European Journal of Business and Management
ISSN 2222-1905 (Paper) ISSN 2222-2839 (Online)
Vol.5, No.2, 2013
www.iiste.org

The Impact of Capital Account Liberalization on Economic Growth in Nigeria

*Okore Amah Okore
Department of Banking and Finance, University of Nigeria, Enugu Campus, Nigeria
Phone No: +234 803 0950 215
Email: krisamah@yahoo.com

**John Okey Onoh
Bursary Department, Renaissance University, Enugu, Nigeria
Phone No: +234 803 540 5014
Email: johnonoh@yahoo.com

Abstract
Capital account liberalization is a parameter used in measuring the degree of openness of an economy, signaling the rate of inflow and outflow of capital from one economy to another without undermining its territorial integrity and independence. The greatest challenge facing the country today is how to grow the economy and reduce poverty. Meeting this challenge is particularly difficult, if Nigeria should rely solely on domestic resources, given the low rate of savings and the attendant savings-investment gap. Against this background, it becomes crucial to try and attract foreign resources into the economy. This study examines the impact of capital account liberalization on economic growth in Nigeria. The period of study covers between 1971 and 2011. This period was divided into Pre-Liberalization and Post-Liberalization eras. The technique of analysis is the Ordinary Least Square Method using the E-view statistical software. The study reveals that capital account liberalization had positive and significant impact on economic growth in Nigeria, therefore, the removal of restrictions from international transactions related to the movement of capital leads to an increase in economic growth.
Keywords: Capital Account Liberalization, Economic Growth and Nigeria

1.0 Introduction

Economic growth and development has remained the focal point of major economic policy of most countries of the world. Developing countries as well as other member countries of the International Monetary Fund (IMF) have always been encouraged to open up to foreign capital flows through the liberalization of their capital account transactions, (Mailafia, 2006). Capital account liberalization is the process of removing restrictions from international transactions related to the movement of capital. It can involve the removal of controls on both domestic residents' international financial transactions and investments in the home country by foreigners (Odusola, 2006).

The structural adjustment programme (SAP) of 1986 set the pace for capital account liberalization in Nigeria. The liberalization of the financial system in 1987 is believed to have attracted many foreign investors to Nigeria. Obadan (2005) posits that the liberalization of capital account of balance of payments is rooted in economic theory. Not only can it help to bridge the savings and foreign exchange gap in national economies, and hence promote higher economic growth, it can also lead to greater efficient allocation of resources internationally and greater portfolio risk diversification, among others. Odusola (2006) is of the view that liberalization of capital account allows for international portfolio diversification. According to him, domestic market agents have the opportunity of diversifying country specific risks, which ordinarily cannot be diversified under capital account restriction.

However, Dani (1998) and Stiglitz (2002) argue that capital account liberalization attract speculative hot money that makes the economy more susceptible to financial crisis. Due to asymmetry of information in many developing economies, markets become inefficient and negative effects of capital account liberalization could manifest in such forms as adverse selection, moral hazard and herd behaviours (Wang, 2002). Obadan (2006) is of the opinion that capital account liberalization heightens the risk of crisis and amplifies the effects of policy distortions through a number of channels. First, is the inflow and outflow of short-term liquid and speculative capital. Second, by allowing the entry of foreign banks, capital account liberalization, like domestic financial liberalization, can squeeze margins and remove domestic banks' cushion against loan losses. Third, like domestic financial liberalization, it can facilitate gambling for redemption, in this case by offering access to elastically supplied offshore funding and by allowing access to risky foreign investment. Fourth, a currency crisis or unexpected devaluation can undermine the solvency of banks and bank customers who have been allowed to accumulate large un-hedged foreign exposures by open capital accounts and lax regulations.

It is in view of the above, that this study seek to determine the impact of capital account liberalization on economic growth in Nigeria.

