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Illicit Financial Flow and Revenue Generation in Nigeria

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Abstract:
The cost of debt servicing in Nigeria is on the rise and takes an increasing portion of the public revenue generated. A report by the Global Financial Integrity shows how countries in Sub-Sahara Africa loses capital illegally of which Nigeria is not excluded. Hence, this study examines the influence of illicit financial flow on revenue generation in Nigeria. The ex-post facto research design was used and secondary data was collected from the 2021 report of the Global Financial Integrity and the National Bureau of Statistics in Nigeria. The data was covered over a time span which ranged from 2005 to 2018. The simple regression model was used to examine the influence of illicit financial flow on revenue generation in Nigeria. The result shows that illicit financial flow has an inverse influence on oil revenue in Nigeria and a positive influence on non-oil revenue in Nigeria. it was concluded from the study that illicit financial flow has a significant influence on revenue generation in Nigeria. It is recommended that the Federal government set up measures to prevent illicit financial flow in Nigeria.

Keywords: Illicit financial flow, non-oil revenue, Oil revenue, Resource curse

INTRODUCTION

Illicit financial flow is a global phenomenon, a 2021 report by Global Financial Integrity (GFI) shows how countries across the globe lose funds to capital flight. Capital flight whether carried out legally or not have a negative consequence which ranges from loss in the potential for economic growth, loss in tax revenue and potential commercial activities.

Bawa and Ogwiji (2020) pointed out that illicit financial flow is not a new phenomenon specially to developing countries. Erik (2015) pointed out that developing countries have lost huge sums of United States Dollars to illicit financial flow. GFI (2021) reported that about one trillion United States Dollars is lost annually from developing countries. They further show that these funds are linked to terrorist financing which are taken from the economy through corrupt practices, money laundering, profit shifting and tax evasion schemes amongst others. GFI (2021) pointed out that tax havens, shell companies, transfer pricing, false invoicing are some of the schemes adopted to facilitate the illicit financial flow out of developing countries. Capital flight is seemingly different from capital outflow which can be described as the outflow of capital from within the country to foreign countries. This occurs as a result of customers within a country patronizing goods that are outside the country. However, capital flight on the other hand is the sudden loss in funds which are in substantial amounts to foreign countries. Capital flight can be carried out legally and illegally. Illicit financial flow is an illegal route of capital flight.

Capital flight is usually triggered by unstable political system in a country, high level of unfavorable business environment which include high level of inflation, low level of domestic interest rate amongst others. All these culminate and also weaken the value of the currency of such an economy which also triggers capital flight. The loss of capital especially through the illicit flow of finances has a negative effect on any country and the effect ranges from loss in potential tax revenue, a decrease in purchasing power for consumers, loss in capital which slows down other commercial or productive activities in such an economy and ultimately hampers the economic growth of the economy (History, 2023). An examination of the revenue generation from oil activities shows that the Nigerian oil sector has increased output and activities compared to when oil was first discovered in commercial quantities in 1978, however, the country is still characterized by low literacy rate, inadequate power supply, non-functional refineries, untapped potentials in the agricultural, manufacturing and mining activities, insecurity amongst others (Joseph & Omodero, 2019). Non-oil revenue is driven basically by tax revenue as tax revenue has been identified as one of the major sources of revenue to any government (Audu, 2020). Nigeria is not exempted from this, however, Audu (2020) showed how Nigeria has had a low tax to gross domestic product (GDP) performance between 2015 to 2021 which is pointed out as poor compared to Nigeria's pairs in the Sub-Saharan Africa which have an average tax to GDP of 18%. This result suggests that the level of economic activities is still low which leads to less tax revenue or it can also be depicted that there exist possible revenue leakages which have made the tax to GDP ratio in Nigeria low. Even though the 2022 report of the National Bureau of Statistics (NBS), shows that Nigeria has a tax to GDP ratio of 10.68%, this is still below the average of similar countries like Nigeria in the Sub-Saharan African region. This is also weak compared to the average of 30% of the top five economies in the world (G5). According to data from the World Bank, Nigeria currently is classified as a developing country hence; the issue of illicit financial flow is not alien to Nigeria. Nigeria suffers from illicit financial flow also as reported by the Global Financial Integrity (GFI) in 2021. Various authors have shown empirically how Nigeria economic growth has been hampered as a result of illicit financial flow (Bawa & Ogwiji, 2022; Joseph & Omodero, 2019; Ogbonnaya & Ogechukwu, 2017). While some others have shown how Nigeria suffers from loss in tax revenue as a result of illicit financial flow (Combes *et al.*, 2021; Thiao, 2020; Onogwu, 2019).

