International Journal of Academic Management Science Research (IJAMSR)
ISSN: 2000-001X
Vol. 3 Issue 3, March – 2019, Pages: 24-36

Foreign Portfolio Investment on Economic Growth of Nigeria: An Impact Analysis

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Abstract: *This study explored the impact of foreign portfolio investment on economic growth in Nigeria from 1986 to 2017. The motivation for this study is driven by the new attention being given to the drive for foreign capital especially in developing economies in an attempt to stimulate economic growth. The study employed Augmented Dickey-Fuller (ADF) test, The Johansen cointegration technique and the Error Correction Mechanism (ECM) in the analysis. The variables employed include: Net foreign portfolio investment, real Gross Domestic Product (GDP), inflation rate, market capitalization and trade openness. The result revealed that foreign portfolio investments have positive significant impact on economic growth in Nigeria. It is therefore, recommended that government should initiate policies that will promote the long-rum growth of the capital market and the economy at large, the government must create a conducive business environment by providing constant power supply, good roads, security of life and property and maintains policy consistency in order to boost local investment in the country, the capital market should be further deepened through the introduction derivatives.*

Keywords: Net foreign portfolio investment, real GDP, inflation rate, market capitalization, trade openness

1.0 INTRODUCTION

Foreign portfolio investment (FPI) is an aspect of international capital flows comprising of transfer of financial assets: such as cash, stock or bonds across international borders in want of profit. It occurs when investors purchase non-controlling interests in foreign companies or buy foreign corporate or government bonds, short-term securities or notes. Accordingly, just as trade flows result from individuals and countries seeking to maximize their wellbeing by exploiting their own comparative advantage, so too, are capital flows as individuals and countries seeking to make themselves better off, moving accumulated assets to wherever they are likely to be most productive (Schneider, 2003). FPI consist financial papers held by foreign investors, FPI does not give the investor the right with direct ownership of financial assets, or direct management the corporate (Onyeisi, et al., 2016).

The need for foreign capital to supplement domestic resources is being felt by the developing economies, in view of growing mismatch between their domestic capital stock and capital requirements. This is evidenced in the new attention being given to the drive for foreign capital especially in developing economies. Fosu and Magnus (2006) and Omisakin, et al., (2009) pointed out rightly that foreign capital inflow is an important vehicle for augmenting the supply of funds for domestic investment. Ngowi (2001) also argues that African countries and other developing countries need substantial inflow of foreign capital to fill the saving and foreign exchange gaps associated with a rapid rate of capital accumulation and growth needed to overcome the widespread poverty in these countries. Besides, developing countries are preferred to developed countries by foreign investors because of the higher rate of return on investment in these countries (Ghose, 2004; Knill, 2005, Vita and Kyaw, 2008). However, whether the foreign investors are willing to take advantage of this high rate of return in the face of high production cost and distorted investment incentives is another issue entirely.

It is evident from the foregoing that a vibrant socio-economic and stable political environment is fundamental in attracting foreign investment and making it beneficial in the host economy. It is on this background that Nigeria liberalized her economy and capital markets, as well as improved its capital market facilities and returned to stable democratic among other things. Portfolio investment is a recent phenomenon in Nigeria. Up to the mid 1980s, Nigeria did not record any figure on portfolio investment (inflow or outflow) in her balance of payments account. The nil return on the inflow column of the account is attributable to the absence of foreign private investors in Nigeria's economy. This is largely because of the non-internationalization of the country's money and capital markets as well as the non-disclosure of the information on the portfolio investments in foreign capital/money markets. Prior to 1995, ownership limits were imposed on foreign participation in the Nigerian economy. In the same vein, Nigerians could not freely invest in other countries.

