



Foreign direct investment and the Nigerian economy: Vision 2020 mission

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Article History

Received 29 November, 2013

Received in revised form 16

April, 2014

Accepted 23 April, 2014

Key words:

Foreign direct investment, Vision 2020, Nigerian economy.

Article Type:

Full Length Research Article

ABSTRACT

This paper examined the nexus between foreign direct investment (FDI) and the vision 2020 economic growth target of Nigeria. Generally, policies and strategies of Nigerian Government towards FDI are shaped by two principal objectives of desire for economic independence and the demand for economic development. From related research and studies, it was revealed that the level of FDI in Nigeria is not adequate. Ordinary least square regression technique and equations was adopted in the analysis of the secondary data. From the findings, it was discovered that increased inflow of FDI in Nigeria is a major pathway towards achieving the vision 2020 economic growth target. The paper therefore recommended among others, the encouragement of domestic investors first before going after foreign investors in addition to Nigeria adopting its own growth and development strategy not on the basis of ideology, but based on its own geographical, historical, economic, political and socio cultural realities.

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INTRODUCTION

Nigeria is a vast country that spans an area of 924,000 sq km with a population of over 150 million people. As the most populous country in Africa, it has a huge economy with a current gross domestic product (GDP) growth rate of 7.23%, an external foreign reserve of \$36bn; inflation rate of 11%; 24 well capitalized banks; 2.6 million barrels per day oil output; 7.57% deposit rate; 18.0% prime lending rate and 4.37% interbank rate (Akinlo, 2004). Nigeria's rich human and material resources and endowments gives it the potential to become Africa's largest economy and a major player in the global economy as envisaged by the present Goodluck Ebele Jonathan Administration's vision of making Nigeria one of the 20 developed economies in the world by the year 2020. One of the most salient features of today's globalization drive is conscious encouragement of cross-border investments, especially by transnational corporations and firms (TNCs). Many countries and continents (especially developing) now see attracting

foreign direct investment (FDI) as an important element in their strategy for economic development. This is most probably because FDI is seen as an amalgamation of capital, technology, marketing and management. Sub-Saharan Africa as a region, now has to depend very much on FDI for so many reasons, some of which are amplified by Asiedu (2001). The preference for FDI stems from its acknowledged advantages (Sjoholm, 1999; Obwona, 2001, 2004). Feldstein (2000) identified the provision of diversification opportunities in other climes through the international flow of capital to reduce the risk faced by owners of capital in their home countries, as one of the advantages of FDI. International investment also provides opportunities for the global transfer of technology and human capacity development in addition to the promotion of competition in the domestic input market. Despite the contributions to corporate tax revenues in the host country from profits generated by FDI, the highly capital intensive technology engendered can exacerbate the unemployment situations in labour surplus host countries.

The importance of FDI in the growth dynamics of countries has created much interest amongst scholars

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and lots of researchers have been focused on the impact of FDI on the economy. Most of the works on the role of FDI on economic growth in Nigeria have examined various aspects. According to Utomi (2007), FDI viz transnational corporations do possess the needed capabilities which can be put to the service of growth in any host economy. A general belief for a country to grow rapidly is for it to industrialize. However, to industrialize a country requires substantial capital investment which is possible through earning of foreign exchange from export, borrowing in the international financial markets, or allowing businessmen to invest in her economy. Agbachi (2007) advised that no country should ever rest on her oars and expect fortune seeking foreign investors to grow her economy for her. It is up to the recipient economy to 'exploit' foreign investors through the judicious use of macro-economic policies deliberately designed to take advantage of the available foreign investment for national economic benefits.

Nigeria is in dilemma, she is in dire need of foreign capital for the on-going internal economic adjustments. Her per-capital income is low; hence the realization of substantial savings to effect capital accumulation for investment is unfeasible. This has rendered the dream of domestic sourcing of finance for investment unrealistic and the scenario has led to increased desire for foreign investment in the provision of desired capital that will help in economic growth. Hence, the need for foreign capital has become indispensable if the economy must come out of the woods to achieve her vision 2020 target.

