

LATEST GLOBAL FINANCIAL CRISIS AND FOREIGN DIRECT INVESTMENT FLOWS IN NIGERIA: THE ROLE OF MARKET SIZE

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Abstract

While there is substantial empirical evidence suggesting that the heightened market apprehension caused by the latest global financial crisis (GFC) resulted in a substantially reduced foreign direct investment (FDI) in many developed and emerging economies, the assertion that developing economies such as Nigeria are insulated from the impact of recent global financial crisis is however not evidence-based. This study therefore deployed the least squares technique to evaluate the effect of the crisis on FDI into the country. The results showed that FDI inflow to Nigeria was not significantly influenced by the recent global financial crisis. The variation in the FDI inflow to Nigeria was due largely to the country's market size and macroeconomic stability. This study recommended further diversification of the economic base of the country in order to enhance its capacity to withstand possible shocks induced by future global crisis.

Keywords: Foreign direct investment; Financial crisis; Nigeria; Dummy regression model

JEL Classification: C22, F02, F21, F40

1. Introduction

The stability of the financial environment is a critical determinant of a nation's economic development. The search by international ventures for higher profit as per the Capital Arbitrage theory propounded by Samuelson (1948) generates active interests in the performances of the global financial system. Foreign investors have had to relocate their funds in response to the various crises that had engulfed the world in contemporary times. The history of economic disequilibria, which caused major global instability in the financial environment, included the great Wall Street crash of 1929, the economic depression of the 1930s, the Japanese asset price crisis of 1990, the Asian financial crisis from 1997 to 1999 and the 'dotcom' bubble burst of late 2000.

A more recent international economic disequilibrium was the housing crunch in the United States of America, which occurred in February 2007. In the opinion of Adamu (2009), the problem could be ascribed to the liberalisation of global financial regulation which generated active speculations, also engendered a novel financial architecture. The financial engineering and mismanagement resulted in disarticulated rating of credit profiles and riskier loans and granted advances. These in turn first led to a thriving boom and consequently resulted in the bust of the housing market. The latest global financial crisis (GFC) from 2008 to 2009 emanated from the United States of America (USA) 2007 and has had widespread consequential deleterious effects.

The current European sovereign debt overhang afflicting Greece and some other European countries in turn had roots in the GFC.

The GFC gave rise to a sharp slackening of the rate of economic growth consequent upon the significant diminution in the asset, company closures, and unemployment. The contagion recessionary impact was exported directly to the highly industrialised countries given the trade inter-linkages. The consequential manifestations of the distress were the volatility and downturns in stock markets resulting in the collapse of financial institutions, worldwide. Other debilitating impact manifested in falling commodity prices, declining remittances, contracting official development assistance (ODA), and the potential of declining foreign direct investment (Thimmaiah, 2013).

Although the effects varied from country to country, the economic position worsened. The global GDP diminished by 0.6 per cent in 2009 as a result of the worldwide recession, the first since the Second World War (IMF, 2010). Indeed, many developed countries introduced unprecedented countercyclical fiscal policies in addition to providing sizeable rescue packages for banks (Blanchard, Dell’Ariccia & Mauro, 2010).

The Nigerian mono cultural economy and the nation’s dependence on foreign capital inflows accounted for the contagious impact of the shock arising from the worldwide financial crisis. Since the pre-independence era, the governments of Nigeria have made unabated efforts at improving its investment climate for attracting foreign investments. The results have been varied. The delayed impact of the latest GFC on FDI was not felt fully until 2010 when the net flow went into the negative region (Figure 1). Indeed, the financial sector enjoyed no immunity as the Nigerian Stock market lost about 70 per cent of its market value in 2009 because of capital flight by portfolio investors and panic selling by local shareholders (CBN, 2010).

