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DETERMINANTS OF ILLICIT FINANCIAL OUTFLOWS IN NIGERIA

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Abstract

The persistence of illicit financial flows (IFFs) in Nigeria poses a significant challenge to fiscal stability, governance integrity, and long-term economic growth. Despite reforms, the scale of IFFs remains alarming, with Global Financial Integrity estimating losses of over \$134 billion between 2003 and 2022. This study examined the macroeconomic and institutional determinants of IFFs in Nigeria, focusing on corruption, political risk, exchange rate, and external debt, while controlling for inflation and interest rates. Adopting a descriptive and correlational research design, the study utilised annual secondary data sourced from the Central Bank of Nigeria (CBN), Global Financial Integrity (GFI), Transparency International (TI), and the Polity IV Index, covering the period 1986 to 2023. The correlational design looks at the connections between key variables, including political risk, corruption, exchange rates, and external debt, whereas the descriptive design examines trends and patterns in IFFs. The analysis employed the Autoregressive Distributed Lag (ARDL) regression technique to capture both short- and long-run dynamics. The results show that corruption reduces IFFs in the short run ($\beta = -1689.19, p < 0.01$) but sustains them in the long run ($\beta = -2298.09, p < 0.01$), while political risk significantly increases IFFs ($\beta = 66048.75, p < 0.01$). Exchange rate depreciation exerts a negative short-run effect ($\beta = -17400.38, p < 0.01$), and external debt produces a substantial long-run adverse effect ($\beta = -10762.76, p < 0.01$). The study concludes that institutional weaknesses and macroeconomic instability jointly drive IFFs in Nigeria. Consequently, the study recommends stronger anti-corruption frameworks by completing the National Anti-Corruption Strategy (NACS) and improving interagency collaboration between the EFCC, ICPC, and NFIU, exchange rate stabilization, and debt management reforms, which should include transparent loan contracting, stringent parliamentary control over borrowing from outside sources, and improved political accountability as policy measures to curb IFFs and strengthen fiscal sustainability.

Keywords: Illicit financial flows, corruption, exchange rate, political risk, external debt, Nigeria

JEL: F38, G28, H26, O55

INTRODUCTION

Illicit financial flows (IFFs) continue to be a major obstacle to global economic growth, threatening social justice, governance, and fiscal sustainability in both rich and developing nations. Global Financial Integrity (2023) estimates that IFFs drain emerging countries of more than \$1 trillion a

year, fuelled by corruption, tax evasion, money laundering, and trade misinvoicing. According to Murongo (2023), these unreported withdrawals impair states' capacity to fund infrastructure, mobilize domestic resources, and deliver critical social services. IFFs are especially severe in Africa, where, according to recent estimates, illegal trade and capital flight account for the majority of the continent's annual losses of approximately \$89 billion, or 3.7% of GDP (UNCTAD, 2020; ICPC, 2024). Deepening poverty and inequality, such losses significantly impede efforts to achieve the Sustainable Development Goals (SDGs).

IFFs have disproportionately impacted Nigeria, the resource-rich nation with Africa's largest economy. According to estimates, illicit outflows cost Nigeria \$134 billion between 2003 and 2022, or about 80% of its yearly expenditures (GFI, 2023; IMF, 2023). Due to these enormous leaks, vital industries like infrastructure, healthcare, and education are deprived of the funding required for long-term growth (ICPC, 2023). To further highlight the widespread scope of the issue, the Nigerian Financial Intelligence Unit (2022) recorded suspicious transactions of more than ₦150 trillion in just three months. Even with increased efforts by organisations like the EFCC, which recovered around \$500 million in 2024 (EFCC, 2025), IFFs are still very much in operation, a reflection of fundamental flaws in economic management, governance, and regulation.

Nigeria's IFF problem has been attributed to a number of institutional and macroeconomic reasons. Corruption is still pervasive, undermining the integrity of regulations and making financial abuses easier (Bawa & Ogwiji, 2022). In a similar vein, Nigeria's growing external debt, which is expected to reach \$43.2 billion in 2023, despite being essential for fiscal assistance, has increased susceptibility to illegal leaks when improperly managed (World Bank, 2023; Afolabi, 2024). As investors and elites shift capital to safer havens, political risk, which is typified by a weak rule of law, policy reversals, and instability in leadership, further accelerates illicit transfers (Mugabe & Mutasa, 2022). Together, these factors threaten Nigeria's institutional resilience and macroeconomic stability.