REVIEW OF RELATED LITERATURE

The concept and theory of foreign direct investment

According to Nwankwo (2007), foreign investment is a type of investment whether in real or financial assets across the national boundaries of the investors with the aim of maximizing the objective function of the investors which can be undertaken by individuals, firms or the government. Basically, foreign investment falls into two broad categories: Portfolio investment and direct investment.

Portfolio investment

This is an investment in which an investor lacks control over the investment. It typically takes the form of investments in financial assets such as bonds and stocks in which the investor does not have controlling interest. The major motivating factor is the favorable interest rate differential that is, capital flow from where it is plentiful to where it is scarce. Portfolio investment can equally be called FDI where you do not have to be involved in the

management.

Direct investment

By direct investment, we mean an investment in a foreign country where the investors retain control over the investment. According to Aremu (2000), FDI shows that the owner of the money is coming to direct the affairs. He has an effective voice in the management.

FDI typically takes the form of a foreigner setting up a subsidiary or taking over/control of an existing firm in the country in question. Usman (2008) asserted that FDI involves the internationalization of product in order to service markets which were formally served by experts. Also, FDI is distinguished from other forms of foreign investment by the fact that it involves not only foreign investment ownership but also foreign control. In other words, FDI occurs only if an individual or organization in a foreign country gains sufficient interest in an operation to acquire control. Therefore, FDI as a concept differs from international or foreign investment which is a much wide concept.

From these definition, a direct investment can be recognized as an incorporated or unincorporated enterprise in which a single foreign investor either controls 10% or more of the ordinary shares of voting powers of an incorporated enterprise or; the equivalent of an unincorporated enterprise; or controls less than 10% /or none of the enterprise, but has an effective voice in the management of the enterprise.

An effective voice in the management means that the foreign investor has the potential to influence or participate in the management of an enterprise. It does not mean that he/she must have absolute control. Generally speaking, investment is the commitment of funds or savings to a specified project with the primary motive of achieving a primary objective which could be profit, fame or good will. A foreign investment is the ownership of property abroad, usually in a company for a financial return. FDI is a subset of foreign investment when, control follows the investment. So, an investment is called direct when the concept of control is introduced to it. In addition, direct investment possesses some other features such as high:

- commitment of capital, personnel and technology between countries; and
- access to foreign materials for either resources of precuts.

The ownership of a controlling interest in a foreign operation is the highest type of commitment to foreign operations. For an investment to be considered direct then there has to be either a minimum of 10 or 25% ownership of the voting rights or shares in a foreign

enterprise. The concept of control is very important in the operation of FDI because in most cases, it is the single most important fact that motivates investors to be willing to transfer technology and other competitive assets.

Despite the fact that many researchers have tried to explain the phenomenon of FDI, we cannot say there is a general theory accepted. But, according to Kindleberger (1969), if everyone agrees on one point, in a world characterized by perfect competition, FDI would no longer exist. Thus, if markets work effectively and there are no barriers in terms of trade or competition, international trade is the only way to participate in the international market. There must be a form of distortion that determines the realization of direct investment, and Hymer was the first who noticed this. He believes that local firms will always be better informed about local economic environment, and for FDIs to take place, two conditions are necessary:

- i. Foreign firms must possess certain advantages that allow their investment to be viable;
- ii. The market of these benefits has to be imperfect (Kindleberger, 1969).

From a macroeconomic point of view, FDI is a particular form of capital flows across borders, from countries of origin to host countries, which are found in the balance of payments. The variable of interest is: Capital flows and stocks revenues obtained from investments.

The microeconomic point of view tries to explain the motivations for investment across national boundaries from the point of view of the investor. It examined the consequences to investors, the country of origin and the host country of the operations of the multinationals rather than investment flows and stock (Lipse, 2001).

The first attempt to explain FDI was considered by the Ricardo's theory of comparative advantage (Hosseini, 2005). However, FDI cannot be explained by this theory, which is based on two countries, two products and a perfect mobility of factors at local level. Such a model cannot even allow FDI. Thus, as Ricardo's comparative advantage theory fail to explain the rising share of FDI, other models were used, such as portfolio theory (Hosseini, 2005). This theory was designed to fail because it explained only the achievement of foreign investments in a portfolio, but could not explain the direct investments. According to the theory, as long as there is no risk or barriers in the way of capital movement, the capital will go from countries with low interest rates to countries with high interest rates. But these allegations have no basis in reality, and the introduction of risk and barriers to capital movement erodes the veracity of the theory, and capital can move freely in any direction (Hosseini, 2005).