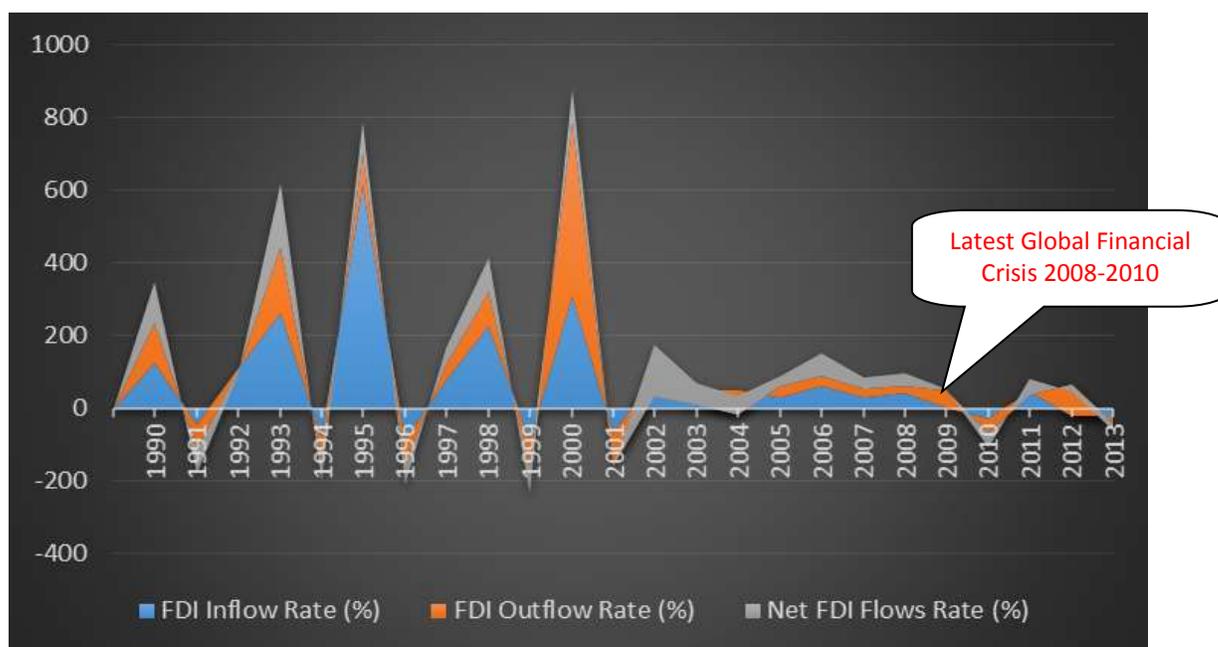


Figure1: Nigeria’s Foreign Direct Investment Growth 1990 -2013
 Source: Compiled by the Authors using data from CBN Statistical Bulletin (various years)

The likely implications of the GFC on the net flow of FDI to Nigeria can therefore not be ignored. The global financial crisis is likely to seriously cause deterioration in the foreign direct investment flow to Nigeria due to increased shortage of international finances. The deterioration in the terms of trade due to the collapse of the prices of exportable commodity prices may deleteriously affect the economy.

Although the consequence of financial crisis and foreign capitals flow has been extensively explored in the literature, there are however only few studies thus far that have brought the two research areas together. The need for this study is to explore the magnitude, dimension and extent of the manifestation of the impact of the latest global financial crisis on the FDI flow in the context of Nigeria. This study concentrates on the role of market size by utilising the Least Squares method to determine its impact on the financial crisis and FDI inflow to Nigeria.

Following this introduction section, the remaining sections of the paper are divided into four. A brief review of previous studies is presented in the next section. In section three, the methodology employed including the data, and model specification are presented. Section four covers empirical results and discussion of findings. In section five, the study is concluded and recommendations are proffered.

2. Literature Review

Conflicting predictions regarding the growth effects of foreign direct investment (FDI) can be seen in the literature. A school of thought provided evidence of in support of positive influence of FDI on the growth of the economy through the innovation. Other identified causative factors include foreign-induced know-how, technology and the modernising spillovers to the economy of the host country (Guloglu et al., 2012; Mebratie & Bedi, 2013; Melnyk, 2014). On the other hand, the opposing school of thought posits that FDI may engender deleterious impact through the crowding out of the domestic investment from the financial benefits and economic space. Other bad influences may arise from the destructive activities of foreign investors (portfolio and / or direct) and their affiliates including foreign vulnerability and consumption dependence. In addition, the market-stealing activities and destructive practices of foreign affiliates may cause the poor absorptive capacity of the host economy (Schoors et al., 2002; Stanisic, 2008; Jyun-Yi, & Chih-Chiang, 2008; Garcia et al., 2013).