While regional and international research emphasises the connection between IFFs, political instability, corruption, and poor debt management (Cobham & Janský, 2020; Bodjongo et al., 2024), little empirical study has concurrently looked at these factors in Nigeria's distinct macropolitical setting. Current research frequently addresses IFFs and capital flight collectively or concentrates just on corruption and external debt, ignoring the interaction of political risks and exchange rate misalignment (Ewubare et al., 2022). This disparity hampers the development of policy solutions that consider the unique realities of Nigeria. Thus, this study examines the institutional and macroeconomic factors that influence IFFs in Nigeria, concentrating on four main variables: external debt, political risk, exchange rates, and corruption. Inflation and interest rates are also included as control variables. The research is guided by the hypothesis that macroeconomic and institutional variables significantly influence the scale of illicit financial flows in Nigeria.

Since weak institutions and unstable macroeconomic conditions seem to increase the risk of capital flight, this study focuses on macroeconomic and institutional factors, which empirical evidence indicates are the most important drivers of illicit financial flows (IFFs) in developing nations such as Nigeria (Afolabi et al., 2024; Bodjongo et al., 2024; Murongo, 2023). To preserve analytical accuracy and focus on variables that have the greatest theoretical and empirical

importance to Nigeria's IFF dynamics, other factors, such as trade structures and technical systems, are recognised but left out.

LITERATURE REVIEW

Conceptual Review

Illicit Financial Flows

According to Omosuyi and Afolabi (2024), illicit financial outflows (IFFs) are cross-border movements of capital that are illegal in their origin. These outflows continue to weaken the fiscal foundation of developing nations. Recent estimates from Africa underscore the magnitude of these flows. According to the Carnegie Endowment for International Peace (2024), Africa loses almost \$88.6 billion a year, or roughly 3.7% of its GDP. According to recent studies, Nigeria loses almost \$18 billion a year due to illicit financial flows, making it the country with the largest share of Africa's IFF burden (BusinessDay, 2025). Moreso, about 20% of Africa's total losses from illegal financial outflows are represented by this startling sum (BusinessDay, 2025). Therefore, it is essential to conceptualise illicit financial outflows in Nigeria as systemic financial leakages that threaten macroeconomic stability rather than just illegal transfers.

Exchange Rate

Exchange rates function as pivotal indicators of a currency's external value, facilitating the connection between domestic and international prices for goods and services (Dabwor et al., 2019). Exchange rates play a pivotal role in the transmission mechanisms of open economies (Chahrour et al., 2021). The exchange rate is a critical macroeconomic variable, particularly in the formulation of general economic policies and economic reform programs, and it is a price that governments closely monitor. Nevertheless, accurately modeling exchange rate dynamics remains a formidable challenge within macroeconomic research. This perspective is reinforced by Soon and Baharumshah (2021), who highlight that the extreme fluctuations in exchange rates pose significant analytical challenges, underscoring the imperative for continued investigation into exchange rate behavior.

Corruption

Corruption is a multifaceted problem that is difficult to eradicate in any nation and is a global issue affecting both developed and developing countries (Ndubisi & Owoseni, 2020). The existence of corruption facilitates money laundering, tax evasion, and various other unlawful financial practices, which hasten the outflow of capital from the region (Houssou & Alinsato, 2023). Corruption, tax revenue mobilization, and capital flight are critical elements influencing economic governance in Eastern African nations and significantly impact the region's socioeconomic development. Despite its wealth of natural resources and expanding economies, Africa confronts substantial barriers to achieving sustainable development. Widespread corruption, alongside challenges in tax administration and the issue of illicit financial flows, severely impedes the region's potential for economic growth and prosperity.

External Debt

External debt refers to the total amount of public and private debt owed by a country to foreign creditors, which includes loans, bonds, and other financial obligations that must be repaid in foreign currency (World Bank, 2023). External debt also refers to the financial commitment that links a debtor country to a lender country, typically in a currency other than that of the debtor nation. It generally encompasses debts that mature within a short term, such as trade debts, which

are due within one or two years or must be paid within the fiscal year when the transaction occurs. External debt can arise from various activities, including trade, contractor-financed projects, supplier credits, private investments, and public borrowing. The sources of these loans include banks, international financial markets (such as Euro money and capital markets), international organizations like the IMF and the World Bank, as well as multilateral and private loans (Udoka & Anyimgang, 2010).

Political Risk

In Nigeria, political risk has been identified as a significant factor contributing to the prevalence of illicit financial flows (IFFs). According to Onuorah & Mbah (2021), Nigeria's political environment is characterized by high levels of corruption, weak institutions, and frequent political upheaval, which create a conducive environment to illicit financial activities. However, corruption undermines regulatory frameworks and enforcement mechanisms, making it easier for illicit flows to occur. Pereira (2020) argues that the weak rule of law and lack of effective governance structures in Nigeria create an environment where IFFs can thrive. Political risk, through its manifestations of corruption and regulatory inefficiency, contributes significantly to the facilitation of these flows. This is particularly evident in sectors like oil and gas, where the potential for significant financial gain attracts illicit activities.