Although more realistically, the new theories of international trade still cannot capture the entire

complexity of FDI and other forms of international production. The new theories of international trade, still cannot explain foreign direct and other forms of international investment (Hosseini, 2005). Robert Mundell (Mundell, 1957) has tried to explain the FDI through a model of international trade, involving two countries, two goods, two production factors and two identical production functions in both countries where production of a good requires a higher proportion of a factor than the other. Mundell's model could not also explain international production through FDI because foreign investment incorporated portfolio investment or short term investment.

Japanese researchers Kojima and Ozawa also tried to create a model to explain both international trade and FDI (Kojima and Ozawa, 1984). They started from the model developed by Mundell and tried to develop it and improve on it. Thus, in the model developed by the two Japanese, FDI takes place if a country has comparative disadvantage in producing a product, while international trade is based on comparative advantage.

Internalization theory (Vintila, 2010) provides an explanation of the growth of the multinational enterprise (MNE) and gives insights into the reasons for FDI.

Foreign direct investment: The Nigerian economy

Significant scholarly efforts have been made to study the role of FDI in the Nigerian economy. Adelegan (2000) explored the seemingly unrelated regression model to examine the impact of FDI on economic growth in Nigeria and found out that FDI is pro-consumption and pro-import and negatively related to gross domestic investment. Akinlo (2004) found out that foreign capital has a small and no statistically significant effect on economic growth in Nigeria. However, these studies do not control the fact that most of the FDI was concentrated in the extractive industry. In other words, it can be pointed out that these works assessed the impact of investment in extractive industry (oil and natural resources on Nigeria's economic growth).

On firm level productivity spill over, Ayanwale and Bamire (2001) assessed the influence of FDI and firm level productivity in Nigeria and reported a positive spill over of foreign firms on domestic firm's productivity. Much of the other empirical work on FDI in Nigeria centred on examination of its nature, determinants and potentials. For example, Odozi (1995) noted that foreign investment in Nigeria is made up of mostly "Greenfield" investment. That is, it is mostly utilized for the establishment of new enterprises and some through the existing enterprises. Aremu (1997) categorized the various types of foreign investment in Nigeria into five: Wholly foreign owned; joint ventures; special contract arrangements; technology management and marketing arrangements; and sub-

contract co-production and specialization. In his study of the determinants of FDI in Nigeria, Anyanwu (1998) identified change in domestic investment, change in domestic output or market size, indigenization policy, and change in openness of the economy as major determinants of FDI inflow into Nigeria and that effort must be made to raise the nation's economic growth so as to be able to attract more FDI. Jerome and Ogunkola (2004) assessed the magnitude, direction and prospects of FDI in Nigeria. They noted that while the FDI regime in Nigeria was generally improving, some serious deficiencies remained. These deficiencies are mainly in the area of the corporate environment (such as corporate law, bankruptcy, labour law, etc) and institutional uncertainty, as well as the rule of law. The establishment and the activities of the Economic and Financial Crimes Commission (EFCC), the Independent Corrupt Practices Commission (ICPC) and the Nigerian Investment Promotion Commission (NIPC) are efforts to improve the corporate environment and uphold the rule of law. The question to answer now is: Have there been any discernible change in the relationship between FDI and economic growth in Nigeria in spite of these policy interventions? Akinlo (2004) investigated the impact of FDI on economic growth in Nigeria using data from the period 1970 to 2001. His error correlation model (ECM) results showed that both private capital and lagged foreign capital have small and insignificant impact on economic growth. This study however established the positive and significant impact of export on growth. Financial development which he measured as M2/GDP has significant negative impact on growth. This he attributed to capital flight. On the other hand, labour force and human capital were found to have significant positive effect on growth. However, an important fact about FDI and growth debate is the endogeneity case in which FDI is theorized to impact positively on economic growth, and consequently leading to greater market which in turn attracts further FDI as well (market size hypothesis). Market size hypothesis states that markets with rapidly expanding economic growth tend to give multinational firms more opportunities to make more sales and profits and therefore become more attractive to FDI (Charkrabarti, 2001). This study will therefore make its contribution by examining the benefits of adopting increased inflow of FDI in Nigeria as a major pathway towards achieving the vision 2020 economic growth target.