Since the internationalization of the capital and money market and enthronement of democracy, cross-border listing and foreign portfolio investment in Nigeria have been encouraged and foreign interest in the country has been rekindled. Despite the pass global economic meltdown and the shunning of risky investments, foreign investors and portfolio managers seeking cheap equities and high-yielding bonds continued to be attracted to Nigerian capital market. Statistics from the Nigerian Stock Exchange showed that portfolio investment inflow by foreign investors during 2009 was in excess of ₦228.986 billion which is an increase, when compared with the ₦153.457 billion recorded in 2008. This increased further to ₦350 billion in 2010 (Ikazoboh, 2011) and furthermore to ₦511.74 billion in 2011 (Onyema, 2012). But the inflow fell sharply in 2015 and 2016 by about 31.9% and 45.5% to ₦470.83 billion and ₦256.52 billion respectively (NSE, 2016). In order to have a clearer picture of the pattern of foreign portfolio investment in Nigeria, it is imperative to conduct the impact of foreign portfolio investment on economic growth of Nigeria.

1.1 Statement of the Problem

Over the years, successive Nigerian governments have viewed foreign investment as a vehicle for political and economic domination of Nigeria and hence the thrust of government policy (indigenization policy) through the Nigeria Enterprise Promotion Degree (NEPD) was to regulate foreign investment, with a maximum of 40% foreign participation allowed. This resulted in a decline in both foreign private investment and foreign portfolio investment and therefore, slowed down growth in all sectors of the economy including the capital market and money market.

The importance of foreign capital flows as a vehicle for economic development has been recognized by different governments the world over. However, the poor and immature state of Nigerian capital and money markets coupled with government regulations may have been responsible for the poor inflow of foreign portfolio investment into Nigeria. Although efforts have been made in making these markets more effective, yet, they are not as sophisticated and vibrant as their counterpart in developed nations, thus cannot compete favourably for investment funds. The advents of technology and globalization have overcome boundary barriers to global investment and as such, the well developed capital and money markets in the world are attracting more foreign investments than the emerging markets. This has been one of the arguments against globalization.

Conducive business environment and strong legal system have been identified as a major attraction for foreign investment. Masoud and Abu Sabha (2014) revealed that financial market stability and condition influence investor's portfolio investment decisions and ultimately portfolio investment flows. Irrespective of how vibrant a capital market may be, an unconducive business environment and weak legal system would not attract foreign portfolio investment. Nigerian business environment has been marred by infrastructural decay such as inconsistent power supply, bad roads among others, insecurity as well as weak and slow judicial process. Equally, the Nigerian business environment is highly uncertain with inconsistencies in government policies and non-transparency of government operations. These unpalatable conditions may have discouraged foreign investors from investing in the capital and money markets. It is in the light of the aforementioned issues that this study would analyze the impact of foreign portfolio investment on economic growth of Nigeria.

1.2 Research Questions

The study would examine the following questions:

1. What is the trend of foreign portfolio investment in Nigeria?
2. How has foreign portfolio investment impacted on economic growth of Nigeria?

1.3 Objectives of the Study

The broad objective of this study is to analysis the impact of foreign portfolio investment on the economic growth of Nigeria. Specifically, this study intends to find out the flowing:

1. To examine the trend of foreign portfolio investment in Nigeria.
2. To investigate the impact of foreign portfolio investment on economic growth in Nigeria.

In an attempt to augment balance of payment problems and stimulate economic growth, most developing nations including Nigeria, now recognize that an inflow of foreign investment may offer some special advantages in the form of positive spillovers. However, since foreign portfolio investments are made with a view of making profits, which will eventually be repatriated to investors home country, the more dominant the foreign portfolio in the capital structure of quoted companies, the greater the tendency of financial distress or insolvency after repatriation. Thus, the strategies that should be adopted towards foreign portfolio investment in Nigeria should comprise a combination of incentives designed to promote foreign portfolio investment inflow as well as regulatory measures aimed at maximizing the country's net benefits from the investment inflows.

This study would contribute to existing literature by attempting to explore the impact of foreign portfolio investment in the economic growth of Nigeria. It would not only affirm its need but would also appreciate the need for protective measures to prevent possible corporate distress in the situation of foreign portfolio repatriation. In addition, specific economic and non-economic determinants of foreign portfolio investment that are peculiar to Nigeria would be identified so as to know how to adjust them appropriately to attract more foreign portfolio investment into the country.

2.0 LITERATURE REVIEW

2.1 Conceptual Issues

Foreign portfolio investment consists of the acquisition of assets by a foreign national or company in a domestic stock/market. In order words, it refers to the holding of transferable securities (issued or guaranteed by the government of the importing country), equity shares; debentures, bonds, promissory notes and money market instruments issued in a domestic market by the nationals of some other countries. The money market instruments include treasury bills, commercial papers, bankers' acceptances and negotiable certificates of deposits (Obadan, 2004).