Theoretical Framework

The Resource Curse Theory and the Debt Overhang Theory provided the theoretical underpinnings of this study, offering a conceptual framework for understanding the factors that influence illicit financial flows (IFFs) in Nigeria. According to the Resource Curse Theory (Auty, 1993), an abundance of natural resources often leads to weak economic performance, poor governance, and widespread corruption. This is further supported by the Debt Overhang Theory (Myers, 1977; Krugman, 1988; Sachs, 1989), which contends that high external debt loads deter productive investment by directing resources towards debt repayment, which in turn causes capital flight and promotes illegal outflows to safer countries. These theories support the inclusion of these variables as important explanatory factors in the current analysis by highlighting the relationship between political risks, corruption, foreign debt, and exchange rate volatility as drivers of IFFs in Nigeria.

Empirical Studies

Epor et al. (2024) examined the role of external debt and international trade within the framework linking foreign direct investment (FDI) to economic growth in Nigeria, Brazil, and Vietnam. Using the autoregressive distributed lag (ARDL) model with annual data from 1990 to 2021, the study found that while trade and FDI positively influenced economic growth, these impacts were not statistically significant. Additionally, the research highlighted that external debt has a long-term impact on economic growth in these countries. The study contributes to understanding how external debt impacts economic growth, but it does not examine its potential role in facilitating illicit financial flows (IFFs). Hence, this research addresses the gap by empirically investigating how external debt, along with other institutional and macroeconomic factors, influences IFFs specifically in Nigeria.

Fiaz et al. (2022) examined the influence of macroeconomic variables on economic growth in Pakistan using monthly data from 1981 to 2020 using a Markov Regime-Switching (MS) model. The findings indicated that inflation, interest rates, and trade openness impacted economic

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growth in both regimes, while the real effective exchange rate exhibited a positive effect. Notably, the adverse effects of interest rates, exchange rates, inflation, and trade openness were found to be more pronounced during periods of low economic growth. The study reveals the impact of macroeconomic instability on economic growth; however, it does not examine how these variables influence illicit financial flows, which the current research addresses.

Macamo and Jalloh (2022) investigated illicit financial flows originating from Mozambique's natural resource sector, particularly emphasizing the impact of macroeconomic factors. Utilizing quarterly time series data from 2008 to 2019, the study employed the ARDL estimation technique and the Granger causality test for data analysis. The findings revealed a positive and significant relationship between exchange rates and IFFs. However, the study is limited to the extractive sector. In contrast, the present research examines the determinants of illicit financial flows within the entire Nigerian economy, without focusing on a specific sector.

Akintonye et al. (2022) conducted a study examining the correlation between tax havens and illicit financial flows originating from 44 African countries between 2005 and 2014. Their findings indicated that the persistent rise in IFFs from Africa can be attributed to factors such as a lack of political will, inadequate institutional frameworks, and poor regulatory oversight. However, the study's focus on taxes highlights a research gap when compared to the current study, which explores additional factors, including corruption, political risks, external debt, and exchange rates.

Sodji (2022) and Agyeman et al. (2022) investigated the effects of capital flight on economic growth in West African Economic and Monetary Union (WAEMU) countries from 1970 to 2016, utilizing data primarily sourced from the World Bank and the International Monetary Fund. Their findings indicated that countries experiencing net capital outflows exhibited diminished economic growth. The studies established a clear link between stunted growth and capital flight and do not examine the root causes of illicit financial flows. In contrast, this study builds on their findings by investigating the governance-related and economic determinants of IFFs in Nigeria. Hence, shifting the focus from consequences to causation.

Inam and Isaac (2022) investigated the dynamic relationships among inflation, interest rates, exchange rates, money supply, and gross domestic product (GDP) to assess how these interactions should inform monetary policy decisions in Nigeria. Utilizing quarterly data from 2010 to 2018, the research employed a Vector Autoregressive (VAR) model to capture the interdependencies among the variables. The results identified the exchange rate as the most influential monetary policy variable due to its significant association with all other variables in the model. The study concludes that effective management of the exchange and interest rates could enhance price stability and foster economic growth. However, it does not consider the implications of these variables for illicit financial flows (IFFs). Hence, this research builds on that foundation by analyzing how selected macroeconomic variables affect the dynamics of IFFs in Nigeria.

