI inflows.

Said and Umar (2020) empirically examinedthe impacts of foreign direct investment on Nigeria's economic growth from 2017 to 2021. They employed Generalised Autoregressive Conditional Heteroscedasticity (GARCH) technique. The result of this showed that the variables—foreign direct investment, exchange rate, and inflation rate—were either stationary at level I (0) or first difference I (I). The GARCH model found that FDI has a positive impact on the exchange rate while the inflation rate has a negative impact.

Okafor (2020) investigated the impact of foreign investment on domestic inflation in Nigeria from 1987 to 2012. The study used ordinary Least Square technique and Granger causality for the estimation and the causality direction of the variables respectively. According to the findings, exports have a large and negative influence on inflation rates, while FDI and FPI have positive but non-significant effects.

Materials and Methods

This section delves into the materials and methods of the study. Sub topics looked at include research design, population of the study, method of data collection, method of data analysis, and model specification.

Research design

The study employs the ex post facto research design since the data cannot be influenced and it is suitable for studies that are looking at causalities.

Population of the Study

The study's population is Nigeria (i.e. geographic variable). Nigeria is a country situated in the West Sub-region of Africa. Her economy has been bedeviled by various macroeconomic indicators especially inflation rate over the years.

Method of Data Collection

Data for this study are collected from the world Development indicator, 2023. The data span from the period of 1999 (when democracy resumed after so many years of military regime) to 2023 (present date of democratic rule). The data variables include: INR (Inflation rate) as the dependent variable; FDI, DRE, and ODA as the independent variables and EXR (Exchange rate) as the country's specific.

Method of Data Analysis

The data for the study are analysed, first for stationarity, using the augmented Dickey-Fuller (ADF) unit root test. Secondly, the co-integration tests for long-run relationship between the dependent variable and the independent variables. Thirdly, the granger causality test to test the causality direction of the variables and lastly, the Ordinary Least Squares (OLS) technique is used to estimate the significance of the variables.

Model Specification

The study adopted the Olabode (2021) mathematical equation below:

$INF_t = \delta_0 + \delta_1\sum_{i=1}INF_{t-1} + \delta_2\sum_{i=1}FDI_{t-1} + \delta_3\sum_{i=1}REM_{t-1} + \delta_4\sum_{i=1}NOA_{t-1} + \mu_i$…*Equation 1*

Where: INF is inflation rate, FDI is foreign direct investment, REM is remittance inflows, NOA is net official development assistance, and μ_i is stochastic value with the following modifications. The removal of the $\delta_1\sum_{i=1}INF_{t-1}$ from the right hand of the equation, the change of the acronyms REM and NOA to read DRE and ODA, and the introduction of the country's specific, EXR.

Therefore, the study's model is specified below:

$INF = f(FDI, DRE, ODA, EXR)$……*Model 1*

As a result of the modification above, the mathematical equation for the study is thus:

$INF_t = \delta_0 + \delta_1\sum_{i=1}FDI_{t-1} + \delta_2\sum_{i=1}DRE_{t-1} + \delta_3\sum_{i=1}ODA_{t-1} + \delta_4\sum_{i=1}EXR_{t-1} + \mu_i$…*Equation 2*

Where:

INF = Inflation rate;

FDI = Foreign direct investment;
DRE = Diaspora remittance;
ODA = Official development assistance;
EXR = Exchange rate; and
μ = Stochastic value.

Apriori Expectation

The dependent variables and their expected signs (apriori expectation) are shown in Table 1 below.

Table 1: Apriori Expectation

Dependent Variables	Expected Sign
FDI	+
DRE	+
ODA	+
EXR	+

Source: Authors' Composition, 2024.

Result and Discussion

Equation 2 above is estimated using ordinary least square method using panel data for Nigeria on the variables included in the model. Result of the model is presented in Table 2 below, showing the levels at which the variables are stationary.

Augmented Dickey-Fuller (ADF) Unit Root Test

The ADF test was carried to test for the stationarity of the variables. The decision rule here is to reject stationary if ADF statistics are < the values at 1%, 5%, and 10% in absolute values or accept stationary if ADF statistics are < the values at 1%, 5%, and 10% in absolute values. This assertion is confirmed by Kozhan, 2010.