IMF (1993) defines foreign portfolio investment as equity and debt issuances including country funds, depository receipts and direct purchases by foreign investors of less than 10% control. Makola (2003) defines foreign portfolio investment as the foreign direct investor's purchase of shares of an enterprise in a country other than its own. According to Holsapple, et al., (2006), foreign portfolio investment is associated with the passive ownership of financial securities, such as shares of a corporation or a limited partnership.

Onuorah and Akujuobi (2013) describe Foreign Portfolio Investment (FPI) as an aspect of international capital flows' comprising of transfer of financial assets: such as cash; stock or bonds across international borders in want of profit stating that it occurs when investors purchase non-controlling interests in foreign companies or buy foreign corporate or government bonds, short term securities or notes. According to Graham and Spaulding (2005), foreign portfolio investment can simply be referred to as indirect investment which in contrast to direct investment, which is the investment of a company from one country making a physical investment into building a factory in another country. In various press releases by the United Nations Conference on Trade and Development (UNCTAD), foreign portfolio investment was defined as an investment involving long-term relationship reflecting an investor's lasting interest in a foreign entity.

2.2 Theoretical Review

Investor's behaviour is featured by choice under risk and uncertainty. The capacity to understand and therefore model this has been enhanced immensely following the expected utility theory of Von Neuman Morgenstein of 1947. Given certain axioms, the theory postulated that choice under uncertainty will be made so as to maximize the investors expected utility. Thus we could say there are three theories, namely; Mean Variance Portfolio Theory (MVPT), Arbitrage Pricing Model (APT), Portfolio Allocation Model (PAM), neoclassical theory of foreign portfolio inflows and models in endogenous growth.

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1. **Mean-Variance Portfolio Theory (MVPT**): The Mean-Variance Portfolio Theory (MVPT) is developed by Markowitz (1952). It considers only the first two moments of expected utility theory (mean and variance). His theory implies that investors should optimize the first two moments of their expected utility. The relationship between an asset mean and variance is then used to construct an efficient set showing the best mean-variance combination positions by combining all assets in portfolio where an investor then chooses any point on the set depending on his choice, thereby rendering other points useless.

2. **International Arbitrage Portfolio Theory (I-APT)*:*** The International Arbitrage Portfolio Theory (I-APT) developed by Ross and Walsh (1983) is a multifactor model that considers additional determinants of expected returns. The international diverse consumption tastes and relative price uncertainty. Fernandez-Arias and Mortiel (1996) developed Return and Credit Worthiness Model and postulate that long run and short run changes in equilibrium capital flows are due to the initial shocks of liabilities, changes in pull factors such as domestic economic environment and push factor like external financial conditions. The money demand and productivity framework by UI-Haque, et al., (1997) essentially traces the causes of capital flows to changes in money demand function, productivity of domestic capital and external factors such as international interest rate. An upward shift of money demand function and increases in productivity of domestic capital will generate capital inflows, ceteris paribus, and vice versa. These factors usually results in sustained capital flows. Falling interest rate, all things being equal, will cause inflow of capital while rising rates will cause outflows.

3. **Portfolio Allocation Model (PAM)**: Feddeke and Liu (2002) developed Portfolio Allocation Model (PAM), which postulates that capital flows are driven by two classes of determinants which are rates of return and risk factors with positive responses to rates of return and negative to risk. PAM is a dynamic optimization model in which an individual seeks to maximize the present value of his utility derived from expected return on a portfolio of capital assets driven by three component of the equilibrium capital flows, namely; (a) initial divergence effect (b) impetus effect (c) time path effect. The initial divergence effect is the ratio of initial divergence between foreign and domestic (the starting level of capital stock) and inter-temporal equilibrium holdings of foreign and domestic assets respectively. The stronger the divergence is in foreign assets

holdings, the greater the capital inflows. The second effect depends crucially on the strength of the social rate of time discounting, marginal rate of return, and marginal cost of adjustment and appropriation risk factors which are due to harsh domestic macroeconomic and policy environment. This serves to enhance or dampen the divergence effect. The time path effect features the optimal mix of flows of funds to foreign and domestic assets as they approach their inter-temporal equilibrium values. It also reinforces either positively or negatively the first two effects.