2.0 Review of Related Literature

2.1 The Concept of Capital Account Liberalization

Cobbam (2001) in Omoruyi (2006) is of the view that capital account liberalization is the process of removing restrictions from international transactions related to the movement of capital. It involves allowing not only foreign direct investment (FDI), but also capital inflows to bond and equity markets and to the banking sector. It can apply to both inflows and outflows of capital. Capital account restrictions can take various forms including:

i. limiting domestic banks' foreign borrowing;
ii. controlling foreign capital coming into the economy;
iii. limiting the sectors of industry in which foreigners can invest; and
iv. restricting the ability of foreign investors to repatriate money earned from investment in the domestic economy, (Omoruyi, 2006).

According to Adedipe (2006), liberal economists have argued against capital restriction for years. This is not withstanding, they appreciate the dangers of badly handled liberalization. These dangers have been evidenced in the financial crises that erupted in most of the emerging economies that attempted liberalization without the supporting initial conditions. Adedipe argued further that, in the developed economies, with deep and diversified financial markets, honest and competent regulators and macroeconomic policies that keep public borrowing and inflation in check, liberal regime for capital flow works best. It works so well that the policy virtually elicits no debate. However, in developing economies, he stated that liberalization of the capital account has proved very costly when combined with interest rate liberalization against the backdrop of weak macroeconomic policy environment and financial markets; see Onwumere, Okore and Ibe (2012).

2.2 Role and Benefit of Capital Account Liberalization

Odusola (2006), stated that the theoretical benefits of the linkages between capital account liberalization and the overall economic growth have been well referred to in the literature (Fischer, 1998; Henry, 2003b; Obadan, 2004; and Le Fort, 2005). The much mentioned benefit of capital account liberalization is the opportunity of increasing the array of assets available in the local markets as well as efficiency and competition in the provision of financial assets.

Capital account liberalization can play an important role in attracting foreign investment to an economy and in helping to manage the macroeconomic implications of such capital flows (Oyejide, 2006). Ojo (2006) put forward that, capital account liberalization engenders competition which induces more efficient financial sector and greater international productivity. Through capital movements, a nation's economy derives more income from the opportunities created by the diversification of portfolio investments and sharing of risks. Higher incomes will encourage more savings, investment and economic growth. Capital flows also facilitate the transfer of technology and commercial know-how through properly negotiated technical agreements thus creating further welfare gains.

2.3 Sequencing of Capital Account Liberalization

According to Mordi (2006), fundamental to this process are issues of macroeconomic stability, adequate prudential supervision and regulation of domestic financial markets and institutions, adequate disclosure practices, corporate governance, as well as avoidance of measures that encourage excessive and unsustainable capital inflows. Mailafia (2006), suggested that, the current account should be liberalized before the capital account. The ability of the financial sector to absorb huge inflows should be put into consideration. He continued that until the required level of efficiency is achieved in the banking sector, liberalization of more volatile short term capital inflows should be implemented with great caution.

There have been debates among economists on the approaches to capital account liberalization in terms of the pace and sequencing of liberalization. In this direction, two broad approaches stand out, namely, the 'big bang' approach and the gradualist approach. The gradualist approach entails a more deliberate and phased strategy to economic reform that emphasizes reforms in the capital account. Under this approach, the phasing of liberalization may be based on distinctions between residents and non-residents as was done in India and South Africa. On the other hand, the 'big bang' approach entails a more rapid transition to open capital account, in some cases involving a one-step process in simultaneously liberalizing controls on capital inflows and outflows. The argument is that since resources are lost through obstacles to free capital flows, the sooner it is liberalized the better (Obadan, 2006).

However, on the question of whether to liberalize gradually or adopt a big bang approach, there was a consensus at the report of a conference held in London on "Capital account liberalization: The Developing Country Perspective", 2000, to adopt a gradual movement towards capital account liberalization.

