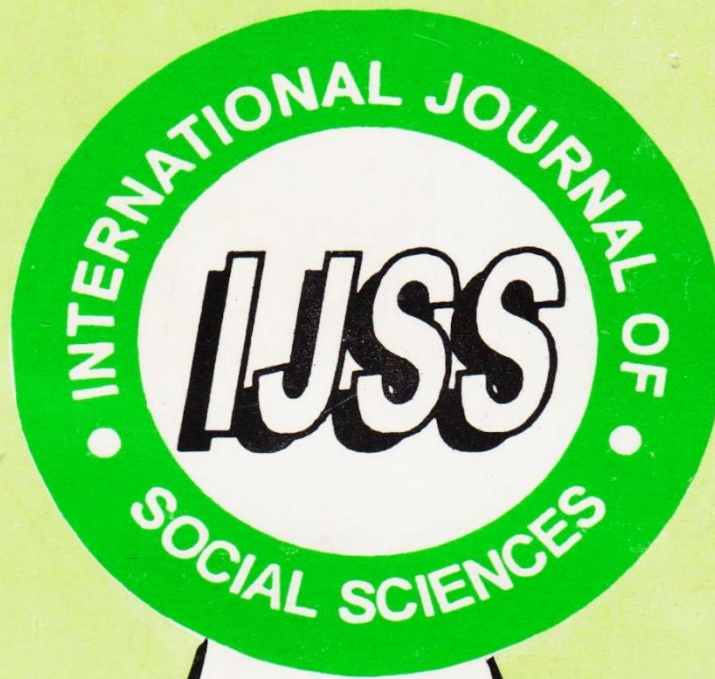


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# **Investment promotion for economic development in Nigeria**

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**ABSTRACT** - This paper analyze the response of investment to adjustment reform in Nigeria through an assessment of indicators of quality of macroeconomic management and their implications for the stimulation of investment in the country. The results of our analysis indicate that there has been some downward trends in the share of investment in the GDP since the introduction of adjustment programme on account of poor management of the reform policies ushering in wild swings in such indicators as fiscal deficits, unstable exchange and interest rates and domestic prices. Given the background of these problems, the paper recommends issues and measures for resurging investment that will foster rapid-economic growth in Nigeria in the approaching millennium.

## **1.0 INTRODUCTION**

Investment is the most and strategic factor in the process of economic development. It is characterized as the main key to economic development. Development economists in both developed and developing economies have identified a strong positive correlation between investment/savings and growth. Armed with projections of the required rates of income growth needed to over-come underdevelopment as well as an assumed incremental capital output ratio (ICOR), economists routinely calculate the required investment ratio needed to achieve the target growth.

The traditional growth model above assumes labour to be in unlimited supply and the only constraint on output growth is capital accumulation. A proportionate mapping of investment and growth is, therefore, presumed. This model of growth via investment has dominated academic and policy prescriptions for a number of years now. The domain of discussions has been on issues concerning the sources of investment finance, and the determinants of investment behaviour. The logic according to Soludu (1998) is simple: once you can explain or predict investment, you can speak authoritatively on growth (and by implication, development).



In Nigeria, the early and mid-1970s held much promise for prospects of investment-led growth and development, with resources made possible by the oil boom. Nigeria's investment rate got to its peak of about 25 per cent of GDP during this period. During the recession of the early 1980s, Nigeria has witnessed a poor investment record which has been identified as a major hinderance to development. In order to stimulate investment and raise it to the level it reached in the 70s, structural adjustment programme was introduced to usher in a liberalization - induced investment climate in the country.

The main objective of this paper is to analyze the response of investment to adjustment policies in Nigeria through an assessment of indicators of quality of macro-economic management and their implications for the promotion of investment in the country.

The rest of the paper is organised as follows:

Section II highlights the literature review with emphasis on (i) investment and economic development; and (ii) determinants of investment in Nigeria. Section III analyzes and assesses, with the aid of indicators of quality of macroeconomic management, the policy performance in the post-adjustment period. Section IV discusses the modalities for stimulating investment as well as recommendations. Finally, section V gives the summary and the conclusions.

## **2.0 THEORETICAL FRAMEWORK AND LITERATURE REVIEW**

### **Investment and Economic Growth**

In order to better appreciate the discussion in this paper, we present in this section, the theoretical link between investment and economic growth. Economic growth, according to Hardwick et al (1986:390) may be defined as an increase in a country's productive capacity, identifiable by sustained rise in real national income over a period of years.