Brown et al. (2022) explored the impact of capital flight on Nigeria's economic development from 1980 to 2020. The ARDL estimation technique was applied to investigate both short- and long-term relationships between the variables. This study focused on the effects of capital flight on

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economic growth, highlighting a research gap as the present study examines the determinants of illicit financial flows in Nigeria.

Bawa and Ogwiji (2022) investigated the influence of illicit financial flows (IFFs) on Nigeria's economic growth employing an ex-post facto research design. Findings revealed that illicit financial flows intercepted by the EFCC exerted a positive effect on Nigeria's economic growth. While the study investigates the economic effects of intercepted IFFs, it does not examine the root cause of such flows. Hence, this research fills this gap by focusing on the determinants of IFFs in Nigeria, incorporating external debt, exchange rates, political risk, and corruption, offering a more proactive and preventive approach.

Ewubare et al. (2022) explored the influence of capital flight on Nigeria's economic development from 1980 to 2020 using the Autoregressive Distributed Lag (ARDL) approach. The findings indicated a negative but significant relationship between GDP and the independent variables over the period examined. The study offers valuable insights into the effect of capital flight on economic growth, but it does not explore the institutional and macroeconomic factors of such outflow. Therefore, this research builds on that foundation by investigating the determinants of illicit financial flows in Nigeria, focusing on both governance-related factors and economic indicators such as political risk, corruption, exchange rate, and external debt.

METHODOLOGY

This study employed an ex-post facto research design using annual time-series data from 1986 to 2023 to examine the macroeconomic and institutional determinants of illicit financial flows (IFFs) in Nigeria. Data on IFFs were sourced from Global Financial Integrity (GFI), corruption from Transparency International's Corruption Perception Index (CPI), exchange rate and control variables (inflation and interest rates) from the Central Bank of Nigeria (CBN), political risk from the Polity IV Index and Worldwide Governance Indicators (WGI), and external debt from the World Bank and Nigeria's Debt Management Office (DMO). The Autoregressive Distributed Lag (ARDL) model was applied to capture both short- and long-run dynamics among the variables. To ensure robustness, unit root tests confirmed that variables were I(0) or I(1), the ARDL bounds test verified cointegration, and diagnostic checks, including heteroskedasticity, serial correlation, and stability tests, established the reliability and validity of the estimated model.

Model Specification

To investigate the short- and long-term links between illicit financial flows (IFFs) and their determinants (corruption, exchange rates, political risks, and foreign debt), this study employed the Autoregressive Distributed Lag (ARDL) model, controlling inflation and interest rates. The model was modified from earlier empirical frameworks on the factors that influence illicit financial flows by Ndikumana and Boyce (2021) and Bawa and Ogwiji (2022), which relate IFFs to institutional and macroeconomic factors like external debt, exchange rates, political risk, and corruption. To adapt its specifications to the Nigerian context, this study uses interest rates and inflation as control variables in an ARDL framework.

$$IFF_t = \alpha + \sum_{i=1}^p \beta_1 IFF_{t-i} + \sum_{j=0}^{q1} \gamma_j COR_{t-j} + \sum_{j=0}^{q2} \delta_j EXR_{t-j} + \sum_{j=0}^{q3} \theta_j POLR_{t-j} + \sum_{j=0}^{q4} \varphi_j EXT_{t-j} + \sum_{j=0}^{q5} \phi_j INF_{t-j} + \sum_{j=0}^{q6} \psi_j INTR_{t-j} + \varepsilon_t$$

Where:

IFF: Illicit Financial Flows at a time

INTR: Interest rate

COR: Corruption level at time

α : Intercept or constant term

EXR: Exchange rate at time

$\beta_i, \gamma_j, \delta_j, \theta_j, \varphi_j, \phi_j, \psi_j$: Coefficients of variables

POLR: Political risks at a time

$p, q_1, q_2, q_3, q_4, q_5, q_6$: Lag orders for variables.