4. **Neoclassical Theory of Foreign Portfolio Inflows**: Neoclassical theory of foreign portfolio inflows which predicts that capital should flow from capital-rich countries to capital-scarce countries, and the Lucas Paradox or why private capital doesn't seem to flow from rich to poor countries. It believes in basic economics argument that capital flows from low return avenues to high returns. However, what we find is opposite as capital flows from emerging markets (where returns are high) to developed markets (where returns are low).

5. **Models in Endogenous Growth**: In the mid-1980s, a group of growth theorists became increasingly dissatisfied with common accounts of exogenous factors determining long-run growth. They favored a model that replaced the exogenous growth variable (unexplained technical progress) with a model in which the key determinants of growth were explicit in the model. Paul Roemer (1986), Lucas (1988), and Rebel (1991) omitted technological change. Instead, growth in these models was due to indefinite investment in human capital which had spillover effect on economy and reduces the diminishing return to capital accumulation. The AK model, which is the simplest endogenous model, gives a constant-saving-rate of endogenous growth. It assumes a constant, exogenous saving rate and fixed level of the technology. It shows elimination of diminishing returns leading to endogenous growth. However, the endogenous growth theory is further supported with models in which agents optimally determined the consumption and saving, optimizing the resources allocation to research and development leading to technological progress. Grossman and Hellmann (1991), incorporated imperfect markets and R&D to the growth model.

2.3 Benefits of Foreign Portfolio Investment

Foreign portfolio investment increases the liquidity of domestic capital markets, and can help develop market efficiency as well. As markets become more liquid, deeper and broader, a wider range of investments can be financed and new enterprises have a greater chance of receiving start-up financing. Savers have more opportunity to invest with the assurance that they will be able to manage their portfolio, or sell their financial securities quickly if they need access to their savings. In this way, liquid markets can also make long-term investments more attractive.

Foreign portfolio investment can also bring discipline and know-how into the domestic capital markets. In a deeper, broader market, investors will have greater incentives to expend resources in researching new or emerging investment opportunities. As enterprises compete for financing, they will face demands for better information, both in terms of quantity and quality. This press for fuller disclosure will promote transparency, which can have positive spill-over into other economic sectors. Foreign portfolio investors, without the advantage of an insider's knowledge of the investment opportunities, are especially likely to demand a higher level of information disclosure and accounting standards, and bring with them experience utilizing these standards and a knowledge of how they function. Foreign portfolio investment can also help to promote development of equity markets and the shareholders' voice in corporate governance. As companies compete for finance, the market will reward better performance, better prospects for future performance, and better corporate governance.

As the market's liquidity and functionality improves, equity prices will increasingly reflect the underlying values of the firms, enhancing the more efficient allocation of capital flows. Well- functioning equity markets will also facilitate takeovers, a point where portfolio and direct investment overlap. Takeovers can turn a poorly functioning firm into an efficient and more profitable firm, strengthening the firm, the financial return to its investors, and the domestic economy. Foreign portfolio investors may also help the domestic capital markets by introducing more sophisticated instruments and technology for managing portfolios. For instance, they may bring with them a facility in using futures, options, swaps and other hedging instruments to manage portfolio risk. Increased demand for these instruments would be conducive to developing this function in domestic markets, improving risk management opportunities for both foreign and domestic investors.

In the various ways outlined above, foreign portfolio investment can help to strengthen domestic capital markets and improve their functioning. This will lead to a better allocation of capital and resources in the domestic economy, and thus a healthier economy. Open capital markets also contribute to worldwide economic development by improving the worldwide allocation of savings and resources. Open markets give foreign investors the opportunity to diversify their portfolios, improving risk

management and possibly fostering a higher level of savings and investment.

