International Journal of
Economic Policy
(IJECOP)

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CARI Journals

International Journal of Economic Policy
ISSN: 2788-6352 (Online)
Vol. 3, Issue No. 1, pp 17 - 31, 2023
www.carijournals.org

The Nexus between Capital Flight and Economic Growth. A Panel Data Investigation of the Mediating Role of Inflation (Kenya: 1986-2021)

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Abstract

Purpose: This paper investigates whether inflation moderated the relationship between capital flight and economic growth in Kenya. The study attempts to answer one question. Has the effect of capital flight on economic growth been influenced significantly by the inflation rate in Kenya?
Design/methodology/approach – The panel data for the variables under study, collected from World Investment Reports published by World Bank, are analyzed using feasible generalized least squares method to examine the relationship between the dependent and explanatory variables over the period 1987–2018. The interaction effect has been studied to examine the growth impact of FDI in presence of host country characteristics.
Findings – The study found out that foreign portfolio investment outflows, profit repatriations, and inflation rates had no significant effects on economic growth when the interaction variable for inflation was included in the model. Outward foreign direct investment had a significant effect on economic growth when inflation is included in the model as an interaction variable with a positive coefficient indicating they had a positive significant relationship. The interaction variable had a negative but insignificant coefficient indicating that inflation rate did not moderate the relationship between capital flight and economic growth. From the empirical findings, we can infer that capital flight did not constrain resources and subsequently did not affect economic growth negatively. We also find that inflation rate cannot be used to control or moderate the effect of capital flight on the economy and Kenya should not pursue policies geared towards using inflation to moderate this relationship.

Originality/value – The present study provides for the first time comprehensive empirical evidence on the relationship between inflation, economic growth, and the increased rate of capital outflows in Kenya. Therefore, this study would be of prime importance for policymakers.
Originality/value – Very few studies have been conducted to examine the nexus between inflation, capital flight and economic growth in Kenyans financial markets. Assessing the interaction of these variables in Kenya and their impact on economic growth by use of panel data methodology is an original contribution of this paper toward the existing body of knowledge.
Keywords: *Inflation, Economic growth in Kenya, Panel data.*
Paper type Research paper

Introduction

The effects of inflation on the macroeconomic variables such as economic growth, foreign capital flows and investments has been put at the center of research, particularly after the global economic crises and market crash in 2007, as well as the Covid-19 pandemic (Dumitrescu, Kagitci, & Cepoi, 2022). Directly, inflation increases transactions and information costs, inhibiting investment and entrepreneurship and ultimately leads to capital outflows from the country when investors choose other foreign countries as their investment destinations. Further, high inflation indirectly discourages any long-term financial contracting and ultimately negatively affect economic growth (Subramaniam & Masron, 2022). The empirical research has accepted that high and volatile oscillations of inflation have a significant effect on the flow of funds in an economy and can be detrimental to economic growth. Empirical investigations have proofed that inflation, foreign capital flows and economic growth have a direct relationship (Tariq, Ahmad, & Amin, 2022). The market responds to capital flows whether in or out of the country through inflation or increased/decreased economic growth (Dumitrescu, Kagitci, & Cepoi, 2022). Further, a high and volatile inflation impedes the growth of the economy, which in turn goes to affect the purchasing power (Baharumshah, Slesman, & Wohar, 2016).

The oscillating levels of inflation has been a challenge in the Kenyan economy. Just like other economies, Kenya has witnessed a rise in inflation owing to various numerous macroeconomic forces which have been kept at bay by the various interventions of effective monetary and the expansionary fiscal policies adopted by the Central Bank (CBK, 2022). The high inflation rates of a country are largely exacerbated by the economic forces, such as economic mismanagement which can easily translate to increased capital flight and decreased economic growth. The overall worst-case effect would be the failure of a country to meet its financial obligations as and when they fall due, thus exposing the country to unfavorable financial standing in the global economy. This would eventually make a country less attractive to the coveted international market investments (Gharagozloo, Chen, & Pour, 2022).

The global environment for international business and cross-border capital and investment outflow has significantly evolved more so in the year 2022, due to the Ukraine war that began when Kenya and the rest of the world was still reeling from the negative effects of the COVID-109 pandemic which exacerbated inflationary pressures worldwide (UNCTAD, 2022). This has led to a downgraded global economic growth projection of 3.1 per cent in 2022, down from the 4.0 per cent that the UN had earlier forecasted at the beginning of the year 2022 (United Nations, 2022). The developing world and more so Kenya in particular was affected severely beyond its immediate vicinity, causing an increased rate of inflation that was manifested by the increased prices of the basket of goods and services (Afridi, Tahir, Sayal, & Naseem, 2020).