EXT: External debt

ε_t : Error term

INF: Inflation rate

The ARDL bounds testing approach is employed to test for the existence of a long-run relationship (cointegration) among the variables. The unrestricted error correction model (UECM) for ARDL is specified below:

$$\Delta IFF_t = \alpha_0 + \sum_{i=1}^p \beta_1 \Delta IFF_{t-i} + \sum_{j=0}^{q1} \gamma_j \Delta COR_{t-j} + \sum_{j=0}^{q2} \delta_j \Delta EXR_{t-j} + \sum_{j=0}^{q3} \theta_j \Delta POLR_{t-j} + \sum_{j=0}^{q4} \varphi_j \Delta EXT_{t-j} + \sum_{j=0}^{q5} \phi_j \Delta INF_{t-j} + \sum_{j=0}^{q6} \psi_j \Delta INTR_{t-j} + \pi_1 IFF_{t-i} + \pi_2 COR_{t-j} + \pi_3 EXR_{t-j} + \pi_4 POLR_{t-j} + \pi_5 EXT_{t-j} + \pi_6 INF_{t-j} + \pi_7 INTR_{t-j} + \varepsilon_t$$

Where:

Δ : First-difference operator, representing short-run dynamics

α_0 : Intercept

$\beta_i, \gamma_j, \delta_j, \theta_j, \varphi_j, \phi_j, \psi_j$: Short-run coefficients for the differenced variables

$\pi_1, \pi_2, \pi_3, \pi_4, \pi_5, \pi_6, \pi_7$: Long-run coefficients for the lagged level variables

ε_t : Error term

The ARDL model was estimated to use appropriate lag lengths selected based on information criteria (e.g., AIC or SBC) to ensure model parsimony and fit. The model accounts for the time series nature of the data and is robust to potential non-stationarity, making it suitable for analysing the determinants of IFFS in Nigeria over the study period.

Estimation Techniques

The study used the Autoregressive Distributed Lag (ARDL) technique, which works well with time-series data that has mixed integration orders [I(0) and I(1)]. This allows Ordinary Least Squares (OLS) to be used to analyse both short- and long-term associations. By combining lagged dependent and independent variables, the ARDL model, with lag lengths chosen using criteria like AIC or SBC, offered a dynamic representation given the annual data and very small sample size. Checks for multicollinearity, heteroscedasticity, and serial correlation were performed, along with pre-estimation and diagnostic tests, such as the Augmented Dickey-Fuller (ADF) unit root test, to guarantee robustness and validate the effectiveness and dependability of the findings.

RESULTS AND DISCUSSION

Descriptive Statistics

Table 1 presents the descriptive statistics of the dependent variable (Illicit financial flows), explanatory variables (corruption, exchange rate, political risk, and external debt), and control variables (inflation and interest rate) to serve as a foundation for understanding the underlying structure and characteristics of the dataset while setting a stage for deeper analytical insights.

Table 1: Descriptive Statistics of the Variables

Variable	Obs	Mean	Std. dev	Min	Max
Illicit FF	20	6,439.85	7,329.27	1,283	24,192
Corruption	20	23.85	4.03	10	28
Exchange Rate	20	271.44	171.65	120	821.79
Political Risk	20	0.5375	0.0229129	0.49	0.58
External Debt	20	47,529.2	23,984.04	18,576	98,335
Inflation	20	13.118	4.504528	5.39	24.66
Interest Rate	20	11.6625	3.100589	6	18.75

Authors Computations, 2025

Table 1 presents the summary statistics for the dataset, which comprises 20 observations spanning 20 years. Illicit financial flows (IFFs) ranged from \$ 1,283 to \$ 24,192, with an average of \$ 6,439.85 and a considerable degree of variability (SD = \$ 7,329.27), reflecting structural and policy variations as well as weak regulations. The average index score for corruption was 23.85 (SD = 4.02), indicating consistency but a substantial fluctuation between the least (10) and most corrupt (28) periods. The currency rate fluctuated widely between 120 and 821.79, with an average of ₦271.44/USD (SD = 171.65), suggesting that external factors and macroeconomic instability were the main causes of this volatility. With values ranging from 0.49 to 0.58 and an average of 0.54 (SD = 0.02), political risk stayed comparatively constant. The external debt ranged from 18,576 to 98,335 USD, with an average of 47,529.2 USD (SD = 23,984.04), indicating considerable variation in borrowing habits and fiscal management. Interest rates were also relatively high and erratic (SD = 3.10%), reflecting monetary policy reactions to inflationary pressures, currency fluctuations, and liquidity management. Inflation likewise exhibited persistently high levels, with notable spikes (max = 24.66%).

Preliminary Analyses

Tables 2, 3, and 4 show the preliminary estimation techniques, such as normality test, pairwise correlation, unit root test, and variance inflation factors, which are utilized in scrutinizing the distribution of variables.