FDI is not always directly channeled. There is the indirect transmission mechanism. Alfaro and Chenz (2010) identified three performance channels through which FDI can influence the performance of the economy. These are the production linkage (direct) channel and the financial linkage (both direct and indirect) channel which can be amplified through the third, the multinational networks (indirect). Thimmaiah (2013) provided evidence of causality from global FDI inflows, outflows and net-flows using secondary data covering the period 1980-2007, prior to the latest GFC. Applying the OLS regression and Granger causality test, he indicated bi-directional causal relationship with Asia and Africa and a uni-directional causal relationship with Europe with world causing Europe inflows. Similar unidirectional causal relationship also subsisted between Europe and Africa in the direction of the former. Thimmaiah also identified Africa as one of the regions sharing bi-causal relationships with world as well as three regions namely Asia, America and Oceania (Figure 2).

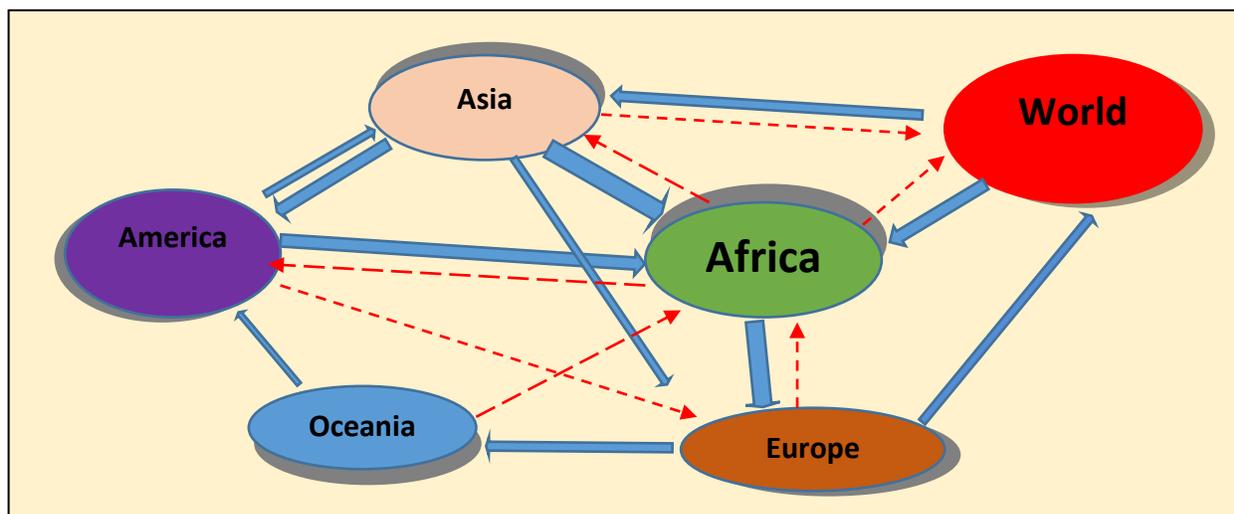


Figure 2 Granger Causality Relations FDI Inflow  FDI Outflow 
 Source: Adapted from Thimmaiah (2013)

A comparative analysis by Poulsen and Hufbauer (2011) found the current GFC to be the biggest one, and has led to a greater change in FDI and its attendant recession. Since the advent of the latest GFC, some research works have reported adverse influence of GFC on FDI. They include Ucal et al. (2010), Dornean et al. (2012), Leven (2012), Li et al. (2012), Bo et al. (2014), Diaconu (2014) and Weitzel et al. (2014). In 2010, a research by Shelburne reports that the foreign investments by the developed and emerging economies were more severely impacted by the crisis than those of the other regions of the world. The position taken by Dullien et al. (2010) is that the developing countries were insulated from the crunch at the inception of GFC. Although these countries were hit hard by the financial and economic crisis, the impact was somewhat delayed. This position is corroborated by the IMF (2010) reported for sub-Saharan Africa 4.8 percentage points during the crisis compared with -2.8 percent and -4.3 percent for United States of America and United Kingdom respectively in 2009.