2.4 Policies for Foreign Portfolio Investment

For foreign portfolio investment, strong and well-regulated financial markets are necessary to deal with the inherent volatility. The financial system must have the capacity to assess and manage risks if it is to prudently and productively invest capital flows, foreign or domestic. Its central role of financial intermediation and credit allocation is a key element of economic growth and development. As has been shown above, foreign portfolio investment can be an important player in this function, and bring additional strengths and benefits, but those benefits will be most effective when working within a healthy financial system.

For a financial system to maintain its health, the institutions within it must be able to identify, monitor and manage business risks efficiently. The payments system, through financial institutions and clearing houses, must be efficient and reliable. The financial system must also have the ability to withstand economic shocks, such as a substantial shift in the exchange or interest rates, or a sudden capital withdrawal. It must, as well, be able to withstand systemic shocks, such as financial distress or bank failure. Systemic risk, from economic or systemic shocks, is a central, and perhaps unique, element of capital markets. It demands adequate capitalization and risk management capabilities.

Adequate and sound prudential supervision is necessary for a healthy financial system. Financial institutions face a myriad of risks: from credit risk to exchange rate risk, from liquidity risk to exposure concentration risk, from various risks stemming from the institution's internal operations to risks inherent in the payments system. Supervisors need to have a sound understanding of all these types of risk and how they can be managed. They also need to understand the environment in which the banks operate, and the various ways these risks can be transmitted. Adequate capital is a necessary element of prudential regulation, providing a safeguard against losses and a cushion in the face of institutional or systemic problems. Financial institutions should also limit their exposure to individual or associated counterparties, to related parties, to market risk, to short-term debt or mismatches in liquidity. The IMF and World Bank have developed effective banking supervision frameworks through financial sector surveillance and assessment, carried out, at least in part, through the Financial Sector Assessment Programme and through Reports on Observance of Standards and Codes.

Although supervisors need to be able to verify that a financial institution's exposure is balanced and capital is adequate, the extent of specificity in the regulations should be a function of the overall soundness and structure of the financial system. Regulation and regulators will be most effective when they create incentives for sound behavior and when their application and practices are able to evolve with the needs of the market. Supervisors need to be aware of the risks and costs of excessive prudential regulation. The costs will be seen in the time and resources required to comply with the regulations, which should be balanced against the need for regulation, but they will also be seen in the effect on innovation and evolution in the markets, which can bring benefits to both the financial markets and the broader domestic economy. Excessive regulation and supervision can put the onus for effective management of financial institutions on the supervisory authorities, rather than the directors and managers of the institutions. This will reduce the effectiveness of management and of market disciplines, potentially the most practical and efficient "regulators." The right balance is essential.

Market discipline can provide the greatest incentives for effective risk management. Therefore, it is important not to subvert it by excessive regulation, but there are other factors to watch to ensure that market discipline is effective. Market discipline depends on clear signals from the market. Government guarantees of financial institutions, or implicit government support, can keep the market from signaling a growing problem, as can government ownership. Financial safety nets and market failure response arrangements need to be able to effectively resolve market distress situations, without creating unnecessary moral hazard. If financial safety nets and market failure responses are not appropriately designed, they can take away, or at least reduce, the financial institution's incentive to manage its risks adequately, the first and best line of defense against risks. Competition in the financial sector will also strengthen market disciplines, and a financial sector open to foreign investment, which can bring with it new and different outlooks and approaches to these problems, will help attain the benefits of competition.

2.5 Empirical Review

Shedding more light on the empirical ambiguity on the impact of foreign direct investment on economic growth in Nigeria, Akinmulegun (2018) explored the effect of capital market development on foreign portfolio investment in Nigeria from 1985 to 2016. The study employed descriptive statistics, Augmented Dickey Fuller (ADF) unit root test, Granger causality and Vector Error Correction Mechanism (VECM) for the analysis. The Granger causality test revealed that there is no causality between capital market development and foreign portfolio investment in Nigeria. Result from the vector error correction model indicated that market capitalization has negative significant effect on foreign portfolio investment in Nigeria while All Share Index has positive relationship with foreign portfolio investment. Therefore, the study concluded that capital market development has significant effect on foreign portfolio investment in Nigeria.