Thus, Omoruyi (2006), suggested that appropriate sequencing of events to achieve maximum benefits from capital account liberalization is as follows:

i. put in place trade liberalization;
ii. undertake macroeconomic reforms, notably sound financial system reforms with good supervisory framework;
iii. maintain independent monetary policy and flexible and sustainable exchange rate regimes;
iv. maintain sound level of international reserves; maintain good database on capital flows;
v. liberalize capital account gradually, analyzing the situation closely using balance of payments official data and other sources;
vi. maintain detailed contingency plans in case trends turn out to be negative;
vii. review existing legal framework for consistency;
viii. train staff to effectively enforce new regulations; and
ix. balance openness with controls of capital account, recognizing lags in policy implementation: perception, recognition lag and impact lag.

3.0 Methodology

The ex-post facto research design was adopted to enable the researchers make use of secondary data to determine the cause-effect relationship of capital account liberalization and economic growth in Nigeria. The variables were observed over the period, 1971 to 2011. The assessment period were divided into two: Pre-Liberalization era (1971-1985) and Post-Liberalization era (1985-2011).

Simple linear regression technique was adopted using E-view statistical software. Onwumere (2009) stated the general simple linear regression model as follows:

$$Y = b_0 + b_1X_1 + \mu \quad - \quad - \quad - \quad - \quad - \quad - \quad - \quad - \quad - (1)$$

where Y is a function of K independent variable which is in the form of X and μ is an error term.
Based on the above, our model for this study is specified as follows:

$$GDP_t = a_0 + a_1CA_t + \mu_t \quad - \quad - \quad - \quad - \quad - \quad - \quad - \quad - (2)$$

where: GDP_t = Gross Domestic Product at time t (A proxy for economic growth); CA_t = Capital Account at time t; μ_t = Random error term at time t.

The above model shall however, be modified to ease computation with the software. It is modified as follows:

$$\text{Log GDP}_t = b_0 + \text{Log CA}_t + \mu_t \qquad - \quad - \quad - \quad - \quad - \quad - \quad - \ (3)$$

where: Log GDP_t = Logarithm of GDP at time t; Log CA_t = Logarithm of CA at time t; μ_t = Random error term at time t.

4.0 Presentation and Analysis of Data

4.1 Presentation of Data

Table 4.1 below presents the quantum and the log values of the model proxies.

Table 4.1: Capital Accounts, Gross Domestic Product, Log of Capital Accounts and Log of Gross Domestic Product

Years	Capital Accounts	GDP at 1990 constant basic prices	Log CA	Log GDP
	(N' Million)	(N' Million)		
1971	293.40	4,715.50	2.47	3.67
1972	269.20	4,892.80	2.43	3.69
1973	144.80	5,310.00	2.16	3.73
1974	(5.90)	15,919.70	-0.77	4.20
1975	141.10	27,172.02	2.15	4.43
1976	(50.60)	29,146.51	-1.70	4.46
1977	150.40	31,520.34	2.18	4.50
1978	1,111.90	29,212.35	3.05	4.47
1979	813.20	29,947.99	2.91	4.48
1980	97.40	31,546.76	1.99	4.50
1981	929.50	205,222.06	2.97	5.31
1982	3,470.90	199,685.25	3.54	5.30
1983	2,735.70	185,598.14	3.44	5.27
1984	171.90	183,562.95	2.24	5.26
1985	(2,555.00)	201,036.27	-3.41	5.30
1986	(1,900.90)	205,971.44	-3.28	5.31
1987	(16,743.30)	204,806.54	-4.22	5.31
1988	(18,447.30)	219,875.63	-4.27	5.34
1989	(30,221.90)	236,729.58	-4.48	5.37
1990	(49,245.30)	267,549.99	-4.69	5.43
1991	(27,482.90)	265,379.14	-4.44	5.42
1992	(138,755.60)	271,365.52	-5.14	5.43
1993	(19,740.90)	274,833.29	-4.30	5.44
1994	30,698.80	275,450.56	4.49	5.44
1995	34,627.40	281,407.40	4.54	5.45
1996	0.00	293,745.38	0.00	5.47
1997	0.00	302,022.48	0.00	5.48