In terms of microeconomic study, Alfaro and Chenz (2010) investigated the differential reaction of companies to the world-wide financial crisis by focusing on the role of FDI in determining the performance of the firm. The study also examined three distinct conduits through which the performance of the firm is influenced by foreign investments. These channels are through production linkages, financial linkages, and multinational networks. The result of their research confirms on average, that the superior performance of multinational owned establishments was better than their local competitors. The role of FDI was more varied. Multinationals with larger international network recorded superior economic performance. Multinational companies with stronger financial base and having vertical production linkages

manifested better responses in comparison with domestic companies. On the other hand, multinational firms with headquarters in countries with a greater occurrence of the financial catastrophe, performed less satisfactorily than those with less impact.

The summary of findings from these studies is that the impact of the latest GFC was felt at different time intervals depending on the structure of the economy and the degree of international connectivity of the countries. Most of the existing studies mainly concentrate on developed and emerging economies with little or no concern for developing economies such as Nigeria. Building on this premise, the present study is meant to empirically examine whether FDI inflow to Nigeria respond significantly to the recent global financial crisis during the crisis period. The methodology for determining the case for Nigeria is presented in the next section.

3.0 METHODOLGY

This section is divided into three sub-sections. The first describes the data and explains their sources. An estimable model upon which policy implications could be derived is specified in the second subsection. This is rounded up with the presentation of the estimation procedures.

3.1 Data Source and Description

The scope of this study spans thirty four years, from 1980 to 2014 covering economic cycles for about 66.6 percent of the independent life of Nigeria. Indeed, 1980 was the first full appropriation year after the institution of the Structural Adjustment Programme (SAP) in the country. The choice of the study period provides an opportunity for a comprehensive assessment of the effect of FDI on the Nigerian economy.

Annual time series secondary data are used. The explained variable measures as a ratio FDI to GDP was sourced from UNCTAD database. For Nigeria's market size (MktZ), the study used the country's domestic growth rate which is also obtained from the same source. Two control variables were included in the analysis, and sourced from various issues of CBN Statistical Bulletin. These are the macroeconomic stability proxied by the natural logarithm of the country's consumer price index and trade openness. The second is the addition of imports and exports as a percentage of gross domestic product (GDP). The latest GFC value was taken as a dummy variable taking 1 for years 2007, 2008, 2009, 2010, 2011 and 0 otherwise. The next discussion is the presentation of the model to be estimated.

3.2 The Model

The Multinational Corporations theory propounded by Brainard (1997) is linked to the Growth-led FDI hypothesis. The two-way link between FDI and economic growth arises from the fact that higher FDI encourages high economic growth in the host country and higher economic growth in the host countries in turn attracts more FDI. Dunning (2000) provides the Eclectic paradigm or OLI (Ownership, Location and Internalisation) which is the framework for this hypothesis. The framework was expanded upon by Dunning and Lundan (2009).

Of interest to this study similar to the position taken by Dornean, Isan and Oanea (2012) is that arising from the Eclectic paradigm. A multinational company possessing ownership advantages usually take advantage of the location in investing in countries with large market size or the high degree of trade openness. The market size is proxied by GDP. The degree of openness is proxied by the sum of imports and exports as ratios of GDP. In effect, a rise in the degree of economical openness or the size of market of the host country will result in a surge in

the level of FDI, since greater profitability will be expected by the investors. Therefore, following Dornean et al. (2012), this paper adopts the basic model Equation (1) which is the functional expression of FDI and financial crisis nexus, formulated as:

$$FDI = f(Mktz, Crisis) \quad (1)$$

Where:

FDI = the flow of foreign direct investment to Nigeria and

$Mktz$ = the Nigeria's market size

$Crisis$ = a dummy variable for the world-wide financial catastrophic period.

The econometric specification of the functional relationship in equation (1) taking natural logs of both sides can be represented as:

$$FDI_t = \alpha_0 + \beta_1 Mktz_t + \beta_2 Crisis + \varepsilon_t \quad (2)$$

Where: the regression parameters are α_0 , β_1 , and β_2 while ε is the regression disturbance term.