Babatope and Audu (2020) showed how economic growth in Nigeria has been performing below expectation and showed empirically a link between accountability and economic growth. Illicit financial flow represents the level of transparency in any economy as countries with quality regulatory system might be less prone to illicit financial flow. On the other hand, Audu (2020) showed how Nigeria tax revenue has also been below the average of developed economies in the world and also below the average of similar African countries. These indices all point to the abysmal economic performance of the Nigerian economy. Studies that considered illicit financial flow influence on revenue examined it from tax revenue perspective (Combes *et al.*, 2021; Thiao, 2020; Onogwu, 2019). However, in Nigeria, government revenue does not emanate from only tax revenue but other forms of revenue. Hence, this study is intended to examine government revenue holistically. Therefore, the main objective of this study is to examine the influence of illicit financial flow on revenue generation in Nigeria. The remaining part of this study covers the theoretical framework on which this study is built, the methodology which explains how the data was gotten and processed, the results and discussion of findings, the conclusion and recommendations.

THEORETICAL FRAMEWORK

This study is hinged on the theory of resource curse theory. The resource curse theory origin can be traced first to Richard Auty in the year 1993. The theory explains that countries that have abundance of natural resources are unable to tap the potential to achieve economic prosperity. The theory is built on the assumption that leaders of such countries utilize the resources for their own selfish purpose rather than for the economic prosperity of their country (Ross, 1999). Some proponents opposed the logic of the resource curse theory stating the economic growth is a function of the value of exports and therefore economic growth is a function on the development of the industrialization and not necessarily the existence of natural resources (Brunnschweiler & Bulte, 2008). In addition, others stated that countries economic performances are a reflection of their economic policies which either promotes commerce and makes it possible for investors both within and outside the country are well motivated to invest in the country (Dunning, 2008). On the other hand, Sachs and Warner (1995) showed empirical evidence that showed how indeed countries rich in natural resources actually perform lower than those with minimal resources. Hence, validating the resource-based theory postulation.

This theory is considered suitable for this study as Nigeria is a country endowed with natural resources such as crude-oil, large expanse of fertile land for agricultural activities, iron-ore, coal, minerals, human resource amongst others. Yet, the country seems to be performing below expectation. Based on this theory, this can be attributed to leadership challenges that prevent the right utilization of the resources which has affected the development of its industrialization and has not encouraged investors to pull in their capital and let such capital remain which leads to the capital flight such as illicit financial flow and hence revenue that should have been taxed are not available and the revenue generated seems to be below expectation. Hence, the need for this study which is to examine the influence on illicit financial flow on revenue generated in Nigeria.

EMPIRICAL REVIEW

Bawa and Ogwiji (2022) examined the impact of illicit financial flow on the level of economic growth in Nigeria. *Ex-post facto* research design and secondary data was gathered from the CBN bulletin and from the EFCC for a period ranging from 2010 to 2019. It was shown from the study illicit financial flow stopped by the EFCC has a positive but insignificant influence on the level of economic growth in Nigeria.

Combes *et al.* (2021) examined the influence of illicit financial flow on tax revenue of Financial Action Task Force countries. *Ex-post facto* research design was used in the study. It was pointed out from their study that illicit financial flow has a significant impact on indirect tax revenue and not a significant impact on direct tax revenue of Financial Action Task Force countries.