It is expected that investor uncertainty and risk aversity could put significant downward pressure on the global foreign capital flows in the coming years, and Kenya will not be an exception to the

projected effects (UNCTAD, 2022). As such, Kenya's economy and the developing countries stands the risk of experiencing significant rises in inflation, which could affect the purchasing power and easily slow down the economic growth. Eventually, this would lead to increased outflow of capital, should the international investors begin to exit the market due to increased cost of doing business (United Nations, 2022).

The global economic pointers in the whole world economy is not making it any better, especially the anticipated interest rate rises in the United States of America, the European and other major economies that are seeing significant rises in inflation. Negative financial market sentiment and signs of a looming recession could accelerate a foreign direct investment downturn (UNCTAD, 2022). Economists suggest the need for a deliberate effort by every country to create relevant buffers that can handle the often-numerous economic shocks that often lead to economic crisis. Policy makers must demonstrate stewardship and come out to control the levels of the capital outflows due to the strong effect it might have on the success or failure of foreign investors (Gharagozloo, Chen, & Pour, 2022). Sub-Saharan Africa's recovery has been sharply interrupted. Last year, activity in sub-Saharan Africa finally bounced back, bringing GDP growth in 2021 up to 4.7 percent. Unfortunately, growth is expected to slow this year by more than 1 percentage point to 3.6 percent, as a worldwide slowdown and a dramatic pickup in global inflation spill into a region already wearied by an ongoing series of shocks. Rising food and energy prices are striking at the region's most vulnerable, and macroeconomic imbalances are approaching levels not seen in decades. (IMF, 2022).

Economic growth plays a critical and yet an important role in affecting inflation. Empirical literature has demonstrated that economic growth has a positive influence on inflation. This has created a challenge in the macroeconomic research, where policy makers have to face a trade-off between high economic growth and combat unemployment but suffer rising inflation or vice versa (Dumitrescu, Kagitci, & Cepoi, 2022). In any given economy, economic growth reflects the optimal level of production, and thus, inflation accelerates as the GDP increases beyond its capacity to produce domestically. Further, if the GDP decreases below its constant level, inflation will decelerate as supplier's attempt to dispose-off the excess supplies by reducing prices (Subramaniam & Masron, 2022).

In Kenya, monetary policy has recently been tightened in a bid to halt rising inflation and the significant capital outflows. A large volume of capital flight reflects excessive taxation and economic mismanagement of the home country. The external borrowing is often fueled by capital flight. It occurs when the domestic currency siphoned out of the country through capital flight re-enters the country in the form of foreign currency that finances external loans to the same residents who transferred the capital (Ampah et al., 2018). As a result, this decreases the return on investors fund forcing them to flee domestic environment to save their domestic assets real value from depreciation (Agbaje, 2014). Often, investors are rational and would react to the inflation effects by transferring their capital to economies with more stable inflation rates, or at least minimal

oscillations (Asongu, Nting, & Osabuohien, 2019). In other words, economies with high inflation oscillations are likely to experience outflow of capital and dwindling investment activity (Ndikumana, Boyce, & Ndiaye, 2015). Given the magnitude and frequency of change in high-tech industries, multinational firms would thus tend to shift their high-tech businesses to countries that has deliberate superior institutional environment and policies that would hedge their investments against inflationary effects (Gharagozloo, Chen, & Pour, 2022)

The theoretical assumption that capital outflows negatively affect economic growth has been tested by many empirical researchers, by use of various samples, variables and research methods. While majority of the macroeconomic studies demonstrate a negative impact of capital outflows on economic growth of developing countries, others find a positive effect to the host economy. While this has happened, limited attention has been paid on inflation which can have a great influence on the macro-economic environment (Dumitrescu, Kagitci, & Cepoi, 2022).

Nevertheless, how inflation responds to changes or shocks in the flow of foreign capital has obtained meager attention in the literature. How capital outflows impacts inflation can significantly affect fiscal and other macroeconomic policy management decisions. Conventionally speaking, increased capital outflow is followed by a rise in inflation. More often, the international finance literature emphasizes the need for the host countries deliberate involvement in reversing the increase of capital outflows in an economy. The role of inflation is yet to be sufficiently addressed as the focus has been mainly on the effect of foreign capital outflow on economic growth.