Table 2: Augmented Dickey-Fuller (ADF) Statistics

Variables	ADF Statistics	1% Critical Value	5% Critical Value	10% Critical Value	Order of Integration	Level of Significance	Remarks
INF	-4.074500	-3.752946	-2.998064	-2.638752	0(0)	.0048(5%)	Stationary
FDI	-5.317142	-3.788030	-3.012363	-2.646119	1(0)	.0003(5%)	Stationary
DRE	-5.583946	-3.769597	-3.004861	-2.642242	1(0)	.0002(5%)	Stationary
ODA	-4.911813	-3.769597	-3.004861	-2.642242	1(0)	.0008(5%)	Stationary
EXR	-4.318698	-3.808546	-3.020686	-2.650413	1(0)	.0034(5%)	Stationary

Source: Researchers' Computation from E-views, 2024.

Table 2 above shows the Augmented Dickey-Fuller unit root test for stationary of the variables. The result shows that INF, FDI and other variables in the model are integrated at the first-order [i.e. 0(0) and 1(0)]. The result reveals that the variables are stationary at levels. Since, ADF statistics are greater than the 1%, 5%, and 10% critical values. Thus, the ordinary least square of data estimation can be applied in the analysis of data.

Co-integration Test

The Johansen co-integration was conducted to ascertain whether a long-run relationship exist among the variables in the model. The test is of two types; the unrestricted co-integration rank test (Trace) and the unrestricted co-integration rank test (Maximum Eigen-value) statistics. The decision rule here according to Johansen, 2009, accept the null hypothesis if the probability of the critical value is > the 5% level of significance or reject the null and accept the alternative if it is < the 5% level of significance.

Table 3: Johansen Co-integration Test

Hypothesized No of CE(s)	Eigen-value	Unrestricted Co-integration Rank Test (Trace)			Unrestricted Co-integration Rank Test (Maximum Eigen-value)		
		Trace Statistics	5% Critical Value	Prob.**	Maximum Eigen-value Statistics	5% Critical Value	Prob.**
None *	0.991120	173.6791	69.81889	0.0000	99.20300	33.87687	0.0000
At most 1 *	0.833355	74.47610	47.85613	0.0000	37.62969	27.58434	0.0019
At most 2 *	0.701109	36.84641	29.79707	0.0065	25.36118	21.13162	0.0119
At most 3	0.324285	11.48523	15.49471	0.1833	8.231667	14.26460	0.3556
At most 4	0.143526	3.253563	3.841466	0.0713	3.253563	3.841466	0.0713
Trace test indicates 3 co-integrating eqn.(s) at the 0.05 level Max-Eigen-value test indicates 3 co-integrating eqn.(s) at the 0.05 level * denotes rejection of the hypothesis at the 0.05 level **MacKinnon-Haug-Michelis (1999) p-values							

Source: Researchers' Computation from E-Views, 2024.

Table 3 shows that there is a long-run relationship between INF and foreign inflows as the informative variable. The results from the Trace and Maximum-Eigen probability show three (3) co-integration equations. The results are based on the probability of the critical values less than 5% level of significance. The study then indicates that there is co-integration among the variables of the model. This connotes that there is a long-run relationship between foreign inflows and inflation rate in Nigeria in long-run.

Granger Causality Tests

The granger causality test was carried out to see the direction of the variables. The direction here could be: bi-directional, unidirectional, and no direction. However, the decision rule is that accept the null hypothesis if the F-probability is > the 5% level of significance or reject the null hypothesis if the F-probability is < the 5% level of significance.

Table 4: Pair-Wise Granger Causality Tests

Null Hypothesis:	**Obs.**	**F-Statistic**	**Remark**
FDI does not Granger Cause INF	21	3.55617	No Causality
INF does not Granger Cause FDI		0.13193	
DRE does not Granger Cause INFL	23	2.05560	No Causality
INF does not Granger Cause DRE		0.19527	
ODA does not Granger Cause INF	23	2.35056	No Causality
INF does not Granger Cause ODA		2.10607	
EXR does not Granger Cause INF	23	2.98316	No Causality
INF does not Granger Cause EXR		3.52480	

Source: Researchers' Computation from E-Views, 2024.