METHODOLOGY

To achieve the stated objectives of the study, annual time series data of the variables were used. The data were sourced from the Central Bank of Nigeria Statistical Bulletin 2009 edition and the Nigerian Federal Office of

Statistics. The period covered by the study was 2000–2009. The choice of the period is informed by the developments in the Nigerian economy during this period, which is being used to predict future trends. Three linear models were developed using the following independent variables: Index of Industrial Production, Gross Fixed Capital Formation (GFCF) and dependent variables of GDP and FDI. The ordinary least square regression technique was used in analysing the developed models. The least square regression formula and equation is presented thus:

$$Y = a + bx + e$$

Where:
$$b = \frac{n\sum xy - (\sum x)(\sum y)}{n\sum x^2 - (\sum x)^2}$$

$$a = \frac{\sum y}{n} - \frac{b\sum x}{n}$$

$$e = \frac{\sqrt{\sum y^2 - a\sum y - b\sum xy}}{n - 2}$$

Where: y=dependent variable; x=independent variable; a=intercept parameter; b=gradient; e=error term; n=sample size.

Therefore, the models are presented thus:

1. FDI = a + b log(IIP) + e
2. FDI = a + b log(GFCF) + e
3. GDP =a + b log(FDI) + e

Assuming a linear relationship, the model equations become:

1. Log (FDI)=a + b log(IIP) + e
2. Log (FDI)=a + b log(GFCF) + e
3. Log (GDP)=a + b log(FDI) + e

ANALYSIS AND RESULT

This section presents the result of regression analysis for the models.

Model Equation 1: Log (FDI)=a + b log(IIP) + e

Table 1. H₀: There is no positive relationship between foreign direct investment (FDI) and index of industrial production (IIP). H₁: There is a positive relationship between FDI and IIP.

Year	FDI million(Y)	IIP million(X)	X ²	XY	Y ²
2000	37333.6	970.2	941288.04	36221058.72	1393797689
2001	37779.6	1066.1	1136569.21	40276831.56	1427298176
2002	39953.6	1112.1	1236766.42	44432398.56	1596290153
2003	45719.4	1172.5	1374756.25	53605996.50	2090253536
2004	102995.8	1379.3	1902468.49	142062106.90	1060813482
2005	133894.5	1510.8	2282516.64	20228710.60	1792778713
2006	212729.4	1666.1	2775889.21	354428453.30	4525378762
2007	245763.3	1878.5	3528762.25	461666359.10	6039959963
2008	229246.4	2118.3	4487194.89	485612649.10	5255391191
2009	259362.5	2374.2	5636825.64	61577447.50	6726890641
n 10	Σ1344778.1	Σ15185.1	Σ18711191.63	Σ 2436372112	Σ 3065444031

$$b = \frac{10 \times 2436372112 - 15185.1 \times 1344778.1}{10 \times 18711191.63 - (15185.1)^2}$$

Therefore b=2.636.

$$a = \frac{1344778.1}{10} - \frac{2.636 \times 1515.1}{10}$$

Therefore a=7.689.

Substituting into the model equation:

$$\text{Log (FDI)} = 7.689 + 2.636 (\text{IIP}) + e$$

$$\text{S.E} = \sqrt{\frac{0.631688}{8}} = 0.281$$

$$R^2 = 0.72.$$

$$\text{Therefore, T Calculated} = 2.636 \sqrt{\frac{1.002381416}{0.199}} = 9.392$$

T Critical value = 2306.

The results from Table 1 show a positive relationship between FDI and industrial production. The elasticity of the index of industrial production with respect to FDI of 2.636 indicates that 1% increase in foreign direct investment will lead to %2.636 increase in the level of industrial output. Also, the coefficient of determination (R²) with a value of 0.72 indicates high positive relationship between foreign direct investment and index of industrial output. Therefore, since the T- calculated value of 9.392 is greater than the critical table value of 2.306 at 0.05 level of significant, we reject the null

hypothesis (H₀) and accept the alternate hypothesis (H₁) which states that there is a positive relationship between FDI and IIP.