Economies quite often face this tradeoff of controlling inflation and achieving the right balance of the right and acceptable levels of capital outflows in the economy. Restraining the inflation rate well within manageable limits can boost a country's economy's growth potential. Equally, a low inflation rate might pose counter-productive effects (Tariq, Ahmad, & Amin, 2022). Although the global inflation risks remain on the downside, there is empirical evidence that inflationary pressures are still accelerating in several developing countries and emerging economies. In particular, many emerging economies and developing countries have faced a substantial acceleration of inflation, over the last few years (Subramaniam & Masron, 2022).

Mawutor, Gborse, Sogah and Mensah, (2022) in their study on Doing Business and capital flight: the role of financial development. Subramaniam and Marson, (2022) investigated if excessive degrees of financial depth would push hyper-inflation. Tariq, Ahmad and Amin, (2022) assessed the non-linear effects of government size on inflation. Limited attention has been paid on the effect of inflation on capital outflows and economic growth. It is against this backdrop that this study investigates the moderating role of inflation in the relationship between foreign capital outflows and economic growth in Kenya. This study aims to address this gap in the present study, which has impactful and significant policy implications with regard to the management of the economy and controlling the levels of capital outflows in the country.

The results of this study will benefit policy makers to appreciate the effect that inflation would have on the economic growth of a country, as well as demonstrate that capital flight can affect

economic growth and justify its adoption in the existing policies in Kenya. Further, policy makers will benefit greatly in the process of amending the Kenya's investment policy to adopt the extreme pressures of inflation on a country's economic growth projection. The study further intends to trigger policy makers to appreciate and model the right mix of capital outflows and inflation limits that would enhance the growth of Kenya's economy.

Literature Review

The purpose of this study was to apply panel data model on the monetary theory of inflation, to test the cause-and-effect relationship between the variables, as well as investigate the role of inflation in the relationship between capital outflows and economic growth in Kenya, using appropriate time series models. Previous literature provides an overwhelming support for the use of monetary theory of inflation, more so in the countries that have high inflation rates, rather than countries with moderate-to-low inflation rates (Joo, Shawl, & Makina, 2022). Thus, the role of monetary theory and policy is to ensure that the excess demand does not lead to increased inflationary pressures, which would ultimately jeopardise the growth of the economy (Subramaniam & Masron, 2022).

Mawutor, Gborse, Sogah and Mensah, (2022) in their study on Doing Business and capital flight: the role of financial development used a two-step system generalized methods of moment empirical model with linear interaction between Doing Business and financial development was estimated. This study used data on 26 countries over 12 years (2004–2015). The main results indicated that, although Doing Business had a significant positive effect on capital flight, the interactive term had a significant adverse effect on capital flight. This outcome suggested that to reduce capital flight, a well-reformed and efficient business environment should be embedded with an efficient, stable and well-developed financial sector. This study's main contributions are that the authors estimated the threshold beyond which financial development helps the business environment reduce the rate of capital flight. Further, the authors have shown that financial development is a catalyst to propel the deterioration powers of the business environment against capital flight.

Subramaniam and Marson, (2022) investigated if excessive degrees of financial depth would push hyper-inflation Using an innovative threshold estimation technique, in quest to provides new evidence on the relationship between finance and inflation with distinct levels of finance. The sample consisted of 10 high inflation countries using time series data for the period of 1992–2020. These 10 countries recorded the world's highest inflation rates in 2017. The results disclosed that financial depth could be the cause of high inflation in the top 10 countries and thus, is not necessarily welcome as too rapid of a price increase may in turn reverse the prospect of economic growth. Searching and strategizing for the optimal level of financing is crucial in facilitating price stability and economic growth.

Tariq, Ahmad and Amin, (2022) Assessed the non-linear effects of government size on inflation in India: recent evidence from smooth transition autoregression model. They aimed to unearth the government size-inflation nexus in India for the period from 1971 to 2019. They found out that there existed a non-linear relationship between the size of the government and inflation in India. The estimated threshold level for government size is precisely found to be 9.27%. As such, the size of the government exerts a negative influence on inflation until it reaches the optimal or threshold level. Any further increase in the size of government beyond this threshold level would result in a rise in inflation.