Table 4 shows the Pair-Wise Granger causality test for the model. Based on the decision rule, there is no direction causality – the independent variable does not granger causes the dependent variable and vice versa.

Ordinary Least Squares (OLS) Estimation

The OLS estimation was carried out to see the significance of the independent variables. The decision rule here is that accept the null hypothesis if the probability is > the 5% level of significance or reject the null hypothesis if the probability is < the 5% level of significance.

Table 5: OLS Estimation

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.390856	22.74901	0.105097	0.9174
FDI	5.917136	3.919864	1.509526	0.1476
DRE	-7.946510	3.820815	-2.079795	0.0513
ODA	2.934345	3.200088	0.916958	0.3707

EXR	0.032296	0.012322	2.620964	0.0168
R-squared	0.315911	Mean dependent var		12.19542
Adjusted R-squared	0.171893	S.D. dependent var		3.703407
S.E. of regression	3.370116	Akaike info criterion		5.450823
Sum squared resid	215.7959	Schwarz criterion		5.696251
Log likelihood	-60.40988	Hannan-Quinn criter.		5.515935
F-statistic	2.193544	Durbin-Watson stat		2.012950
Prob(F-statistic)	0.108581			

Source: Researchers' Computation from E-Views, 2024.

Table 5 above shows the result of the estimated model using the OLS techniques. The result shows that FDI has an insignificant positive impact on inflation rate in Nigeria (i.e. probability = 0.1476 and coefficient = 5.917136). DRE has a significant negative impact on inflation in Nigeria (i.e. probability = 0.0513 and coefficient = -7.946510). ODA has an insignificant positive impact on inflation in Nigeria (i.e. probability = 0.3707 and coefficient = 2.934345). EXR, the country's specific has a significant positive impact on inflation in Nigeria (i.e. probability = 0.0168 and coefficient = 0.032296)

The coefficient of determination, R-square (R^2) is 0.315911, depicting that about 32% of the reason inflation rate is going up is caused by the independent variables in the model. However, the F-statistic shows that the overall model is insignificant (i.e. probability = 0.108581 and coefficient = 2.193544). This confirmed the test of the granger causality. However, DRE in the granger causality test shows no direction but alone shows a significant negative impact in the OLS test of the model.

Conclusion and Recommendations

The objective of this study is to investigate the impact of foreign inflows on the inflation rate in Nigeria. For this objective to be achieved, a country specific, exchange rate is included in the model for the study. To substantiate the impact of foreign inflows on inflation rate in Nigeria, the OLS test was conducted. The outcome of the OLS test revealed that foreign inflows variables have an insignificant positive impact on inflation in Nigeria except for DRE that has a significant negative impact.

From the Granger causality test it shows that if foreign inflows are appropriately utilised, they will bring about increase in production of goods and services, helping to drive inflation rate down. The result of the OLS corroborates the studies of Awe, 2013; Changaya & Olanrewaju, 2020; Said & Umar, 2020; and Okafor, 2020. On the other hand, it negates the studies of Uche & Ilori, 2014; Roy & Rahman, 2014; Afolayan & Jimoh, 2019; Orji, Aliyu, Olalekan & Olusegun, 2020; Olabode, 2021; and Obi-Nwosu, Ogbonna & Ibenta, 2021.

The study, therefore, recommends that the government should encourage inflows of FDI and properly direct funds to meaningful investment in the critical sectors of the economy for the adequate production of goods and services for both export and domestic consumption to improve our balance of payments. Also, DRE should be improved upon and funds directed to capital investment and less on purchases of foreign or imported goods and luxury items that are not meant for further production of goods and services. Again, the government should put into use ODA's funds; a proper matching concept should be adopted instead of diversion of funds to other uses. This will stop further ODAs because proper retirement or accountability of how the funds are spent cannot be made. If these recommendations are carried out, they will not only curb inflation rate but bring about enormous economic stability in Nigeria in the long-run.

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