Model Equation 2: Log (FDI)=a + b log(GFCF) + e

$$b = \frac{10 \times 2762380194 - 242.689 \times 1344778.1}{10 \times 5962.6 - (242.689)^2}$$

Therefore b=0.873.

$$a = \frac{1344778.1}{10} - \frac{0.873 \times 242.689}{10}$$

Therefore a=0.281

Substituting into the model equation:

$$\text{Log (FDI)} = 0.281 + 0.873 (\text{GFCF}) + e$$

$$\text{S.E} = \sqrt{\frac{0.316800}{8}} = 0.199$$

$$R^2 = 0.95.$$

$$\text{Therefore, T Calculated} = 0.873 \sqrt{\frac{89.79179726}{0.199}} = 41.57$$

T Critical value = 2.306.

The result from this model shows that there exist a relationship between FDI and GFCF (Table 2). Also, the coefficient of determination (R²) with a value of 0.95 indicates high positive relationship between FDI and GFCF which could serve as a measure of standard of

Table 2. H₀: Foreign direct investment (FDI) has no impact on gross fixed capital formation (GFCF). H₁: FDI has impact on GFCF.

Year	FDI million(Y)	GFCF million(X)	X ²	XY	Y ²
2000	37333.6	20.19	407.90	753765384	1393797689
2001	37779.6	24.035	577.70	908032686	1427298176
2002	39953.6	30.474	928.70	1217546006	1596290153
2003	45719.4	25.43	646.70	1162644342	2090253536
2004	102995.8	23.159	536.30	2385279732	1060813482
2005	133894.5	22.998	528.90	3079305711	1792778713
2006	212729.4	22.583	509.90	4804068.04	4525378762
2007	245763.3	22.773	518.60	5596767631	6039959963
2008	229246.4	24.041	577.90	5511312702	5255391191
2009	259362.5	27.006	729.30	7004343675	6726890641
n 10	Σ1344778.1	Σ242.689	Σ5961.60	Σ 762380194	Σ 3065444031

Table 3. H₀. No positive relationship exists between foreign direct investment (FDI) and gross domestic product (GDP). H₁. Positive relationship exists between FDI and GDP.

Year	GDP million(Y)	FDI million(X)	X ²	XY	Y ²
2000	329178.7	37333.6	1393797689	1228942591	1083586165
2001	356994.3	37779.6	1427298176	1348710186	1274449302
2002	433203.5	39953.6	1596290153	1730803936	1876652724
2003	477533	45719.4	2090263536	2183252224	2280377661
2004	527576	102995.8	1060813482	5433811218	2783364358
2005	561951.4	133894.5	1792778762	7523952384	3157668983
2006	595821.6	212729.4	4525378762	1267487715	3550033790
2007	634251.1	245763.3	6039959963	155876434	4022744579
2008	672202.6	229246.4	5255391191	1541000261	4518563354
2009	716949.7	259362.5	6726890641	1859498666	5140168723
n 10	Σ 5305642.9	Σ1344778.1	Σ 3065444031	Σ 2567621562	Σ 2649257923

living. Since the T- calculated value of 41.57 is greater than the critical table value of 2.306 at 0.05 level of significant, we reject the null hypothesis(H₀) and accept the alternate hypothesis(H₁) which states that FDI has impact on GFCF.

Model Equation 3: Log (GDP)=a + b log(FDI) + e

$$b = \frac{10 \times 2567621562 - 1344778.1 \times 5305641.9}{10 \times 3065444031 - (1344778.1)^2}$$

Therefore b=0.291.

$$a = \frac{5305642.9}{10} - \frac{0.291 \times 1344778.1}{10}$$

Therefore a=9.792.

Substituting into the model equation:

$$\text{Log (GDP)} = 0.281 + 0.873 (\text{FDI}) + e$$

$$\text{S.E} = \sqrt{\frac{0.010954}{8}} = 0.037$$

$$R^2 = 0.877.$$

$$\text{Therefore, T Calculated} = 0.291 \sqrt{\frac{0.0959711342}{0.037}} = 7.548$$

T Critical value = 2.306.