Methodology

Purposive sampling method was applied. The necessitate data with information on foreign portfolio investment outflows, inflation, economic growth and profit repatriations were sourced from the African Development Bank, World Development Indicators, Central Bank of Kenya, International Monetary Fund, UNCTAD and the UNCOMTRADE. The World Investment Report compiles data on around 1,600 World Development Indicators for 217 countries drawn from official sources and is an open data source available on the World Bank website. To investigate whether the inflation rate moderated the relationship between capital flight and economic growth in Kenya, the following panel regression equation was estimated:

$$GDP_{\text{it}} = \beta_0 + \beta_1 FPIO_{It} + \beta_2 OFDI_{It} + \beta_3 PR_{It} + \beta_4 INF_{It} + \beta_5[(\text{INF} \times FPIO) + (\text{INF} \times OFDI) + (\text{INF} \times PR)]it + \ldots\ldots \mu_{it}$$

Where GDP is economic growth, FPIO is foreign portfolio investment outflows, OFDI is outward foreign direct investment, PR is profit repatriations and INF is the inflation rate. The interaction variable is [(INF ×FPIO) + (INF ×OFDI) + (INF ×PR)] which measures the moderation effect. The data was converted to their natural logs in order to deal with the problems of dispersion or high values and also establish elasticity relationships between the variables.

The Unit root tests were conducted on the variables in a bid to avoid the challenge of a spurious regression in this model. The Levin, Lin and Chu T- statistic test for stationarity which is suitable for panel data sets was used for this study. The test covered the most general specification for all the pooled variables which obviously included a constant, a trend and lags. Lastly, there was need to conduct a Hausman test in order to make a determination on the model to use, i.e the fixed effects model or the random effects model for the study to evaluate the moderating role of inflation in the relationship between capital flight and economic growth in Kenya.

Research Findings and Discussion

GDP had a nominal mean of 1.22 and a standard deviation of 0.86 meaning that GDP was not volatile or deviate much during the period of study. FPIO had a mean of 21.53 and a standard deviation of 2.79 indicating that there were small deviations from the mean during the period of

study and that FPIO was stable. The nominal mean of OFDI was 21.75 with a standard deviation of 3.15 signifying stability in OFDI. Profit Repatriations was also stable during the period of study with a nominal mean of 22.96 and a standard deviation of 1.8. Inflation rate did not deviate much during the period of study with a mean of 2.09 and a standard deviation of 0.68. None of the variables was normally distributed. All had probability values of less than 0.1 which means they were all significant at 10 percent level of significance.

Table 1: Summary statistics

	LN_GDP	LN_FPIO	LN_OFDI	LN_PR	LN_INF
Mean	1.229575	21.53296	21.75882	22.95632	2.085275
Median	1.545507	21.98226	21.91164	23.37228	2.182008
Maximum	2.128503	25.70966	28.02187	25.30448	3.828182
Minimum	-1.461018	16.08565	13.54338	19.66922	0.441025
Std. Dev.	0.862899	2.787498	3.158391	1.804555	0.682925
Skewness	-1.661849	-0.480563	-0.415703	-0.582966	-0.269900
Kurtosis	4.844879	2.467572	3.019288	2.080312	3.565657
Jarque-Bera	119.2170	9.959746	5.705758	18.19310	5.043651
Probability	0.000000	0.006875	0.057678	0.000112	0.080313
Sum	243.4558	4263.527	4308.245	4545.351	412.8845
Sum Sq. Dev.	146.6850	1530.718	1965.160	641.5145	91.87816
Observations	198	198	198	198	198

Correlation analysis

The data was converted to their natural logs to address the problem of large values and eliminate heteroscedasticity. It was then subjected to correlation analysis to ensure there were no highly correlated variables so as to avoid the problem of multi-collinearity in the model. FPIO, OFDI and PR had correlation coefficients of 0.01, 0.18 and 0.02 respectively with GDP signifying weak positive correlations. INF had a correlation coefficient of -0.23 signifying a weak negative correlation with GDP. None of the independent variables had a high correlation with GDP. The correlation coefficient results were summarized in the table below;

Table 2: Correlation analysis

Correlation	LN_GDP	LN_FPIO	LN_OFDI	LN_PR	LN_INF
LN_GDP	1.000000				
LN_FPIO	0.010345	1.000000			
LN_OFDI	0.177592	0.191477	1.000000		
LN_PR	0.024676	0.854434	0.189041	1.000000	
LN_INF	-0.234319	-0.100345	0.004312	-0.116992	1.000000

Unit root tests

Unit root test were conducted to ensure that the series were stationary and address the problem of having a spurious regression. A variable can only be said to be stationary when it has no unit root which is denoted in literature as 1(0). A non-stationary variable can have one or more-unit root and it is denoted by I (d), d is the number of unit root that the variable possesses and by implication, the number of unit roots that the variable must be differenced in order to make it stationary.