This is the baseline model of the research. In order to learn whether the effect of the global financial crisis on FDI flows is influenced by the country's market size, equation (2) is further extended and formulated to incorporate $MacST$ and TOP which are the control variables denoting macroeconomic stability and trade openness respectively in order to explain the inflow of FDI to Nigeria as represented by equation (3)

$$FDI = \alpha_0 + \beta_1 MktZ_t + \beta_2 (Crisis_t * Mktz_t) + \beta_3 MacST_t + \beta_4 TOP_t + \varepsilon_t \quad (3)$$

3.3 Estimation Technique and Procedure

Three step approach have been adopted for this paper. The preliminary step is to understand the characteristics of the dataset. The next step is to check for the stability of the variables (stationarity) by deploying the Augmented Dickey Fuller (ADF) test. The tactics is to include a time trend and a constant term into the original form (level) of the ADF equation. A constant is added to the ADF equation when testing the first differences.

In testing a long-run relationship between two variables, the necessary condition is that stationarity is recorded in first differences I(1) (see Dickey and Fuller, 1981; Said and Dickey, 1984). In the event that the variables are stationary in first differences, the next step is to test for cointegration. If however the variables are all stationary at level (i.e. I(0)) the Least Squares method (LS) as deployed by Dornean et al. (2012) will be utilised.

4. Empirical Findings and Discussions

4.1 Preliminary Analyses

The preliminary characteristics of the data and the summary of the statistics of the variables (FDI, MktZ, Crisis, macroeconomic stability (MacST) and trade openness series) are presented in Table 1.

Table 1: Descriptive Statistics

Variable	Mean	Maximum	Minimum	Std. Dev.	Skewness	Kurtosis
FDI	3.05	7.69	-0.79	1.95	0.22	2.85
MktZ	5.22	11.36	-0.69	2.95	-0.04	2.65
Crisis	0.12	1.00	0.00	0.33	2.37	6.63
MacST	20.71	72.81	4.67	18.60	1.41	3.70
TOP	20.80	37.60	7.99	6.16	0.21	3.39

Source: Authors' computation using E-views

The mean value indicates that average FDI growth rate as a share of GDP in Nigeria between 1980 and 2014 is (3.05%). There is evidence of significant variations in the trends of the FDI flows to Nigeria over the scope covered. This is shown by the huge difference between the minimum and maximum values of FDI in Nigeria. Similar evidence is also found for other variables namely MktZ, MacST and TOP.

With respect to the statistical distribution of the series, the series are all positively skewed save for market size. The FDI and MktZ are platykurtic in nature since their kurtosis values, 2.85 and 2.65 respectively are less than 3 which is indicative of a higher than normal distribution. However the other variables, are leptokurtic in nature indicating a flatter than normal distribution.

4.2 Unit Roots and Variables Validity Tests

The next step in the estimation process is to ascertain whether the series are stationary in order to apply the appropriate regression model. Based on results from Table 2, we can see that all the series are stationary. The results of the Augmented Dickey-Fuller (ADF) test results are shown in Table 2.

Table 2: Stationary Test Results

Variable	Augment Dicky-Fuller (ADF)	
	Level Test	I(d)
FDI	-3.14 ^{a**}	I(0)
MktZ	-4.27 ^{a*}	I(0)
MacST	-3.61 ^{b**}	I(0)
TOP	-3.42 ^{a**}	I(0)

Source: Authors' computation

Note:

^a Indicates a model with constant but without deterministic trend;

^b is the model with constant and deterministic trend as exogenous lags are selected based on Schwarz info criteria.

* and ** imply that the series is stationary at 1% and 5% respectively.

The order of integration is I(0) for all the concern series test performed. The choice of this technique is borne out of the fact that the concerned time series variables are all stationary at level. This justifies the use of Least Square (LS) method as the most appropriate estimation technique as deployed by Dornean et al. (2012) in the context of this study. The need for cointegration test therefore does not arise. In the next section, the results of model estimation are presented.

