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THE ROLE OF INSTITUTIONAL QUALITIES ON REMITTANCE-INVESTMENT NEXUS IN NIGERIA: AN INTERACTIVE EFFECT APPROACH

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ABSTRACT

Institutional development unlocks growth potential and does not intrinsically suffer from diminishing returns. Improved institutional framework increases investment over the long-term. The present study adopted Autoregressive distributed Lag model with econometric interactive approach to investigate the role of institutional qualities on remittance-investment nexus in Nigeria. Annual secondary data covering the periods of 1981Q1 to 2020Q4, and were obtained from the World Development Indicators (WDI) published by the World Bank, Statistical Bulletin published by the Central Bank of Nigeria (CBN) and International Country Risk Guide. The current research produced mixed results. It shows that government stability and religious tensions (two proxies for institutional qualities) dampen the effect of international remittances on private investment, while control of corruption enhances the effect of international remittances on private investment in Nigeria. The positive coefficient of the interaction term indicates that the impact of remittances on investment can be enhanced in Nigeria. It is therefore recommended that the government improve the quality of their institutions since high quality institutions helps a nation to continue on her long-term trajectory of progress.

KEYWORDS: *Institutional Qualities, Control of Corruption, Religious Tension, Government Stability, International Remittances, Private Domestic Investment*

INTRODUCTION

Investment expenditure in economic analysis is both a component of aggregate demand and an injection into the circular flow of national income. It is a crucial variable on the supply side of the economy as it is the means by which changes in the real capital stock are brought about, thereby adding to country's productive capacity. Investment is spending devoted to increasing and maintaining the stock of capital. The stock of capital consists of the factories, machines, offices, and other durable products used in the process of production. The capital stock also includes residential housing as well as inventories. Gross domestic investment, therefore, represents total additions to a country's capital stock. If the capital stock grows larger overtime, the increase in capital stock per period of time is known as net investment. Gross domestic investment is therefore, made up of replacement investment or depreciation and net investment. Gross domestic investment can also be classified into public and private. While private investment refers to expenditure in acquisition of machinery and equipment to increase the firm's output, public investment comprises of social and economic infrastructure. Changes in the growth rate of an economy are majorly caused by changes in investment. It is a well-known fact that an increase in

investment will lead to an increase in productive capacity resulting to reduced unemployment, low poverty and high standard of living. It is a major explanation of and contributory factor to long run growth in the economy. Investment not only depends on economic factors but also on political and legislative factors. Investment is perhaps the most variable and volatile components of aggregate demand and fluctuations in its level are highly correlated with fluctuations in the Gross National product. This is because it is affected by the cyclical behaviour of the economy. Businesses are always wary of the changing expectations; it falls sharply during recessions and rises during booms.

Investment is financed from savings (domestic or foreign). While investment is financed from domestic saving in the advanced economies, foreign saving is often used to supplement domestic saving in the financing of investment in many developing countries.

An old phenomenon that is gaining increasing attention and importance in development finance as well as in international finance is the issue of migrant remittances. Yet, these international remittances by migrant workers from their employment income, particularly to developing countries, are usually overlooked in discussions on international financial flows. Data from the World Development Indicators (WDI) show that by 2017, remittances had out spaced Foreign Direct Investment (FDI) and official development Assistance (ODA), being second only to oil as a foreign exchange earner for Nigeria as of 2017. World Bank estimates show that as of 2015, Nigeria has moved into the top five recipients of remittances in the world and received 77 and 82% of the total remittance inflow to West African countries in 2016 and 2017, respectively. The rapid growth of remittances in Nigeriaraises the question of whether these money(s) are used towards investment and thus expansion of the productive capacity of the economy. Despite the significant flow of remittances into the country in the recent past, not much is known about the impact of these remittances on real gross private investment levels in the country. Empirical research from other countries has produced mixed results (Okeke, Utomi and Ezenekwe, 2019). The growth of remittance inflows in developing countries has generated intense debate and controversy among academics and policy makers studying the contribution of remittances on the economic welfare of recipient economies (Adams and Cuecuecha, 2010). The controversy revolves around the issue of how the remittances are spent. Burnside and Dollar (2000) argues that the effect of remittance inflows on the economic development of recipient countries hinges on whether they are invested or consumed. If invested, remittances will generate a positive impact on growth and if consumed, there will be either no direct impact on growth or there will be a reduction in growth if remittances cause households to substitute labour for leisure.