Intercept and level I (0)

Gross Domestic Product (GDP)

GDP was found to be stationary at intercept and level I (0) because the Levin, Lin & Chu t* statistic had a probability value of 0.0000 which is significant at 5% level of significance. Therefore, we rejected the null hypothesis that GDP had a unit root.

Table 3: Unit root test for Gross Domestic Product (GDP)

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-6.12840	0.0000	7	203
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-8.24925	0.0000	7	203
ADF - Fisher Chi-square	90.2104	0.0000	7	203
PP - Fisher Chi-square	90.2485	0.0000	7	203

Foreign Portfolio Investments Outflow (FPIO)

The Levin, Lin & Chu t* statistic for FPIO had a probability value of 0.0374 which is significant at 5% level of significance. Therefore, we reject the null hypothesis that FPIO had a unit root.

Table 4: Unit root test for Foreign Portfolio Investments Outflow (FPIO)

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-1.78223	0.0374	7	196
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	1.64625	0.9501	7	196
ADF – Fisher Chi-square	4.01948	0.9953	7	196
PP – Fisher Chi-square	1.50809	1.0000	7	196

Outward Foreign Direct Investments (OFDI)

OFDI was found to be stationary at intercept and level I (0) because the Levin, Lin & Chu t* statistic had a probability value of 0.0000 which is significant at 5% level of significance. Therefore, we rejected the null hypothesis that OFDI had a unit root.

Table 5: Unit root test for Outward Foreign Direct Investments (OFDI)

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-4.91071	0.0000	7	229
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-3.45651	0.0003	7	229
ADF - Fisher Chi-square	34.5526	0.0017	7	229
PP - Fisher Chi-square	32.3975	0.0035	7	229

Profit Repatriations (PR)

The Levin, Lin & Chu t* statistic for PR had a probability value of 0.0054 which is significant at 5% level of significance. Therefore, we reject the null hypothesis that PR had a unit root.

Table 6: Unit root test for Profit Repatriations (PR)

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-2.54739	0.0054	7	245
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	0.29832	0.6173	7	245
ADF - Fisher Chi-square	8.14388	0.8817	7	245
PP - Fisher Chi-square	8.55022	0.8587	7	245

Inflation (INF)

INF was found to be stationary at intercept and level I (0) because the Levin, Lin & Chu t* statistic had a probability value of 0.0000 which is significant at 5% level of significance. Therefore, we rejected the null hypothesis that INF had a unit root.

Table 7: Unit root test for Inflation (INF)

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-6.76819	0.0000	7	245
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-8.76721	0.0000	7	245
ADF - Fisher Chi-square	94.7125	0.0000	7	245
PP - Fisher Chi-square	96.4204	0.0000	7	245

Panel Regression Equation

Hausman test.

The null hypothesis indicates that that both the fixed effect and Random effect estimation methods are suitable and should yield similar coefficients. The alternate hypothesis indicates that at least one of the two estimation methods is suitable for the study. A significant Hausman statistic will indicate a difference in the coefficients of both the estimation methods. As such, the null hypothesis is rejected that both models are suitable. In that case the fixed effect model is considered suitable. Consequently, an insignificant Hausman statistic implies a rejection of the null hypothesis that both estimation methods are suitable and in cush a case, the Random effects estimation method considered as the most suitable.

Table 8: Correlated Random Effects - Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.000000	5	1.0000

Random Effects Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LN_FPIO	0.028763	0.051465	0.558887	0.5769
LN_OFDI	0.113378	0.044729	2.534768	0.0121
LN_PR	0.074663	0.077565	0.962598	0.3370
LN_INF	1.520308	1.190037	1.277531	0.2030
MOD_INF	-0.028612	0.018625	-1.536200	0.1261
C	-2.797703	2.643713	-1.058248	0.2913
	Effects Specification			
			S.D.	Rho
Cross-section random			0.000000	0.0000
Idiosyncratic random			0.833500	1.0000
	Weighted Statistics			
R-squared	0.100390	Mean dependent var		1.229575
Adjusted R-squared	0.076963	S.D. dependent var		0.862899
S.E. of regression	0.829028	Sum squared resid		131.9593
F-statistic	4.285177	Durbin-Watson stat		1.839270

Prob(F-statistic)	0.001020		
	Unweighted Statistics		
R-squared	0.100390	Mean dependent var	1.229575
Sum squared resid	131.9593	Durbin-Watson stat	1.839270

The moderating role of inflation in the relationship between capital flight and economic growth.

