CHAPTER ONE
INTRODUCTION

1.1 Backgroundof the Study

Globalfinancial crisis, also known as the financial crisis of 2007/ 08, is consideredby many economists to have been the worst financial crisis since the GreatDepression of the 1930s. (Reuters, September 30, 2009. Williams, Carol J. It threatened the collapse of large financialinstitutions, which was prevented by national governments but stock marketsstill dropped worldwide. In many areas, the housing market also suffered,resulting in evictions, foreclosure and prolonged unemployment. The crisisplayed a significant role in the failure of key business, declines in consumerwealth estimated in trillion of U.S dollars, and a downturn in economicactivity leading to the 2008 - 2012 global recession and contributing to theEuropean sovereign debt crisis, (Brookings, LarryElliot 2012). The active phase of the crisis, which manifested as a liquiditycrisis can be dated back from August 9, 2007, when BNP Paribas terminatedwithdrawals from three hedge funds citing ‘a complete evaporation of liquidity’Larry Elliot (2012).

Thebursting of the U.S (United States) housing bubble, which peaked in 2004,caused the values of securities tied to U.S real estate pricing to plummet, damaging financial institutionsglobally Micheal Simkovic, (2010). The financial crisis was triggered by acomplex interplay of policies that encouraged home ownership, providing easieraccess to loans for (lending) borrowers, overvaluation of bundled sub prime mortgages based on thetheory of that housing prices would continue to escalate, questionable tradingpractice on behalf of both buyers and sellers, compensation structures thatprioritize short- term deal flow over long-term value creation, and a lack ofadequate capital holdings from banks and insurance companies to back thefinancial commitments they were making Micheal Simkovie (2010) regarding banksolvency, declines in credit availability and damaged investor confidence hadan impact on global stocks markets, where securities suffered large lossesduring 2008 and early 2009. Economies worldwide slowed during this period, ascredit tightened and international trade declined World Economic Outlook,(2009). Governments and central banks responded with unprecedented fiscalstimulus, monetary policy expansion and institutional bailouts Kavaljit Singh(2008).

Inthe U.S, congress passed the American Recovery and Reinvestment Act of 2009;many causes for the financial crisis have been suggested, with varying weightassigned by experts (Ben Bernanke, 2007).The U.S senate’s Levin Coburn Reportconcluded that the crisis was the result of ‘high risk, complex financialproducts, undisclosed conflict of interest, the failure of regulators, thecredit rating agencies, and the market itself to rein in the excesses of WallStreet. The Financial Crisis Inquiry Commission concluded that the financialcrisis was avoidable and was caused by ‘widespread failures in financialregulation and supervision’, dramatic failures of corporate governance and riskmanagement at many systemically important financial institutions, a combinationof excessive borrowing, risky investment, and lack of transparency by financialinstitutions, ill preparation and inconsistent action by government that addedto the uncertainty and panic, a systemic breakdown in accountability andethics, collapsing mortgage-lending standards and the mortgage securitizationpipeline, deregulation of over-the-counter derivatives, especially creditdefault swaps and the failures of credit rating agencies to correctly pricerisk Kevm Drum (2009).

WestAfrican Monetary Zone (WAMZ) was established by the authority of the Heads ofStates and government of five West African member states, including Nigeria,Ghana, Gambia, Sierra Leone and Guinea in December 2000. The objective was toestablish a monetary union, a common central bank and introduce a singlecurrency to be called the ECO. After a decade of being an observer status,Liberia was absorbed as a full fledged member of West African Monetary Zone in2010. The West African Monetary Institute (WAMI) which would primarilyundertake technical preparations for the launch of the monetary union and theestablishment of a West African Central Bank (WACB) was established andcommenced operations in March 2001.

However,slow progress casts shadow on the possibility of West African Monetary Union;various deadlines have been set for the commencement of the monetary unionproject in 2003, 2005, 2009, and even January 2015, these dates have been missed already. This is because the sixmember states of WAMZ are finding it difficult to simultaneously meet allagreed macroeconomic convergence criteria before the project can take off(Onyinye Nwachukwu and Nnanna (2012).

TheWAMZ project requires all member states to meet four primary criteria and sixsecondary macroeconomic convergence criteria as pre-conditions for take off ofthe common monetary space. The four primary criteria include that each memberstate must maintain a single digit inflation rate in year, keep fiscal deficitwithin 5% of GDP, ensure that its central bank’s financing of fiscal deficitdoes not exceed10% of previous year’s tax revenue, and keep to gross externalreserves that cover at least three months of imports (Centre Bank of Nigeria,(CBN) Annual Reports, various years). Also, the six secondary convergencecriteria on the hand include, clearance and non-accumulation of arrears, taxrevenue that should be at least 20% of GDP, salary mass of not more than 35% oftax revenue, public investment from domestic resources of at least 20%, realdeposit interest rate which must not remain positive and nominal exchange rateappreciation or depreciation within a band of 15% of 2006 WAMZ exchange rate.But West African Monetary Institute (WAMI) says that the multilateralsurveillance missions it had conducted so far to assess the compliance of themember states shows that members find it difficult to satisfy and sustain theirperformance on the convergence criteria (Obaseki, (2001) and Onwioduokit(2001).