Economic growth and economic development are obviously closely related; for the purposes of this paper, however, we draw an important distinction between them. A country is enjoying economic development when it is experiencing economic growth, as defined above, and at the same time is undergoing major structural changes in the economy like a shift from agriculture to manufacturing. With this distinction, economic growth is dealt with in the context of an industrialized economy such as the UK or USA, and economic development in the context of a less developed country, such as India or Nigeria.

Developing economies, particularly in Africa, face a shortage of investible funds, and there is a strong preference for foreign investment and/or national savings to fill the gap. Since this will take some time given the need to provide enabling environment and revamp the economy before substantial national savings could be realized, the typical developing country is expected to, at least in the short run, be a net foreign borrower (Ariyo, 1998).

The simple model adopted here which highlights the condition under which the various development financing sources can contribute positively to growth is based on a model proposed by Greene and Khan (1990) for developing countries. This model has also been used by Ariyo (1998). The model is constructed by the following equations:

$$Q = f(K) \quad (1)$$

Which states that domestic output ( $Q$ ) is a function of capital stock, where  $f(K)$ , the marginal product of capital, is positive. That is,  $dr/dk = f'(K) > 0$ . It is also assumed that capital stock can be disaggregated as to its domestic or foreign sources of funding, and that their respective marginal products can be accurately measured.

Real National Income ( $Y$ ) is defined as the difference between real output and interest payment on foreign debt, i.e

$$Y = Q - rD \quad (2)$$

Where  $r$  = foreign interest rate and  $D$  = stock of external debt. Combining equations (1) and (2), and differentiating with respect to time, we obtain:

$$Y = f'(K) - rD - r'D \quad (3)$$

Where a dot over a variable denotes a time derivative.

By disaggregating savings to comprise private savings ( $S_p$ ), government savings ( $S_g$ ), and foreign savings ( $S_f$ ), we have;

$$S = S_f + S_g + S_p \quad (4)$$

Private savings can also be specified as a function of disposable income:

$$S_p = S (1-t)y \quad (5)$$

Where  $S$  is the average propensity to save and  $t$  is the average tax rate on income. Government savings is the fiscal balance which in this model is defined as income tax revenues ( $Ty$ ) less government expenditures on goods and services ( $G$ ). That is:

$$S_g = Ty - G \quad (6)$$

Finally, foreign savings equals the current account balance (CAB) less foreign borrowing ( $D_f$ ):

$$S_f = CAB - D_f \quad (7)$$

At equilibrium, savings (S) will be equal to investment (K), and by substituting (5), (6) and (7) into identity (4) we obtain:

$$K = S = S(L-t) + ty - G + D \quad (8)$$

Converting equation (3) into growth rates and substituting for K from (8) yields:

$$y/y = f_k S(L-t) + t - G/y + (f_k - r) D/y - rD/y \quad (9)$$

Equation (9) suggests the following policy implications:

- (i) a country can increase its growth of real national income by foreign borrowing as long as the marginal product of (externally - financed) capital  $f'(K)$  exceeds the cost of foreign borrowing ( $r$ ); the optimal level of foreign borrowing would be attained at the point where  $r = (f'K)$ ;
- (ii) an increase in private saving through an increase in the average propensity to save would raise the growth rate;
- (iii) an increase in fiscal deficit brought about either by decline in tax revenue or an increase in government expenditure would have an adverse effect on growth, and
- (iv) a rise in the foreign interest rate would lower the growth rate (by the value of the debt - to-income ratio), as would a decline in external debt stock ( $D$ ).

All development economists have identified a strong, positive correlation between investment and economic development. According to them, investment is a major determinant of level, structure and rate of economic development. To show how investment matters in an economic growth process, the Harrod - Domar growth model assigns a key role to investment in the process of economic growth (Hardwick et al, 1986:392) and Jhingan, 1985:58) the model takes the view that economic growth is particularly the result of capital accumulation (investment), as it is generally accepted that more capital goods will be required if there is to be growth.

Other growth models with separate factors of production (Ramsey, 1928; Solow, 1956; Koopmans 1965; Cass, 1965; Soludo, 1998; and Barro and Sala-i-martin 1990, 1991), predict that output/income can only grow through increased factor accumulation and technical progress. More broadly, all growth models have come to accept that the rate of growth of an economy is determined by the accumulation of physical and human capital, the efficiency of resource use and the ability to acquire and apply modern technology. Positive factor accumulation (especially physical capital) can itself only take place through net investment (Soludo, 1998).