It is however theoretically plausible that decreasing rate of investment in the country of origin could induce migrants to increase remittances to finance investment opportunities. Migrants overseas might want to exploit the investment opportunities in their home country and make abnormal profit before other firms will come into the industry, this might induce them to increase the amount of money remitted to their family at home which is solely for investment purposes. Bangladesh and Pakistan, two of the leading recipients of remittances (in absolute terms), seem to provide some anecdotal evidence in this respect. In Bangladesh, emigrant workers that have an intention to return home invest 75% of their income in importing machineries and equipment needed for establishment of industries so as to maximize profit of an untapped market; while in Pakistan, the government bank issues certificates in return for foreign currency payments. These certificates carry an interest rate that is approximately two percent above the Euro-deposit rate, and they are redeemable in foreign or domestic currency at a premium of eight to fifteen percent above the official exchange rate. Furthermore, when deposited in banks and other institutions or used in purchase of treasury certificates, remittances provide a readily available

source of investment capital. Just like the Classical Developmentalist Optimism theory of 1982, O'Neill (2001) observed that it is the high rate of remittances that increases investment in India.

A rational investor will want to understand a country's long-term potential in order to decide whether it wants to develop a lasting business enterprise in that country or not. Much of the realization of potential in any business strategy depends on the non-threatening 'enabling environment' over and above an economy's short-term growth success. This enabling environment can be the existence of political stability, because the lower the probability of political instability and/or a politically motivated violence, the more a country's citizens are incentivized to invest in their own prosperous future. The effectiveness of government institutions is an indicator of good enabling environment because it captures the quality of public services and the degree of its independence from political pressures, thus fostering a benign context for private investment (Allard Bruinshoofd, 2016). It is not farfetched to argue that migrant transfers meant for investment purposes could be severely limited in the presence of acute political instability, corruption and go-slow bureaucracies (Imene and Dorsaf, 2017).

Institutional quality means the extent to which a country's institutions facilitate international transactions, and provide for their security and predictability. Institutional quality is a broad concept that captures law, individual rights, and high-quality government regulation and services. Institutional development is the best indicator for structural development and long-term welfare creation for a nation. It unlocks growth potential and does not intrinsically suffer from diminishing returns (Allard, 2016). Institutions are humanly devised constraints that shape interaction between people. High quality institutions ensure that those wielding executive power are subject to the law; and individuals, entrepreneurs, challengers of the present economic system are protected by the law in their ventures and their investment in human and physical capital as well as new technological endeavours. The quality of the institutions captures the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development, thus laying down uniform rules of economic engagement. A weak institution like that of Nigeria may not create conducive environment to business operation. The level of corruption in Nigeria is very high which may have affected the level of private investment, because, the stronger the control of corruption is, the more economic success is a function of effort and competence, rather than connections and bribery. No matter how willing a migrant may be to remit part of his income to the country of origin for investment purposes, political stability, less corruption and efficient bureaucracy and avenues of redress are paramount in boosting investor confidence. Sequel to this, it has become crucial to explore the role of institutional qualities on the remittance-investment nexus in Nigeria.

It is against this background that this study seeks to empirically analyse the role of institutional qualities on remittance-investment nexus in Nigeria's economy.

LITERATURE REVIEW

Theoretical Literature Review

Prospect Theory of Migrants' Remittance Decisions

Prospect theory is an alternative theory of behavioural decision making under uncertainty developed by Kahneman and Tversky (1979) as an alternative to the hitherto dominant theory of expected utility theory of decision making under risk. Prospect theory is an empirically derived descriptive rather than normative theory of decision making under uncertainty.

Therefore, prospect theory suggests the decision makers under uncertainty evaluate outcomes in terms of gains and losses relative to reference point in their choice selection. They are therefore more sensitive to gains and losses relative to this reference point rather than changes in their level of wealth and welfare as utility theory postulates. In making decisions, what influence decision makers most and thereby act as carriers of value or utility are changes rather than final asset position that include current wealth (Kahnerman and Tversky, 1979). This reference dependence in decision choices under risk is central to prospect theory. This theory postulates that emigrants decide to remit part of their labour income because of the prospects of increasing rate of return on their investment. It also states that emigrants develop a level of trust on those family relatives who they remit the money into their account.