Thiao (2020) assessed the influence of illicit financial flow on the level of government revenue in selected West African countries. *Ex-post facto* research method was used and secondary data was collected over a period range from 1996 to 2013. It was pointed out from the study that illicit financial flow has a negative significant influence on the level of government revenue of selected West African countries.

Onogwu (2019) assessed the trend of illicit financial flow and its influence on economic development in Nigeria. Qualitative research method was used in this study and literature were reviewed. It was revealed from the study that illicit financial flows have significantly deprived Nigeria of development funds.

Joseph and Omodero (2019) evaluated the influence of illicit financial flows on the growth of the Nigerian economy. *Ex-post facto* research design was used and secondary data over a period range from 2005 to 2018. The outcome of their study showed that illegal commercial activities have an inverse influence on the level of economic growth in Nigeria.

Ogbonnaya and Ogechukwu (2017) assessed the effect of illicit financial flow on economic growth level in Nigeria. *Ex-post facto* research design was used and secondary data from 1980 to 2015 was used in the study. Their study showed that illicit financial flow has a significant influence on the level of economic growth and development in Nigeria.

Gap in the Study

From the review of existing related literature, it is revealed that there is paucity of studies in this direction, this might be due to the difficulty in obtaining data on illicit financial flow (Joseph & Omodero, 2019). In addition, studies in Nigeria related to the theme of this study examined how illicit financial flow influenced economic growth. Hence, this study is intended to fill a methodological gap by using public revenue generated as an economic performance proxy rather than gross domestic product. Hence, the below hypotheses are tested in this study which are:

- H_o1: Illicit financial flow does not have any significant influence on oil revenue in Nigeria.
- H_o2: Illicit financial flow does not have any significant influence on non-oil revenue in Nigeria

METHODOLOGY

The quantitative research method was adopted for this study. The *ex-post facto* research design was used in this study as it allowed the examination of past events. The geographical boundary of this study is Nigeria and secondary data was gathered over a fourteen-year time frame spanning from 2005 to 2018 based on the availability of data collected. The simple regression method is used to carry out the inferential analysis in this study. The regression model is used as it allows the examination of the influence of the independent variable (illicit financial flow) on the dependent variable (revenue generated). The T-test was used to test the significance of the result at a set rate of 5%. The breakdown of the regression model is depicted below:

$$Y=f(X)$$

Revenue = f (Illicit financial flow).

Mathematically, this can be written as shown below:

$$ORV = \beta_o + \beta_{1IFF} + e \quad \ldots\ldots\ldots\ldots \text{i}$$

$$NRV = \beta_o + \beta_{1IFF} + e \quad \ldots\ldots\ldots\ldots \text{ii}$$

Where,
ORV = Oil Revenue (Dependent Variable)
NRV = Non-Oil Revenue (Dependent Variable)
β_o = Intercept where independent variable is zero
β_{1IFF} = Illicit financial flow (Independent Variable)
e = error term

DATA ANALYSIS AND DISCUSSION OF FINDINGS

The result of the hypotheses tested is displayed in this section.

- Hypothesis One: Illicit financial flow does not have any significant influence on oil revenue in Nigeria.

Table 1: Regression Result on Hypothesis One

Estimation Techniques	**Regression Result**			
Dependent Variable: ORV	**Coeff.**	**Std. Err**	**T-Stat**	**Prob**
Constant	6752.957	728.423	9.271	0.000
IFF	-0.318	0.145	-2.191	0.049
Adjusted R^2	0.226			
F-Stat	$F_{(1, 14)}$ = 4.80 (0.049)			

Source: Researchers Computation (2023)

Table 1 reveals that illicit financial flow has an inverse influence on oil revenue. It further shows that illicit financial flow has a significant influence on oil revenue. This means that the higher the level of illicit financial flow out of Nigeria, the lower the level of oil revenue generated. The result also shows that illicit financial flow explains about twenty-seven percent of what happens in oil revenue in Nigeria.