### 3.0 MACROECONOMIC MANAGEMENT AND INVESTMENT CLIMATE IN NIGERIA: SOME EMPIRICAL ANALYSIS

With respect to Nigeria, the major determinants of foreign direct investment have been identified to include: the size of domestic market; capacity utilization; fiscal deficits; inflation; exchange rate volatility; interest rates; macroeconomic policies and institutional factors. These factors which are involved have been analyzed in detail by Ariyo (1998) on which this section has drawn. Although this focus is on Nigeria, the substance of his analysis is applicable to all developing economies.

Ariyo pointed out that with all the factors involved, only the size of the domestic market appears to have been encouraging; others remain less promising. As regard the size of the domestic market, Nigeria has the largest domestic market in the whole of sub-Saharan Africa with a population of 88.5 million people, the domestic market remains large and attractive for domestic and foreign investment. This is attested to by the fact that the bulk of portfolio investment flow into Nigeria in 1996 alone through the Nigerian Stock Exchange amounted to over US \$33 million.

However, this potential is being submerged under the various disenabling factors. For example, Table 1 shows that the level of capacity utilization in the Nigerian manufacturing sector was 57.5 per cent in 1980 decreased to 36.4 in 1986 and thereafter declined to 29.3 per cent in 1995.

**Table 1: Some Relevant Macroeconomic Indices**

Year	Capacity Utilization	GROSS NATIONAL SAVINGS			
		AMOUNT			
		Deficits (₦ 'million)	% of GDP	Amount (₦ 'million)	Growth Rate (%)
1980	57.5	11557.0	23.3	5,769.9	38.6
1981	55.5	13969.2	27.7	6,562.6	13.7
1982	35.5	1862.2	3.6	7,514.4	14.5
1983	47.8	5290.9	9.3	9,443.9	25.6
1984	39.9	4690.4	7.4	10,988.1	16.3
1985	12.7	5105.4	7.2	12,521.8	13.9
1986	36.4	8804.3	12.2	13,934.1	11.2
1987	42.0	5889.7	5.5	18,676.3	34.0
1988	44.2	12,224.5	8.4	23,249.0	24.4
1989	42.4	15,134.7	6.7	23,801.3	2.3
1990	39.0	22,116.1	8.5	29,651.2	24.5
1991	32.4	35,755.2	11.0	37,692.6	27.1
1992	41.8	39,532.5	7.2	54,116.8	43.5
1993	37.2	107,186.0	15.3	85,107.9	57.1
1994	30.4	(70,270.6)	2.7	91,128.8	1.1
1995	29.37	(6,702.6)	0.5	17,297.8	11.2

**Note:** Figure in parentheses are surpluses

**Source:** Central Bank of Nigeria Statistical Bulletin, Vol.6, No.2, December, 1995.



Overall average capacity utilization for the period stood at 44.8 per cent in which Ariyo pointed out that this fact does not seem good for investment because projects are hardly considered feasible at least less than 50 per cent capacity utilization.

For each year from 1980 to 1995, the fiscal operations of the Federal Government resulted in deficits (Table 1). The deficits ranged from its lowest level of ₦8804.3 million in 1986 to a whopping ₦107,186.0 million in 1993. As a percentage of Gross Domestic product (GDP) it ranged from a low of 5.5% in 1987 to 15.3% in 1993. On average, deficits as a percentage of GDP stood at 8.0 per cent over the period 1980 - 1995, a picture which Ariyo has pointed out that the level of deficit in Nigeria has become unsustainable since the beginning of 1980. Judging from the theoretical proposition of an inverse relationship between fiscal deficits and private investment, Nigeria is an infertile ground for alternative financing. Theoretically, the linkage between fiscal deficits and private investment is anchored on the crowding out effect of deficits especially when financed through public sector borrowing, as has been in Nigeria over the years.