Table 2: Normality Test

Variable	Obs	Pr(skewness)	Pr(kurtosis)	Joint Test	
				Adj chi2(2)	Prob>chi2
Illicit FF	20	0.5022	0.2824	4.69	0.1905
Corruption	20	0.7012	0.2310	3.57	0.1762
Exchange Rate	20	0.8181	0.7032	4.82	0.1872
Political Risk	20	0.3047	0.8399	1.20	0.5499
External Debt	20	0.0800	0.8881	3.51	0.1726
Inflation Rate	20	0.1775	0.2960	3.31	0.1910
Inflation Rate	20	0.6370	0.4553	0.84	0.6581

Authors Computations, 2025

Table 4.2 presents the results of the normality test conducted on the variables, i.e., illicit financial flows, corruption, exchange rate, political risk, external debt, inflation, and interest rate, to assess whether the data for each variable conforms to a normal distribution using individual tests for skewness and kurtosis as well as a joint test based on the adjusted chi-squared statistics. While the skewness tests whether the distribution is symmetrical, the kurtosis tests for the tailedness of the distribution, and the joint test combines the skewness and kurtosis tests. From the table, all variables exhibit p-values greater than 0.05 for skewness, kurtosis, and joint tests, indicating no significant deviation from normality for any variable. Hence, since all variables are normally distributed, the parametric statistical methods can be appropriately applied.

Correlation Analysis

Table 3: Pairwise Correlation

	Illicit FF	Corruption	Exchange Rate	Political Risk	External Debt	Inflation Rate	Interest Rate
Illicit FF	1.0000						
Corruption	0.354	1.0000					
Exchange Rate	0.482	0.3594	1.0000				
Political Risk	0.282	0.5344	0.1846	1.0000			
External Debt	- 0.538	0.2024	0.5525	0.0588	1.0000		
Inflation Rate	- 0.334	-0.071	0.699	0.347	0.395	1.0000	
Interest Rate	0.348	0.414	0.784	-0.426	0.508	0.455	1.0000

Authors Computations, 2025

According to the pairwise correlation results, which are shown in Table 4.3, illicit financial flows (IFFs) have a positive association with political risk, corruption, and exchange rates, but a negative correlation with foreign debt. Additionally, there is a significant correlation between corruption and foreign debt, exchange rate volatility, and political risk, indicating that corruption may be exacerbated by ineffective debt management. Similar to how policy inconsistencies and growing debt may be the driving forces for IFFs, the exchange rate has a positive correlation with both political risk and external debt. Only a tiny positive correlation between external debt and political risk suggests that volatility has little bearing on borrowing habits.

Unit Root Test

Table 4: Augmented Dicky-Fuller Unit Root Test

Method	Statistic	Prob.**
ADF - Fisher Chi-square	68.1918	0.0000
ADF - Choi Z-stat	-5.39676	0.0000

Intermediate ADF test results

Series	Prob.	Lag	Max Lag	Obs
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D(ILLICITFINFLOW)	0.0003	0	1	18
D(CORRUPTION)	0.0001	0	1	18
D(EXCHANGERATE)	0.0086	0	1	18
D(EXTERNALDEBT)	0.0035	0	1	18
D(INFLATIONRATE)	0.0083	1	1	17
D(INTERESTRATE)	0.0183	1	1	17
D(POLITICALRISK)	0.0012	0	1	18

Source: Author's Computation; 2025

The ADF test verifies that all variables are stationary at first difference (I(1)), with p-values less than 5% and highly significant statistics. The results support the appropriateness of ARDL analysis of both short- and long-term dynamics in illicit cash flows using optimal lags (0-1).

Model Selection

Table 5: Model Selection Criteria
Dependent Variable: ILLICITFINFLOW

Model	LogL	AIC*	BIC	HQ	Adj. R-sq	Specification
3	-162.696475	18.494366	19.140561	18.603728	0.908273	ARDL (1, 1, 1, 1, 1, 0, 1)

Authors Computations, 2025

Based on comparisons of information criteria, the model selection findings show that Model 3, designated as ARDL (1,1,1,1,0,1), is the best model for analysing illicit financial flows (IFFs). AIC = 18.494, BIC = 19.141, HQ = 18.604, and LogL = -162.696. The lowest AIC value confirms that Model 3 offers the best fit and parsimony balance. Strong explanatory power is demonstrated by the adjusted R² of 0.908, which indicates that the independent variables and their lags account for around 91% of the variation in IFFs. The model is robust, well-specified, and appropriate for further cointegration testing and error correction analysis because the selected lag structure covers both short- and long-run dynamics, with one variable having an immediate influence at lag 0.