- Hypothesis Two: Illicit financial flow does not have any significant influence on non-oil revenue in Nigeria

Table 2: Regression on Hypothesis Two

Estimation Techniques	**Regression Result**			
Dependent Variable: NRV	**Coeff.**	**Std. Err**	**T-Stat**	**Prob**
Constant	1431.011	394.530	3.627	0.003
IFF	0.210	0.079	2.670	0.020
Adjusted R^2	0.320			
F-Stat	$F_{(1 14)}$ = 7.13 (0.020)			

Source: Researchers Computation (2023)

Table 2 shows that illicit financial revenue explains about thirty-two percent approximately of non-oil revenue in Nigeria. the result further reveals that illicit financial flow has a positive influence on the level of non-oil revenue in Nigeria. The result also shows that this is significant. Therefore, in summary, the result shows that the higher the level of illicit financial flow out of Nigeria, the higher the level of non-oil revenue in Nigeria.

Discussion of Findings

The result on hypothesis one shows that illicit financial flow has a significant inverse influence inverse influence on oil revenue in Nigeria. This is in line with the result of Theo (2020) who opined that illicit financial flow has a negative influence on government revenue among West African countries. Similarly, Onogwu (2019) opined that illicit financial flow has rubbed the Nigerian government of funds that would have been used in developing the country. These arguments are in line with the resource curse theory which explains how policies are not favorable such that investors look for either legal (capital flight) or illegal (illicit financial flow) of withdrawing their funds from the system and thereby impacting negatively on the economic performance of the country.

On the other hand, the result on hypothesis two shows illicit financial flow has a significant positive influence on non-oil revenue in Nigeria. This is in variance with the position of Thia (2020) who pointed out that illicit financial flow has an inverse influence on government revenue. The result from this study in view of non-oil revenue shows that the more the illicit financial revenue, the more the non-oil revenue. A possible reason for this could be that these funds are brought in to undertake commercial activities which are non-oil related and are then taken out. This suggests that the Nigerian economy can easily attract foreign investments which generates revenue activities but some of these funds are taken out. Therefore, to tap fully from the investments brought in, as predicted by the resource curse theory, policies that will encourage investors to retain their funds in the Nigerian economy needs to be promulgated so that Nigeria can fully tap from foreign investment and local investment working within the economy and as such, public revenue will be higher.

CONCLUSION AND RECOMMENDATION

The focus of this study is to examine the influence of illicit financial flow on revenue generation in Nigeria. the result from this study shows that illicit financial flow has an inverse influence on oil revenue generation in Nigeria. It also shows that illicit financial flow does have a positive influence on non-oil revenue generation in Nigeria. In conclusion, the study shows that illicit financial flow does have a significant influence on revenue generation in Nigeria. Based on the results from this study, it is recommended that the federal government should ensure that all loopholes that lead to illegal leakage of revenue out of Nigeria should be sealed. This can be achieved by reviewing laws and mechanisms such as fund transfers that allow for movement of funds over the shores of Nigeria and regulate their activities so as to curb the illicit flow of revenue out of Nigeria in order to enhance revenue generated from oil revenue. In addition, the federal government needs to create an environment that encourages investors to channel their fund into Nigeria and adequately reward them such that they don’t create mediums to move their revenue out of the country in order to boost non-oil revenue.

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Appendix

Appendix I: Raw data extracted

	Illicit financial flow (a)	Oil revenue (b)	Non-oil revenue (b)
Year	N' Million	N' Million	N' Million
2005	2359.2	4762.4	785.1
2006	2363	5287.6	677.5
2007	2100.26	4462.9	1264.6
2008	2692.35	6530.6	1336
2009	4167.72	3191.9	1652.7
2010	2480.37	5396.1	1907.6
2011	1551.66	8879	2237.9
2012	791.16	8026	2628.8
2013	4213.57	6809.2	2950.6
2014	2414.37	6793.8	3275
2015	4277.17	3830.1	3082.4
2016	8350.06	2693.9	2922.5
2017	10464.2	4109.7	3335.1
2018	9051.48	5545.8	4005.9

Source: (a) GFI (2021), (b) NBS (2021)