Table 2 shows the distribution of the banking system's credit to the economy between private and the public sectors. On average, the credit to the government sector constitutes 48.0% of the total banking system's credit between 1980 and 1992, and for many years it was applied for financing budget deficits. To a potential investor in Nigeria, the fear of unavailability

**Table 2: Banking system's credit to the Economy (₦'million)**

Year	Aggregate Credit (Net) (1)	Credit to Private Sector (2)	Credit to Government Sector (3)	3 as a % of (3)
1980	10,787.5	7190.3	3,596.5	33.3
1981	16,268.5	9654.4	6,613.4	40.7
1982	21,906.8	11,371.5	10,555.3	47.9
1983	28,182.4	12,353.9	15,828.2	56.2
1984	31,141.6	12,942.0	18,199.6	58.4
1985	32,680.3	13,700.2	18,980.1	58.1
1986	36,926.5	17,365.0	19,455.3	52.8
1987	46,926.5	25,476.1	21,450.1	45.7
1988	57,362.3	29,773.6	45,591.0	76.0
1989	49,259.1	30,942.8	18,316.3	37.2
1990	66,996.5	36,631.0	30,345.5	45.3
1991	83,823.7	45,325.2	38,498.5	45.9
1992	141,735.7	61,010.3	80,715.4	56.9
1993	274,134.3	95,285.0	184,848.7	67.4
1994	350,622.7	122,273.3	228,349.4	65.1
1995	375,991.4	151,065.4	224,677.8	59.8

Source: Central Bank of Nigeria Statistical Bulletin, Vol. 6, No.2, 1995.

of credits from the domestic financial markets (due to government borrowing requirement to finance fiscal deficits) appears real. This constitutes a serious disincentive to investment.

Current inflation rates in Nigeria could be described as high and volatile, as shown in Table 3 for the period 1980 to 1995. From 20.0% in 1991, it decreased to 7.7% in 1982. In 1983 it rose again to 23.2% and further to 37.6% in 1984. In 1994 and 1995, the inflation rates were 55.3% and 72.3%

**Table 3: Inflation, Exchange and Interest Rate in Nigeria**

Year	Inflation (1)	Exchange Rate (2)	Interest Rate		Index of Financial Repression	
			Lending	Deposit	Lending Rate	Deposit Rate
1980	9.9	0.5464	9.50	6.50	-0.4	-3.5
1981	20.9	0.6100	10.00	6.50	-10.9	-14.4
1982	7.7	0.6700	11.25	8.00	3.8	0.3
1983	23.2	0.7241	11.50	8.00	-11.7	-15.2
1984	37.6	0.7649	13.00	10.00	-26.6	-29.6
1985	5.5	0.8938	11.75	10.00	6.25	4.5
1986	5.4	2.0206	12.00	10.00	6.6	4.6
1987	10.2	4.0179	19.20	15.80	9.0	5.6
1988	38.3	4.5367	17.60	14.30	-20.7	-24.0
1989	40.9	7.3916	24.60	21.20	-16.3	-19.7
1990	7.5	8.0378	27.70	23.00	20.2	15.5
1991	13.0	9.9095	20.80	20.10	7.8	7.1
1992	44.5	17.2984	31.20	20.50	-13.3	-24.0
1993	54.2	22.0502	18.32	28.02	-36.0	-26.2
1994	55.3	21.8861	21.00	15.00	-34.3	-40.3
1995	72.3	21.8861	20.82	14.11	-18.3	-58.2

**Note:** Financial repression is defined as the difference between interest rates and inflation rates.

**Source:** Central Bank of Nigeria Statistical Bulletin, Vol 6, No.2, December, 1995.

72.3% respectively. The high rates of inflation had no doubt, been traceable to the fiscal deficits and the unstable exchange rates of the Naira. Also, the trend of movement in foreign exchange values of the Naira to the US dollar reported in Column 2 of Table 3 reveals a systematic depreciation in the value of the Naira over the years, notably between 1989 through 1995. More remarkable is the highly volatile behaviour of this trend which is largely attributable to policy instability and frequent changes in the manipulation of the so-called market - determined exchange rate since 1987, which led to the chaotic behaviour of exchange rate and negatively affected the efficiency of the exchange rate market.

Until 1987 the Nigerian financial system was highly repressed. Since then interest rates have been determined largely by the market system. However, in 1991 government imposed a maximum lending rate of 21% but



quickly reverted to market determined rates in 1992, and by 1994 the rates became officially fixed again. These inconsistencies in policy and management practices, particularly the pegging system, resulted in financial repression within the economy (see columns 5 and 6 of Table 3).

With regard to investment, the performance of aggregate savings constitutes the basic yardstick to appraise the macro-economic environment. Table 1 columns 4 and 5 contain the national savings and savings growth rates from 1980 to 1995. As evidenced from the table nominal aggregate national savings have been on the increase and its growth rates positive throughout the years under review, a trend which argues well for substantial investment in the economy. This evidence, however beclouds the relatively poor performance and impact of gross national savings in financing economic development.