The Flexible Accelerator Theory

This is also called Capital Stock Adjustment model. This theory of flexible accelerator has been developed in various forms by Chenery, Goodwin, Koyck and Junankar but the most accepted approach is by Koyck in his work "Distributed Lags and Investment" in 1954. The flexible accelerator theory removes one of the major weaknesses of the simple accelerator principle that the capital stock is optimally adjusted without any time lag. In the flexible accelerator, there are lags in the adjustment process between the level of output and the level of capital stock. It holds that the larger the gap between the existing capital stock and the desired capital stock, the greater a firm's rate of investment. The hypothesis is that firms plan to close a fraction of the gap between the desired capital stock, K* and the actual capital stock, K in each period (Jhingan, 2004). This gives rise to a net investment equation of the form of:

$$I = K^* - 1 = \Delta k$$

$$\text{so } I = \Delta K = k\Delta Y_t$$

Where I is net investment, Δk is a change in capital stock, ΔY_t is the change in the current output level where k is the capital-output ratio.

The strengths of the theory include the following:

- The flexible accelerator is a very important contribution to the theory of investment which solves the problem of lags in investment demand.
- It also incorporates the effects of depreciation and excess capacity in the capital stock adjustment.
- It highlights the effects of lags in the capital stock adjustment.

The flexible accelerator model has been attributed as the best theory or model used in analyzing remittance-investment nexus by Cherono (2013) and Okuda Henry (2010). Flexible Accelerator model added that the lag of previous investments affects the present investment. The lag might be bureaucratic delays, bottlenecks in acquiring loans, financial constraints, ease of accessibility of credit, e.t.c. hence helped in overcoming the weakness of the fixed accelerator model. Moreover, the theory highlighted the effects of lags in the capital stock adjustment. Here, the inflow in remittances cannot immediately bring about increase in the national output through investment, but have to adjust in order to bring about the expected increase. Hence, the theory is more realistic as compared to fixed accelerator model of investment.

Empirical Literature Review

Su, Sun, Ahmad and Mirza (2021) investigated the role of remittances and institutional quality in promoting private investment for emerging seven (E7) economies using advanced panel data econometric tools. The results of the study reveal that improvement in institutional quality and channeling inflow of remittances, and overcoming financial risk shall help promote private investment in these countries.

Okeke (2021) investigated the impact of international remittances on unemployment in Nigeria using the two-stage least squares (2SLS) and discovered that international remittances affect unemployment negatively.

Okeke, Chinanuife, and Mogbo (2021) in their study of the causal relationship between international remittances and private domestic investment using Toda and Yamamoto Causality approach observed that there is a unidirectional causal relationship between remittances and private investments in Nigeria. Okeke, Utomi, and Ezenekwe (2019) investigated the impact of international remittances on private investment in Nigeria. Ordinary least square was used to analyze time series data sourced from World Development indicators. The result revealed that remittances increase the rate of private investment in Nigeria and that previous investment is a determinant of current investment.

Hayot, Lee and Yessengali (2020) in their study of the nexus of remittances, institutional quality and financial inclusion using the dynamic panel data method found that the impact of remittances on financial inclusion is conditional on institutions.

Murat, Hayot, and Veysel (2019) investigated the non-linear effect of remittance inflows on financial inclusion in high remittance-receiving developing countries during 2011-2017. The results of the study showed that the effect of remittances on the financial inclusion was conditional upon people's perception about institutions. The results suggested that the impact of remittances on financial inclusion was U-shaped.

Hamma (2018) in her study termed "Migrant Remittances and Economic Growth: The Role of Financial Development and Institutional Quality" employed the Two-Stage Least Squares in 14 Middle East and North Africa (MENA) countries. The results reveal a complementary relationship between financial development and remittances to ensure economic growth. The estimations show that remittances promote growth in countries with a developed financial system and a strong institutional environment.

Kratou and Gadzer (2018) analyzed the effect of remittances on economic growth in a panel of thirty African countries. They looked at how the financial and institutional context influences a country's capacity to benefit from remittances using the Generalized Method of Moments (GMM). The results show that the relationship between financial development and remittances is a positive one for conducting economic growth. Remittances are more effective in countries that have a good governance system and are capable of providing suitable public services.

Ajide, Adeniyi and Raheem (2017) examined the causal relationship between remittances and investment volatility through the intermediating role of institutions using the Generalized Method of Moments (GMM). The results reveal that institutional quality has no significant role in mitigating investment volatility, and the interactive terms of both remittances and institutions significantly mitigated the negative impacts of investment volatility with the exception of the political component of the institutional architecture.

Asogwa and Okeke (2013) in their study of the crowding out effect of budget deficits on private investments in Nigeria observed that budget deficits crowds out private investments in Nigeria.