1.2 Statementof the Problem

Thetheory of the two-gap model had acknowledged that capital inflow was needed toprovide the required growth that would make economic take-off possible indeveloping countries. Chenery and Strout (1966). This implies that thedevelopment of emerging economics is imbedded in their ability to embrace theglobal production web through capital inflow which brings increaseproductivity, technology transfer, effective competition and economic growth(Ha-jonahing, 2000).

Hence,over the years, private capital inflow had taken off, driven by a number ofdomestic and external factors that contributed towards enhancing the region's(ECOWAS) attractiveness for foreign investors. In April 2000, the WAMZcountries agreed to move toward monetary integration such proposal has beensigned to provide much needed exchange rate and price stability in the WAMZregion. Above all, the agenda is expected to stimulate capital flows and investment that enhances growth anddevelopment in the WAMZ countries in spite of the possible benefits of theforeign capital in the host economy, it is worrisome that African sub-regionWest Africa has not attracted sufficientforeign capital that will launch them into economic development.

Itis therefore important to understand theunderlying factors, which are significant in linked with net capital inflows toguide policy and regional reforms and their effective implementation in theWAMZ region. Especially now that WAMZ nations are taking important steps toimprove their investment climate, governance, infrastructures and over allmacroeconomic investment (UNECA and AUC, 2011)

1.3 ResearchQuestions

Thisstudy seeks to address the following research questions:

1) Whathas been the trend of foreign capital inflows (FCI) in the WAMZ countries overthe years?

2) Whatis the composition of foreign capital inflows in the WAMZ countries over theyears?

3) Whichof the foreign capital inflows (FCI) foster more growth across the WAMZcountries?

1.4 Objectiveof the Study

Havingstated the research problem, the main objective of this study is to determineif capital inflows foster economic growth in Anglophone West Africaspecifically, this study intends to find out the following.

i)To examine extensively the capital flowsacross the WAMZ region.

ii)To unravel the trend of foreign capitalinflows (FCI) in the WAMZ countries over the years.

iii)To examine the composition of foreigncapital inflows in the WAMZ countries over the years.

iv)To investigate the specific type offoreign capital flows (FCF) that foster more growth in the various WAMZcountries.

1.5 ResearchHypothesis

Thehypothesis to be tested is that

H_o: There is no significant relationshipbetween global crises and foreign capital flows in West African MonetaryZone. (WAMZ)

H_1: There is no significant relationshipbetween global financial crises and foreign capital flows in West AfricanMonetary Zone. (WAMZ)

1.6 Scopeof the Study

Thestudy is restarted on the trend and composition of international capitalinflows as well as its role in the economic growth of the WAMZ. Theinternational flows to be considered are Foreign Direct Investment (FDI),Foreign Private Inflows (FPI), and Official Development Assistance (ODA).

Indoing this, my interest is mainly on the WAMZ countries which include, theGambia, Ghama, Guinea, Liberia, Nigeria and Slerra Jeone. The empiricalinvestigation would be limited to the period between 2001 and 2014.

1.7 Justificationof the Study

Foreigncapital flows have become one of the most important issues in the internationalmacroeconomic literature (Alfaro *et al.,*2005; Prasade *et al.,* 2003). And asnoted earlier, there is virtually no study on the subject with specific to WDMZas a regional bloc. From this stand, there is a yawning gap in the literatureon the compotation of international capital flows and their implications on theWAMZ economic growth which need to be filed consequently, private capital flowshave outstripped official flows as a source of development finance but the WAMZ nations still attract more thefollowing facts. WAMZ needs to attract substance private capital flows tocompensate for the perennial widening defect in the current accounts; secondly,capital flows are needed to accelerate the growth rate of WAMZ economy for theattainment of the Millennium Development Goals (MDGs) and vision 2020 in someWAMZ counties. Thirdly, foreign inflows can increase welfare by enablinghouseholds to smooth out their consumption overtime and achieve higher level ofconsumption (Calvo *et al.,* 1996).

Also,there have been calls at national, regional and international levels to attractprivate capital to developing countries in general consideration of the aidsfatigue and fiscal pressure on industrial/donor countries and the resultantdestine in ODA flows (Montul and Sharma 1997). Furthermore, the result of thisstudy will feed in to policy formulation framework of the WAMZ countries understudy in order to enhance their attraction and utilization of foreign capitalflows. This will subsequently contribute immensely to the achievement of theirvarious international macroeconomic goals.

Toother researchers, policy makers, and academic, the result of this make willform a veritable reference material in their own policy making and researchefforts.

1.8 Organizationof the Study

Theresearch work consists of five different chapters chapter one is theintroductort part, chapter two examines the theoretical review, empiricalreview, methodological review and implication of the current, while chapterthree examines the theoretical framework, model specification, estimationtechnique and chapter four focuses on results presentation, discussion ofresults and comparison of results with previous findings and the last chapterexamines clearly the summary of findingsconclusions, recommendations, ;imitations of the study and suggestions for future research.