Ariyo (1998) has identified some factors that have affected the transmission of savings to investment in the Nigerian economy. According to him, the factors include (i) inadequate information about investment opportunities; (ii) an unpredictable economic or industrial environment; (iii) non-availability of viable productive gestures; and (iv) a poor enabling environment and inadequacy of gross deficiency of required infrastructure. He therefore remarked that these factors reflect the deficiencies to the institutional arrangement for economic management in Nigeria.

During the 1980s, the investment share in the GDP declined, though it still remain high by historical standards. After 1983, however, the investment profile began to fall dramatically. Thus, with the collapse of the oil market in the 1980s, investment also fell, thereby leading to a decline in economic growth, with a view of arresting this decline, the government adopted the structural adjustment programme (SAP) in 1986 to achieve a greater capacity for development

Table 4 reveals the relative contribution of investment to total development financing, the share of investment in the GDP, besides the impact of investment activities on economic growth. Regarding the first focus, Table 4 (Columns (i) to (iv) indicate the declining role of investible funds (gross national savings) and foreign direct investment in Nigeria's development financing efforts. In fact, 'debt' has consistently replaced investible funds as the major source of development financing. This trend has accounted for the dismal performance of the economy and the derailment of adjustment programme.

Data relating to the composition and the ratio of investment to GDP are also revealing. Columns (v) to (vii) on Table 4 show the share of public and private investment to total investment. They also show the overall decline in

**Table 4: Development Financing in Nigeria Some Indicators**

Year	Share of Total Development Financing (%) Investment/GDP (%)						
	Total Debt (i)	External Debt (ii)	Direct Foreign Investment (iii)	Gross National Saving (iv)	Total (v)	Total (vi)	Private (vii)
1980	0.75	0.66	0.288	0.002	22.2	15.4	6.8
1981	0.78	0.70	0.239	0.001	23.3	16.8	6.5
1982	0.71	0.67	0.289	0.0005	20.0	13.0	6.1
1983	0.76	0.72	0.239	0.0003	14.7	10.5	4.2
1984	0.74	0.70	0.59	0.0003	9.5	7.2	2.3
1985	0.74	0.70	0.258	0.0002	8.9	6.9	2.0
1986	0.72	0.69	0.277	0.00003	14.9	11.6	3.3
1987	0.75	0.70	0.29	0.00005	13.7	9.8	3.9
1988	0.73	0.71	0.269	0.00003	13.5	9.4	4.1
1989	0.75	0.72	0.249	0.0001	14.1	9.7	4.4
1990	0.77	0.74	0.229	0.0001	14.5	8.4	6.1
1991	0.74	0.71	0.259	0.0001	16.3	10.3	6.1
1992	0.76	0.60	0.239	0.0001	16.4	11.8	4.0
1993	0.84	0.59	0.62	0.0795	13.6	13.3	0.3
1994	0.78	0.57	0.056	0.0717	na	na	na

Sources: Ariyo (1998)

investment as a ratio of GDP over time, as well as the crowding-out effect of public investment on private investment. According to Ariyo (1998), these are serious issues for policy concern, more so, when empirical evidence indicates that the fastest growing development economies are characterized not only by a rising investment ratio but also the dominance of private investment over public investment.

#### **4.0 PROMOTING INVESTMENT GROWTH IN NIGERIA**

In this section, we draw upon the existing literature and the empirical analysis reported in section 3 to identify the major issues involved in the effort to foster the promotion of investment that would enhance economic development in Nigeria. The major issues involved are:

- (i) the macroeconomic environment;
- (ii) appropriate macroeconomic policies;
- (iii) the debt overhang problem
- (iv) achieving a deregulated financial environment; and
- (v) promotion of foreign private investment.

In what follows, these key issues will be briefly discussed and suggestions made as to the optimal policy response - provided the objective is to ensure a significant recovery of investment and guarantee rapid and sustainable economic growth and development in the years ahead.

#### **4.1 A CONDUCTIVE MACROECONOMIC POLICY ENVIRONMENT**

An important lesson of the economic crisis of the 1980s in Nigeria is that a conducive economic setting for high investment and rapid economic growth in the long term requires, as a necessary precondition, a good macroeconomic environment for stimulating private investment should one characterized by stability and predictability. In addition, the macroeconomic environment should be one which:

- (i) promotes allocative efficiency;
- (ii) encourages and rewards individual initiative;
- (iii) creates a more level playing field for the private sector by dismantling monopolies and establishing more transparent regulatory systems;
- (iv) promotes a stronger and sounder banking system that protects the savings of small depositors and elicits increased savings;
- (v) encourages greater transparency and accountability in government and corporate affairs; and
- (vi) reduces uncertainty so as to accelerate the investment response to incentive packages.