Bjuggren, Dzansi and Shukur (2010) investigated the effect of remittances on investment using the Generalized Method of Moments (GMM). The results reveal that remittances, high quality institutional framework, and well-developed credit market increase investment. However, it is also found that the marginal importance of remittances as a financial source for investment decreases with improved institutional framework and a more developed credit market.

MODEL SPECIFICATION

The main objective of this study is to examine the role of institutional qualities on remittance-investment nexus in Nigeria. For this purpose, the model adapted for this study is Cherono (2013) which is also predicated on the theoretical framework of Flexible Accelerator model of Investment regarding the ability of capital stock (which is now migrants' remittances) to influence the level of investment.

According to International Country Risk Guide (ICGR), governance indicators or institutional qualities are classified into six groups; but we added Ease of Doing business in order to check whether enabling environment that will attract investment has been created. The institutional qualities or governance indicators being a composite variable are further decomposed in a functional form as:

$$PDI = f(VOA, PSAV, GEF, REQ, RUL, COC, EDB)$$

While the econometric form is stated as:

$$PDI_t = \beta_0 + \beta_1 VOA_t + \beta_2 PSAV_t + \beta_3 GEF_t + \beta_4 REQ_t + \beta_5 RUL_t + \beta_6 COC_t + \beta_7 EDB_t + \mu_t$$

Where

VOA means Voice and Accountability. It measures the extent to which a country's citizens can select and challenge its government, thus limiting executive power. PSAV means Political stability and Absence of violence. It measures the likelihood of violent threats to, change in, and government including terrorism. GEF means Government effectiveness. It measures the quality of public services and the degree of its independence from political pressures, thus bolstering a benign context for private investment. REQ means Regulatory quality. It measures the ability of government to formulate and implement sound policies and regulations that permit and promote private sector development, thus laying down uniform rules of economic engagement. RUL means Rule of law. It measures particularly the quality of contract enforcement, property rights, the police, the courts, i.e. the enforcement of the rules of society. COC means Control of Corruption. It measures the exercise of public power for private gain; including both petty and grand corruption and state capture (the stronger is control of corruption, the more economic success is a function of effort and competence, rather than connections and bribery). EDB means Ease of doing Business. It measures a multitude of aspects that determine the extent to which the regulatory environment is conducive to business operation.

Since, the study adopts three of these variables as representative of other components of institutional qualities.

$$\Delta lnPDI_t = \Phi_0 + \sum_{i=1}^{q} \Phi_1 \Delta\, lnIMR_{t-i} X \Delta lnGSTA_{t-i} + \sum_{i=1}^{q} \Phi_2 \Delta\, lnIMR_{t-i} X \Delta lnCOC_{t-i}$$
$$+ \sum_{i=1}^{q} \Phi_3 \Delta\, lnIMR_{t-i}\, \mathrm{X}\, \Delta lnREQT_{t-i} + \mu_t$$

Where

GOVSTA is Government Stability

COC = Control of Corruption

REGT = Religious Tensions

Table 1: A Priori Expectation for Institutional Quality Variables

Variables	Expected Apriori Sign
Government Stability	Positive
Control of Corruption	Positive
Religious Tensions	Negative

DATA ANALYSIS AND DISCUSSION OF RESULTS

Stationarity test was conducted using two traditional unit root tests to side step spuriousness of the regression result. The traditional tests employed was Phillips-Perron (PP) test. One advantage of Phipps-Perron over the popular Augmented Dickey-Fuller is that PP tests are robust to general forms of Heteroskedasticity in the error term. Another advantage is that the user does not have to specify a lag length for the test regression.

Table 2: Phillips-Perron Test Result

Variable	PP Statistic	PP Critical Value	Level of Integration
PDI	-4.626095	-2.882748	I(0)
IMR	-3.644957	-2.882433	I(1)
GSTA	-3.861118	-2.884291	I(0)
COC	-14.62355	-2.885051	I(1)
REGT	-3.771335	-2.885051	I(1)

Dependent Variable: Private Domestic Investment

Method: ARDL

Table 3: Role of Institutional Qualities on Remittance-Investment Nexus

Variable	Coefficient	Standard Error	t-statistic	Prob.
PDI(-1)	0.902231	0.085660	10.53271	0.0000
PDI(-2)	0.284919	0.118538	2.403600	0.0179
PDI(-3)	-0.415897	0.087304	-4.763790	0.0000
IMR*GSTA	-0.000262	0.000123	-2.121206	0.0362
IMR(-1)*GSTA(-1)	9.52E-05	0.000202	0.471465	0.6382
IMR(-2)*GSTA(-2)	5.76E-05	0.000231	0.249324	0.8036
IMR(-3)*GSTA(-3)	0.000175	0.000239	0.731087	0.4663
IMR(-4)*GSTA(-4)	-0.000312	0.000138	-2.256431	0.0260
IMR*COC	0.001361	0.000460	2.958715	0.0038
IMR*REGT	-0.000163	0.000218	-0.747424	0.4564
C	7.703627	1.568536	4.911348	0.0000