The main objective of this study was to assess the moderating role of inflation rate on the relationship between capital flight and economic growth in Kenya. The hypothesis to test for this specific objective was:

H_{01}: Inflation rate does not moderate the relationship between capital flight and economic growth in Kenya.

The Chi-square test statistic was 0.0000 with an insignificant probability value of 1.0 which was insignificant at 5 percent level of significance. This therefore meant that the null hypothesis was rejected in favor of the random effects model. Therefore, we accept the random effects model as suitable for this study.

The interaction variable MOD_INF had a coefficient of -0.03 and an insignificant probability value of 0.1261 which is insignificant at 5 percent level of significance. This means that inflation did not moderate the relationship between capital flight and economic growth in Kenya during the period of this study. n. This finding is consistent with the previous empirical evidence that the monetarist theory of inflation is more applicable to countries with high inflation experiences than to countries with moderate or low inflation rates.

Conclusion

This paper investigates whether inflation moderated the relationship between capital flight and economic growth in Kenya. The study attempts to answer one question. Has the effect of capital flight on economic growth been influenced significantly by the inflation rate in Kenya? Empirical results show that foreign portfolio investment outflows, profit repatriations, and inflation rates had no significant effects on economic growth when the interaction variable for inflation was included in the model. Outward foreign direct investment had a significant effect on economic growth when inflation is included in the model as an interaction variable with a positive coefficient indicating they had a positive significant relationship. The interaction variable had a negative but insignificant coefficient indicating that inflation rate did not moderate the relationship between capital flight and economic growth.

From the empirical findings, we can infer that capital flight did not constrain resources and subsequently did not affect economic growth negatively. We also find that inflation rate cannot be

used to control or moderate the effect of capital flight on the economy and Kenya should not pursue policies geared towards using inflation to moderate this relationship. Although the study demonstrated that inflation rate did not moderate in the relationship between capital flight and economic growth, the findings demonstrated that inflation was a significant factor that affect the rate of economic growth as well as the level of capital outflow in Kenya. The study results concluded that inflation significantly affected economic growth in Kenya. Further, capital outflows had a positive and significant relationship with inflation rate. This means that inflation was influenced by the volume of capital outflows in Kenya. The conclusion agrees with the findings of Afirid et al. (2020) who concluded that inflation rate appeared to be significant determinants of economic growth whereas in earlier specifications their impacts were though positive but largely insignificant. Further, inflation rate had a positive impact on economic growth.

The positive impact of inflation on economic growth supports the hypothesis that moderate inflation of single digit could be good for the growing economy as it provides positive confidence to all stakeholders especially producers. Moderate inflation provides signals to producers that the economy is growing, and hence further production would be priced highly and hence the profit margin would flourish significantly.

The findings have implications for the conduct of fiscal policy in Kenya. The government should adhere strictly to the discipline in the conduct of fiscal and monetary policies, to curb inflation and enhance economic growth synchronously, hence alleviating any loss of capital to foreign economies. Also, the Central Bank of Kenya should develop a threshold-effect mechanism that can identify the optimal rate of inflation that would exacerbate economic growth and minimize the need for both local and foreign investors to withdraw their capital from the country.

Further, in light of the findings from this study, policymakers of developing economies should focus on the development of financial markets to attract and retain investments in country while maintaining a liberalized trade policy stance and macroeconomic stability at the same time for realizing the growth enhancing impact of retained investments in country as opposed to capital outflows outside the country. Lastly, as a stopgap measure, the government should make a deliberate effort to establish a mechanism to return any repatriated revenues raised by developed home countries that should have accrued to developing host countries, but were repatriated due to unfavorable policies or unexplored treaties.

Areas of Further Studies

The findings of this study set a ground for further research in a number of areas. A more vigorous academic inquiry is invited to make more informative conclusions on the effect of capital flight on economic growth, as well as prescribe a threshold of inflation rate that would be critical in achieving a modest economic growth, since inflation was found to be sufficiently good for a growing economy. More studies are invited to shed light on the impact of capital outflows on inflation because the threshold approach has not been adequately examined in past studies. Lastly,

future studies should encompass a wide range of countries and include different determinants of economic growth such as physical capital, government consumption and greenfield investments.

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