ARDL

Table 6: ARDL Long Run Form

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	124431.8	40597.47	3.065015	0.0221
ILLICITFINFLOW(-1)*	-0.913648	0.122179	-7.477934	0.0003
CORRUPTION(-1)	-2099.648	349.0999	-6.014463	0.0010
INFLATIONRATE(-1)	-549.0185	401.6533	-1.366897	0.2207
INTERESTRATE(-1)	1750.555	488.2295	3.585516	0.0116
POLITICALRISK(-1)	20969.91	64486.51	0.325183	0.7561
LOG_EXCHANGERATE(-1)	2798.653	4099.716	0.682645	0.5203
LOG_EXTERNALDEBT**	-9833.374	2758.727	-3.564461	0.0119
D(CORRUPTION)	-1689.194	404.2602	-4.178482	0.0058

D(INFLATIONRATE)	-324.9552	261.3423	-1.243408	0.2601
D(INTERESTRATE)	801.2827	325.7447	2.459849	0.0491
D(POLITICALRISK)	66048.75	44402.61	1.487497	0.1874
D(LOG_EXCHANGERATE)	-17400.38	4721.068	-3.685688	0.0103

Levels Equation
Case 2: Restricted Constant and No Trend

Variable	Coefficient	Std. Error	t-Statistic	Prob.
CORRUPTION	-2298.093	445.2988	-5.160788	0.0021
INFLATIONRATE	-600.9081	415.6126	-1.445837	0.1984
INTERESTRATE	1916.006	535.7743	3.576143	0.0117
POLITICALRISK	22951.84	69461.79	0.330424	0.7523
LOG_EXCHANGERATE	3063.162	4484.773	0.683014	0.5201
LOG_EXTERNALDEBT	-10762.76	2919.106	-3.687005	0.0102
C	136192.3	49008.11	2.778975	0.0320

Authors Computations, 2025

With D(ILLICITINFLOW) as the dependent variable, the ARDL (1,1,1,1,1,0) model captures both short- and long-term dynamics. The significant negative lagged dependent variable ($\beta = -0.9136$, $p < 0.01$) confirms equilibrium restoration at an average rate of 91.4% annually. In the long run, illegal financial flows are significantly reduced by corruption ($\beta = -2298.093$, $p = 0.0021$) and external debt ($\beta = -10762.76$, $p = 0.0102$), while interest rates enhance flows ($\beta = 1916.006$, $p = 0.0117$); the impacts of inflation and exchange rates are insignificant. Similarly, short-run estimations indicate that while inflation and political risk are not significant, corruption ($\beta = -1689.194$, $p = 0.0058$) decreases flows, interest rates ($\beta = 801.28$, $p = 0.0491$) increase flows, and exchange rate depreciation ($\beta = -17400.38$, $p = 0.0103$) decreases flows.

Table 7: ARDL Short Run Form

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(CORRUPTION)	-1689.194	194.0384	-8.705461	0.0001
D(INFLATIONRATE)	-324.9552	108.2809	-3.001040	0.0240
D(INTERESTRATE)	801.2827	161.8884	4.949598	0.0026
D(POLITICALRISK)	66048.75	17016.95	3.881351	0.0082
D(LOG_EXCHANGERATE)	-17400.38	1940.175	-8.968461	0.0001
CointEq(-1)*	-0.913648	0.060956	-14.98853	0.0000
R-squared	0.962436	Mean dependent var		25.94737
Adjusted R-squared	0.947988	S.D. dependent var		6713.801
S.E. of regression	1531.157	Akaike info criterion		17.75752
Sum squared resid	30477726	Schwarz criterion		18.05577
Log likelihood	-162.6965	Hannan-Quinn criterion.		17.80800
Durbin-Watson stat	2.387113			

Authors Computations, 2025

Strong dynamics of illicit financial flows (IFFs) are revealed by the short-run ARDL (1,1,1,1,1,0) model, which covers the period from 2004 to 2023. The error correction term (-0.9136, $p < 0.01$) confirms a steady long-run connection and a quick 91% yearly adjustment to equilibrium. In the medium term, interest rates (801.28, $p 0.01$) and political risk (66048.75, $p 0.01$) significantly raise IFFs, but corruption (-1689.19, $p 0.01$) and inflation (-324.96, $p 0.05$) significantly decrease them. Additionally, exchange rate depreciation lowers IFFs (-17400.38, $p < 0.01$), which may be a result of tighter controls during currency instability or decreased capital flight profitability. Over 94% of the variation is explained by the model (Adj. $R^2 = 0.948$), and its robustness and lack of autocorrelation are confirmed by its low residual errors and Durbin-Watson statistic (2.39). These results demonstrate how, in the near term, macroeconomic volatility and institutional quality both influence Nigeria's IFFs.