Source: Researcher’s Compilation from E views 10.0

From the table above, it should be noted that the interactive effect of remittance-investment nexus and government stability shows that government stability affects remittance-investment nexus negatively which is contrary to a priori expectation. A unit increase in the multiplicative effect of remittance and government stability would bring about 1.17% decreases in private investment in Nigeria though it is statistically insignificant. Moreover, the interactive effect of remittance-investment nexus and control of corruption shows that control of corruption affects remittance-investment nexus positively which is in line with a priori expectation. A unit increase in the multiplicative effect of remittance and control of corruption will bring about 0.0014 unit increases in private domestic investment, and it is statistically significantly different from zero. This shows that the effect of remittances on private domestic investment is conditional, depending on individual's perception of how the government of the day is controlling corruption, because the stronger the control of corruption is, the more economic success is a function of effort and competence, rather than connections and bribery. This finding shed light that positive perception of the public towards the financial prudence, discipline and the spirit of due process towards the government of the day does matter. Trust of remittance recipients towards the quality of institutions available can further enhance the impact of remittances on private investments in Nigeria. Furthermore, it was discovered that religious tensions are negatively related to remittance-investment nexus which is also in line with a priori expectation. A unit increase in the multiplicative effect of remittance and religious tensions will bring about 0.00016 decreases in private domestic investment. Religious tensions like Boko Haram, Shites, Fulani Herdsmen, and others discourages remittance recipients and even migrants from investing in the country, knowing that such investment would be destroyed by religious fanatics at the insurgence of religious war. This points to the inability of the government to control different religions within the country, and as well maintain peace and security among the populace. Poor institutional quality of receiving country increases the risk of expropriation, distorts the investment opportunities and increases the return required on investments. Furthermore, in line with a priori expectation, religious tensions in its interactive form with remittance inflows have a negative relationship with private domestic investment. As a result, it can be deduced the prevalence of religious conflict dampens the effect of remittance inflows on private investment in Nigeria. The quality of institutions in Nigeria dampens the impact of remittance inflow on private investment except control of corruption. This shows that the policies of the present administration are gradually producing results as the level of corruption is being control. The present institutions in Nigeria scare away investors in our economy. This might be as a result of policy summersault, domestic violence and terrorism, lack of accountability and transparency on the side of the government, e.t.c.

The result of remittance-investment nexus and institutional quality model reveals that there exists a negative relationship between the interactive term of investment-remittance nexus and government stability which is one of the proxies for institutional qualities. Control of corruption in its interactive form with remittance inflows has a positive relationship on private domestic investment; hence the stronger the control of corruption, the greater the inflow of remittances needed for investment purposes. From an investment risk point of view, sound institutions ameliorate the risk of expropriation, political and economic stability, and hence the required rate of return. Furthermore, it makes it relatively easy for entrepreneurs to identify investment opportunities and secure the interest of outside investors to exploit such opportunities.

CONCLUSION AND RECOMMENDATION

The study examined the role of institutional qualities on remittance-investment nexus in Nigeria from 1981Q1 to 2020Q4. Since the analysis is based on time series data and in order to avert the occurrence of spurious results and to determine the order of integration, the variables were investigated for their stochastic properties, using the two traditional and one

modern unit root tests. The traditional test deployed is Phillips-Perron (PP). The results of the unit root tests indicate that all the variables tend to be stationary in first difference except Private Domestic Investment (PDI) and government stability (GSTA) which tend to be stationary at level in PP tests. The findings of the study revealed that institutional quality variables in Nigeria dampen the impact of remittance inflow on private investment in Nigeria.

Therefore, it is recommended that the government should do the following:

- Restore the confidence and trust of the public by promulgating and implementing laws and policies that will strengthen the legal, political financial and economic base of the Nigerian society. The trust of the public on their country's institutions encourages the public to invest more in their economy, and ameliorate capital flight and brain drain.
- Government should enhance the quality of institutions in the Nigeria economy such as reducing bureaucratic processes, improving credit allocation, reducing religious tensions, effective control of corruption, strengthen the credit regulation, ensuring higher transparency, and reinforcing the information disclosure in the financial sector.

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