1998	1,313.40	310,890.05	3.12	5.49
1999	1,218.90	312,183.48	3.09	5.49
2000	3,324.00	329,178.74	3.52	5.52
2001	0.00	356,994.26	0.00	5.55
2002	(6,547.00)	433,203.51	-3.82	5.64
2003	2,621.10	477,532.98	3.42	5.68
2004	4,721.50	527,576.04	3.67	5.72
2005	962,972.00	561,931.39	5.98	5.75
2006	1,357,983.63	595,821.61	6.13	5.78
2007	0.00	634,251.14	0.00	5.80
2008	0.00	672,202.55	0.00	5.83
2009	0.00	718,977.33	0.00	5.86
2010	0.00	776,332.21	0.00	5.89
2011	0.00	834,161.83	0.00	5.92

Source: Central Bank of Nigeria Statistical Bulletin, 2011

4.2 Analysis of Results

Table 4.2: Pre-Liberalization Era (1971 - 1985)

Dependent Variable: LOGGDP
Method: Least Squares
Sample: 1971 -- 1985
Included observations: 15

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOGCA	-0.011386	0.082457	-0.138079	0.8923
C	4.590803	0.214063	21.44606	0.0000

R-squared	0.001464	Mean dependent var	4.571333
Adjusted R-squared	-0.075346	S.D. dependent var	0.601544
S.E. of regression	0.623794	Akaike info criterion	2.017574
Sum squared resid	5.058554	Schwarz criterion	2.111981
Log likelihood	-13.13181	F-statistic	0.019066
Durbin-Watson stat	0.187005	Prob(F-statistic)	0.892294

Source: Authors' E-view Computation

As indicated in the above table, the impact of capital accounts on gross domestic product before liberalization, is negative and non-significant (coefficient of logca = -0.01, t-value = -0.14) using 1971 - 1985 data. The probability value of 0.00 > 0.05 indicates that capital accounts had no significant impact on GDP before liberalization. On the whole the coefficient of determination as revealed by R-square (R^2) indicates that 0.001 of the variations observed in the dependent variable were explained by variations in the independent variable. The test of goodness of fit as indicated by R^2 was properly adjusted by the Adjusted R-Square of -0.07. The overall probability (F-statistics) is 0.89 which is greater than 0.05 indicates that the impact was non-significant.

Table 4.3: Post-Liberalization Era (1986-2011)
Dependent Variable: LOGGDP
Method: Least Squares
Sample: 1986 - 2011
Included observations: 26

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOGCA	0.022568	0.009567	2.359011	0.0268
C	5.570206	0.034545	161.2427	0.0000

R-squared	0.188227	Mean dependent var	5.569615
Adjusted R-squared	0.154404	S.D. dependent var	0.191551
S.E. of regression	0.176143	Akaike info criterion	-0.561233
Sum squared resid	0.744636	Schwarz criterion	-0.464457
Log likelihood	9.296034	F-statistic	5.564934
Durbin-Watson stat	0.209092	Prob(F-statistic)	0.026802

Source: Authors' E-view Computation

As shown in the above table, the impact of capital accounts on gross domestic product after liberalization is positive and significant (coefficient of logca = 0.02, t-value = 2.36). The probability value of 0.00 < 0.05 indicates that capital account has a significant impact on GDP after liberalization. On the whole the coefficient of determination as revealed by R-square (R^2) indicates that 18.8% of the variations observed in the dependent variable were explained by variations in the independent variable. The test of goodness of fit as indicated by R^2 was properly adjusted by the Adjusted R-Square of 15.4%. The overall probability (F-statistics) is 0.027 which is less than 0.05 indicates that the impact is significant.

5.0 Conclusion

The paper set out to examine the theoretical and empirical issues on capital account liberalization with a view to determining the impact of capital account liberalization on economic growth in Nigeria. In other to achieve the above objective, the period under study which is 1971 - 2011 was divided into two: Pre-Liberalization Era (1971-1985) and Post-Liberalization Era (1986 - 2011). Findings from the study shows that capital account had a negative non significant impact on Gross Domestic Product and therefore economic growth before liberalization.