The results from this model show that there exist a positive relationship between GDP and FDI (Table 3). Furthermore, the independent variable with a coefficient of 0.291 means that a unit change in value of FDI will lead to a 0.291 unit increase in the GDP of the Nigerian

economy, thereby stimulating the growth of the economy. Also, the coefficient of determination (R^2) with the value 0.87 means that there exist a strong relationship between FDI and GDP, which is a proxy for measuring growth. Therefore, since the T- calculated value of 7.548 is greater than the critical table value of 2.306 at 0.05 level of significant, we reject the null hypothesis (H_0) and accept the alternate hypothesis (H_1) which states that there exist a positive relationship between FDI and GDP.

Conclusion

Managing the Nigerian economy to achieve high quality growth via the year 2020 that reduces vulnerability to shocks and leads to sustainable development requires that the structure of the Nigerian economy be transformed from a low-income agrarian to high income industrial and service based economy. The transformation requires a strategy for industrialization and agricultural modernization; right economic, social and sectoral policies; investment in people, infrastructure and knowledge; improving the functioning of the market and business environment; and mobilizing the resources to achieve the objectives. FDI have been acknowledged as a major propellant of growth through transfer of technology, technological innovations, and other externalities. While this study recognizes that creating the necessary environment is critical for the attraction of FDI, Nigerian Government must acknowledge the fact that the basic element in any successful development strategy is to encourage domestic investors first before going after foreign investors. Thus, the most effective strategy for attracting foreign investment is to make the Nigerian economy very attractive to Nigerian investors first.

Recommendation

Based on the conclusion above, it is recommended that:

1. Nigeria should adopt its own growth and development strategy not on the basis of ideology but based on its own geographical, historical, economic, political and socio cultural realities.
2. Nigeria should invest in and accumulate human and physical capital; and knowledge as well as encourage innovation and technology transfer which are necessary for igniting and sustaining economic growth, for a successful development experience.
3. Successful macroeconomic and sectoral policies can be regarded as a pre-condition for growth: Fiscal policy, monetary policy, public revenue management, financial development, FDI and trade policy. Nigeria should make the necessary policy interventions required to create an environment in which the private sector, which is the engine of economic growth, can operate.
4. Nigeria should develop and strengthen institutions and bureaucracies to support its economic development agenda.
5. The Nigerian Government needs to embark on capital project, which will enhance the infrastructural facilities with which foreign investors can build on.
6. Efforts should be made at solving the problems of government involvement in business; relative closed economy; corruption; weak public institutions; and poor external image. Therefore, the Nigerian Government should continues with its privatization programme, external image laundry, seriousness and openness in the fight against corruption, and signing of more trade agreements.

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APPENDICES

Appendix 1. Foreign direct investment flow and index of industrial production (2000-2009).

Year	FDI million	IIP million
2000	37333.6	970.2
2001	37779.6	1066.1
2002	39953.6	1112.1
2003	45719.4	1172.5
2004	102995.8	1379.3
2005	133894.5	1510.8
2006	212729.4	1666.1
2007	245763.3	1878.5
2008	229246.4	2118.3
2009	259362.5	2374.2

Source: Central Bank of Nigeria Statistical Bulletin 2009 Edition.

Appendix 2. Foreign direct investment flow and gross fixed capital formation (2000-2009).

Year	FDI million	GFCF million
2000	37333.6	20.19
2001	37779.6	24.035
2002	39953.6	30.474
2003	45719.4	25.43
2004	102995.8	23.159
2005	133894.5	22.998
2006	212729.4	22.583
2007	245763.3	22.773
2008	229246.4	24.041
2009	259362.5	27.006

Source: Central Bank of Nigeria Statistical Bulletin 2009 Edition.

Appendix 3. Foreign direct investment flow flow and gross domestic product in Nigeria (2000-2009).

Year	GDP million	FDI million
2000	329178.7	37333.6
2001	356994.3	37779.6
2002	433203.5	39953.6
2003	477533	45719.4
2004	527576	102995.8
2005	561951.4	133894.5
2006	595821.6	212729.4
2007	634251.1	245763.3
2008	672202.6	229246.4
2009	716949.7	259362.5

Source: Central Bank of Nigeria Statistical Bulletin 2009 Edition.