#### **4.2 SOUND MACROECONOMIC POLICIES**

According to Iyoha (1998), to rekindle investment for economic development, there is the need for the government to formulate and implement sound macroeconomic policies that promote growth through low inflation, sound money, prudent fiscal policies and a sustainable current - account/balance-of-payments position. In Nigeria, the macroeconomic policies should be designed to reduce instability engendered by externally - generated shocks.

#### **4.3 THE DEBT OVERHANG**

Nigeria's high external debt stock and debt service burden are also viewed as inhibiting investment. A reduction of external debt flow will be critical. Consequently, the authorities need to articulate creative strategies for bringing about debt reduction so that the high debt stock and accompanying debt service burden do not continue to reduce investment and hamper economic growth.

#### **4.4 DEREGULATED FINANCIAL ENVIRONMENT**

Pill and Pradhan (1997), have established that if there is a financial liberalization, market determined interest rates would result in modestly positive interest rates. These, in turn, will increase the resources available to the financial system, since bank deposits offering a competitive return will attract savings that were previous held outside the formal financial sector.



Moreover, positive real interest rates will provide an incentive for borrowers to invest in more productive activities, thereby improving the productivity of the economy as a whole. Consequently, financial liberalization should lead to an increase in both quantity and the quality of financial intermediation by the banking system.

Financial deregulation can therefore stimulate economic growth and development through a variety of channels. Since the financial system performs the vital function of raising funds for, and channelling funds to, productive investment, successful financial liberalization is usually an important component of a country's strategy for economic growth.

#### **4.6 PROMOTION OF FOREIGN PRIVATE INVESTMENT**

Foreign private investment which includes foreign private direct investment and foreign private portfolio investment is an important component of aggregate investment, especially in developing countries. In Nigeria, for instance, where savings are low, speedy policy and structural reform should be undertaken to attract foreign private investment. Experience has shown that investors choose countries with stable political and economic environments. Open markets, minimal regulation, good infrastructure facilities, and low production costs are also key factors in attracting and holding foreign investment.

#### **5.0 SUMMARY AND CONCLUDING REMARKS**

Investment has been identified as the key factor or the Kinetic force in the process of economic development, the latter is usually preceded by capital formation and accumulation. In view of this fact, Nigeria will have to undertake speedy policies and structural reforms to rekindle investment that will enhance economic growth and development. In this paper, we have therefore, been keen to analyze the response of investment to reform policies in Nigeria through an assessment of indices of quality of macroeconomic management and their implications for the stimulation of investment in the country. Our supposition before the analysis was that investment has not resurged in spite of the adjustment reform programme to restore the enabling environment for this purpose.

Among the relevant factors identified to influence the flow of investment in the Nigerian economy are: Size of domestic market; capacity utilization; fiscal deficits, inflation, exchange rate volatility, interest rates, macroeconomic policies and institutional factors. Judging from the size of domestic market, the economy has potentials for massive domestic and foreign investment subject to their current challenges.

Our study has discovered the declining contribution of investment to development financing in Nigeria and the increasing dependence upon

debt's for development financing, a trend Ariyo (1998) suggests does not augur well for a developing nation like Nigeria.

As we have demonstrated in our analysis, there has been some downward trends in the share of investment in the market in the 1980s thereby leading to a decline in economic growth. With a view of arresting this decline, the Government adopted the Structural Adjustment Programme (SAP) in 1986, however, due to lack of unrestrained consumption in the face of dwindling resources and maladjustment to SAP initiatives and policy reversals, there were wild swings in such indicators as fiscal deficits, unstable exchange and interest rates, and domestic prices (inflation).

Given the background to these manifested problems, the last section of the paper attempted to identify the major issues involved in investment promotion, provided the recommended issues are addressed, we can reasonably expect a resurgence of private and aggregate investment and rapid - economic development in Nigeria in the approaching millennium. The key issues to be addressed in the Nigerian economy are:

- \* development a conducive macroeconomic policy environment;
- \* designing and implementing appropriate macroeconomic policies;
- \* articulating creative strategies for bringing about debt reduction;
- \* achieving a deregulated financial environment; and
- \* putting in place the financial infrastructure needed to attract foreign private investment.

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*Investment promotion for economic development*

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