Discussion of Findings

IFFs in Nigeria are primarily driven by corruption, exchange rate volatility, and political risk based on the analysis of the dependent variable (illicit financial flows) and independent variables (corruption, exchange rate, external debt, and political risks), with inflation and interest rates serving as controls. The country loses billions of dollars in revenue that could be used to support vital industries like infrastructure, healthcare, and education because of corruption, which makes it possible for tax evasion, embezzlement, and fraudulent transactions. Practically, it damages institutional integrity, raises operating expenses, encourages informal markets, and threatens anti-corruption laws. Economically, it increases inequality, reduces creditworthiness, and amplifies capital flight. By enabling money laundering, trade misinvoicing, and parallel markets, corruption stabilises IFFs and distorts economic systems. This is in line with the research of Kar and Spanjers (2015), Integrity (2017), Collin (2020), and Musselli and Bürgi (2020).

IFFs are also significantly influenced by exchange rate volatility and misalignment, which lower reserves, skew trade balances, erode tax receipts, erode monetary policy, and increase inflationary pressures. Long-term instability encourages capital flight overseas and arbitrage exploitation through black-market trading, round-tripping, and fraudulent invoicing. These actions undermine public confidence in financial institutions and foster an environment that is conducive to offshore operations by squandering liquidity, discouraging domestic investment, and overtaxing regulatory oversight. These flows are made worse by political risk, which manifests as instability, poor governance, and unpredictable policy. Risks like these weaken financial stability, discourage foreign direct investment, reduce tax receipts, increase inequality, and exacerbate inflationary pressures. In addition to undermining anti-money laundering initiatives, elites frequently take advantage of weak institutions to transfer illegal funds, which exacerbates inequality, poverty, and instability. These results are consistent with the work of Aziani (2018), Signé et al. (2020), Cobham and Janský (2020), Brandt (2023), Rao (2013), Reuter (2017), and Forstater (2018).

On the other hand, it was discovered that external debt harmed IFFs, indicating that stronger international oversight and repayment requirements might have limited illegal outflows. This conclusion contradicts Amadi et al. (2021), who observed a positive connection, but confirms Lawanson (2014), who stressed debt surveillance as a curb on capital flight. Meanwhile, high or fluctuating interest rates also influence IFFs by discouraging domestic investment, rewarding offshore savings, and creating arbitrage opportunities through trade underestimating and round-

tripping. Inflation-eroded real interest rates that are consistently high put pressure on financial institutions, increase non-performing loans, and exacerbate regulatory vulnerabilities, all of which contribute to the risks associated with IFF. This result is consistent with Miethe (2024), Kar and Spanjers (2015), and Kvasha et al. (2019). Collectively, the findings demonstrate that macroeconomic instability, political risks, and institutional flaws promote IFFs in Nigeria, even though debt management reforms might provide some control.

The findings of the study align with the Resource Curse Theory and the Debt Overhang Theory. As investors anticipate future tax burdens and debt servicing constraints, high external indebtedness discourages productive investment and encourages capital flight. This aligns with the Debt Overhang Theory, which is supported by the substantial correlation between illicit financial flows and external debt. According to the Resource Curse Theory, nations with a wealth of natural resources frequently suffer from weak institutions, poor governance, and rent-seeking practices that encourage illegal outflows. This is also supported by the significant impact that corruption, political risk, and exchange rate volatility have on IFFs. These connections demonstrate how Nigeria's reliance on natural resources, growing debt load, and institutional weakness foster a systemic atmosphere that supports ongoing illegal financial flows.

CONCLUSION AND RECOMMENDATION

The study concludes that the main drivers of illicit financial flows (IFFs) in Nigeria are interest rates, political risk, exchange rate volatility, and corruption. While parallel markets and misaligned exchange rates encourage capital flight, corruption makes embezzlement and resource diversion possible. International asset transfers are further encouraged by political risks like instability and policy reversals. Parallel investment channels that support outflows are also maintained by volatile interest rates associated with inflation. In contrast, IFFs are not significantly impacted by inflation or external debt. Based on the findings and related conclusions, the following recommendations are offered:

- i. Anti-corruption frameworks should be strengthened through collaboration with international partners to enhance transparency and accountability in public financial management. Also, consistent and market-driven exchange rate policies should be adopted to minimize arbitrage opportunities and illicit transactions tied to forex manipulation. In addition, strengthening political institutions is vital to ensuring policy consistency and political stability.
- ii. Interest rate stability should be maintained through sound monetary policies and investment-friendly reforms to discourage capital flight. However, transparent debt management practices must be enforced to ensure external borrowing is tied to productive investment and subject to public scrutiny. Given the insignificant effect of inflation on IFFs, policymakers should prioritize structural reforms, governance improvements, and regulatory effectiveness over inflation targeting alone.

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