4.2 Results of Model Estimation

The result of the estimation using least squares method with the dependent variable being FDI as a percentage of GDP is reported in Table (3)

Table 3 Estimation Result

	Baseline Model			Extended Model		
	Coefficient	Standard Error	t-Statistic	Coefficient	Standard Error	t-Statistic
Constant	2.63*	0.78	3.37	1.17	1.30	0.90
MktZ	0.24**	0.10	2.33	0.18***	0.10	1.79
Crisis	-0.01	1.05	-0.01	0.03	0.93	0.03
MacST				0.05*	0.02	3.17
TOP				-0.0117	0.5	-0.24
R-square	0.31			R-square 0.49		
Adjusted R-Square	0.24			Adjusted R-Square 0.40		
F-Statistic	4.49 (0.01)			F-Statistic 5.44 (0.0013)		
D.W. Statistic	1.60			D.W. Statistic 1.99		

Source: Estimated by the Authors using EViews 07

Note: *, ** and *** denotes 1, 5 and 10 per cent level of significance respectively.

The estimated baseline and extended models are presented as equations (4) and (5) respectively.

$$FDI = 2.63 + 0.24Mktz - 0.01Crisis \quad (4)$$

T-Statistics (3.37) (0.24)** (-1.01)

$$R^2 = 0.31 \quad \overline{R^2} = 0.24 \quad DW = 1.60$$

$$FDI = 1.17 + 0.18Mktz + 0.03*0.18(Crisis * MktZ) + 0.05MacST - 0.0117TOP \quad (5)$$

t-Statistic (0.90) (1.79)** (0.03)*(1.79) (3.17)* (-0.24)

$$R^2 = 0.49 \quad \overline{R^2} = 0.40 \quad DW = 1.99$$

Using the baseline model, the FDI is related significantly at 5 percent level with t-statistic of (0.24) to the market size. With a coefficient of 0.24, one hundred percent increase in the market size will cause a rise of 24 percent in foreign direct investment. This is in concert with the extended model which shows that FDI is related significantly at 5 percent level to the market size with t-statistic of (1.79). The coefficient of 0.18 means that one hundred percent increase in the market size will cause an increase of 18 percent in foreign direct investment.

The relatively low values of the coefficient of determination notwithstanding, the Durbin–Watson (DW) statistic used to spot the presence of autocorrelation are within the acceptable levels especially for the extended model (Durbin and Watson, 1950)

The summary of our empirical finding from both the baseline and extended models of the study is that FDI inflow to Nigeria does not respond significantly to the latest global financial

crisis. In effect, the variation in the FDI inflow to Nigeria even during the period could not be empirically attributed to the financial crisis per se, but to the country's market size and macroeconomic stability.

This is at variance with the findings of some of the researches on the developed nations which found adverse correlation between the GFC and FDI (UNCTAD, 2009; Shelburne, 2010; Blanchard, Dell'Ariccia and Mauro, 2010). Even the explanation of Dullien et al. (2010) that the impact of the crisis on the developing countries was somewhat delayed because they are not in the main stream of the international economic order is of limited validity.

The main drivers of FDI into Nigeria are the size of the market and the macroeconomic stability which is consistent with the Capital Arbitrage theory propounded by Samuelson (1948). The basic fundamentals of the country were not seriously affected. The growth rate on the average was 5.91 percent (2005-2015). In the fourth quarter of 2010, 8.60 percent growth rate is achieved which is an all-time high. A record low of 2.35 percent is recorded in the second quarter of 2015 (Trading Economics, 2015).

4 Conclusion and Recommendation

Most of the existing literature on the impact of the latest financial crisis on foreign direct investment flow paid little or no attention to developing economies. Since Nigeria is not in autarky and therefore partly insulated from the deleterious and beneficial externalities of the global economic order, an examination of the recent financial crisis becomes manifest.

This study therefore deployed the least squares technique to evaluate the effect of the crisis on FDI into the country. The results show that FDI inflow to Nigeria is not significantly influenced by the recent global financial crisis. This however, is in tandem with the UNCTAD (2009) submission, which explains that FDI inflows to developed countries were the most affected by the crisis and that FDI inflows to developing economies are comparably more resilient to the crisis. The variation in the FDI inflows to Nigeria was due largely to the country's market size and macroeconomic stability.

This study recommends further diversification of the economic base of the country in order to enhance its capacity to withstand shocks induced by possible future global crisis.

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