The study also revealed that, the impact of capital account on Gross Domestic Product after liberalization is positive and significant. Hence, opening up to foreign capital account flows through the liberalization of capital account transactions increases Gross Domestic Product and therefore economic growth. Thus, capital account liberalization enhanced economic growth in Nigeria. Therefore, the removal of restrictions from international transactions related to the movement of capital leads to an increase in economic growth. This is consistent with the findings of Obadan (2005).

REFERENCES

Adedipe, B. (2006), "Capital Account Liberalization: What Options for Developing Economies?". CBN Economic and Financial Review, 44(4).
Alilonu, E.O.(2006), "A Welcome Address at the 2006 in-house Seminar on 'Capital Account Liberalization: Issues, Problems and Prospects' for CBN Executive Staff". CBN Economic and Financial Review, 44(4).
Central Bank of Nigeria (2011), "Statistical Bulletin". Vol. 22
Cobbam, A. (2001), "Capital Account Liberalization and Poverty". Paper Commissioned by the Bretton Woods Project and Oxfam, Oxford University.
Dani, R. (1998), "Who Needs Capital Account Convertibility?" in S. Fischer, R.N. Cooper, R. Dornbusch, P.M. Garber, C. Massad, J.J. Polak, D. Rodrik and S.S. Tarapore, Should the IMF Pursue Capital Account Convertibility? Princeton, N.J. : International Finance Section, Department of Economics, Princeton University, p. 55-65.

Fischer, S. (1998), "Capital Account Liberalization and the Role of the IMF". Princeton Essays in International Finance, No. 207. p 1-10

Henry, P. B. (2003b), "Capital Account Liberalization: the Cost of Capital and Economic Growth". American Economic Review, p. 91-96.

International Monetary Fund (2005), "The IMF's Approach to Capital Account Liberalization". Independence Evaluation Office.

Le Fort, G. (2005), "Capital Account Liberalization and the Real Exchange Rate in Chile". IMF Working Paper (WP/05/132).

Mailafia, O. (2006), "Capital Account Liberalization: Reflections on Theory and Policy". CBN Economic and Financial Review, 44(4).

Mordi, C. N. O.(2006), "A Welcome Address at the 2006 in-house Seminar on 'Capital Account Liberalization: Issues, Problems and Prospects' for CBN Executive Staff". CBN Economic and Financial Review, 44(4).

Obadan, M. I. (2004), "Foreign Capital Flows and External Debt: The Perspectives of Nigeria and the LDCs Group". Broadway Press Limited.

Obadan, M. I. (2005), "Financial Globalization in Sub-Sahara Africa". A Research Report Prepared at the United Nation's African Institute for Economic Development and Planning, Dakar.

Obadan, M. I. (2006), "Capital Account Liberalization: Experience from the Emerging Market Economies". CBN Economic and Financial Review, 44(4).

Odusola, A. F. (2006), "Capital Account Liberalization in Nigeria: Problems and Prospects". CBN Economic and Financial Review, 44(4).

Ojo, M. O. (2006), "Capital Account Liberalization: The ECOWAS Experience". CBN Economic and Financial Review, 44(4).

Okogu, B. and Osafo-Kwaako, P. (2006), "Sequencing Capital Account Liberalization". CBN Economic and Financial Review, 44(4).

Omoruyi, S. (2006), "Capital Account Liberalization: The Way Forward for Nigeria". CBN Economic and Financial Review, 44(4).

Onwumere, J.U.J. (2009), "Business and Economic Research Methods", Enugu: Vougasen Ltd.

Onwumere, J.U.J; Okore, O.A. and Imo, I.G. (2012), "The Impact of Interest Rate Liberalization on Savings and Investment: Evidence from Nigeria". Research Journal of Finance and Accounting, 3(10), p. 130-136. www.iiste.org

Oyejide, T. A. (2006), "Globalization and Capital Account Liberalization". CBN Economic and Financial Review, 44(4).

Stiglitz, J. (2002), "Globalization and its Discontents". New York: Norton.

Wang, Y. (2002), " Capital Account Liberalization: The Case of Korea". Korea Institute for International Economic Policy.