Using Augmented Dickey Fuller, Phillip Peron tests, Cointegration test, Vector Auto-Regressive technique, Variance Decomposition and Impulse Response analysis, Ibrahim and Akinbobola (2017) investigated the relationship between foreign portfolio investment, democracy and economic growth in Nigeria from 1986 to 2013. The results revealed that foreign portfolio investment inflow was more stable in democratic periods between 1999 and 2013 than the military periods between 1986 and 1998 and that the correlation between economic growth and foreign portfolio investment is positive and very significant. Furthermore, the result revealed that in the longrun foreign portfolio investment had positive and significant effect on the economic growth in Nigeria. It also showed that democracy had a positive and significant effect on economic growth, while it has positive but not significant effect on the relationship between foreign portfolio investment and economic growth. Similarly, Shanab (2017) examined the effect of Foreign Portfolio Investment (FPI) on capital market indices for the period 2005-2016. The study employed Ordinary Least Square (OLS) for the analysis. The study revealed that there is a statistically significant effect on both the purchases and sales by foreign investors on market capitalization. The study also found no statistically significant effect between inflation and market capitalization.

Using series quarterly data from 2007Q1 to 2015Q4, Haider, et al., (2017) investigated the impact of stock market performance and inflation on foreign portfolio investment (FPI) in China. The study employed descriptive statistics for the analysis. The results showed that there was significant positive impact of stock market performance on the FPI, whereas inflation is found to be negatively associated with the FPI. Also, Oladejo (2016) investigated the impact of foreign portfolio investment on Nigerian economic growth for the period of 1991 to 2014. The ordinary least square estimation method was employed for the data analysis. The findings revealed, among others, that there were increase in the foreign portfolio investment for a given period, followed by decline, as a result of massive capital outflow and divestment by the investors, caused by the global recession.

Okafor, Ugwuegbe and Ezeaku (2016) investigated the relationship between foreign capital inflows and economic growth in Nigeria for the period of 1981 to 2014. The Augmented Dickey-Fuller test, Cointegration test and Toda Yamamoto test of causality was employed for the analysis. The result revealed that there is bi-directional causality running from GDP to foreign direct investment as well as from foreign direct investment to GDP. It also indicates that there is a unidirectional causality between foreign private investment and GDP with causation running from foreign private investment to GDP. Furthermore, the result showed a unidirectional causality between GDP and foreign aid with causation running from foreign aid to GDP. Finally the joint causation between all the components of foreign capital inflow, that is, foreign direct investment, foreign private investment, foreign aid and GDP indicates that increase in foreign capital inflow causes GDP to increase positively. Similarly, using Augmented Dickey-Fuller (ADF) unit-root test, Johansen Co-Integration Test and *Error Correction Model (ECM)*, Ezeanyeji and Ifebi (2016) investigate the impact of foreign direct investment on sectoral performance in the Nigerian economy with special reference to the Telecommunications Sector from 1986 to 2014. The results showed that foreign direct investment has contributed significantly to the performance of the telecommunications sector in terms of its contribution to the Gross Domestic Product of Nigeria.

Ogujiuba and Obiechina (2012) examine the relationship existing among foreign private capital components and foreign portfolio investment, economic growth and some macroeconomic indicators; interest rate and inflation rate as well as policy implications, there from, using time series data from 1986-2008. A non restrictive vector Autoregressive (VAR) model was developed while restriction is imposed to identify the orthogonal (structural) components of the error terms – structural vector Autoregressive (SVAR). The study indicates that the response of the GDP to shocks from the foreign portfolio investment is not contemporaneous and this is applicable to other variables. It is somewhat sluggish but returns faster to equilibrium compared to the response from the Net Portfolio Investment. Restructuring the recursive Cholesky structural decomposition of the impulse response function, both in the short-run and long-run, the result indicates that the Net Portfolio Investment impact on the GDP at the short-run, while the Net Direct Investment does not. Also, the interest was shown to impact on the Net Portfolio Investment in the short-run.

Also, Chukwuemeka, et al., (2012) worked on the long-run influencing factors of foreign portfolio investment in Nigeria. They discovered the appropriate policies to attract foreign portfolio investment in the long-run. They used the quarterly time series data over the period of 1981-2010. Market capitalization, real exchange rate, real interest rate, real gross domestic product, and trade openness were considered variables. Net portfolio investment was considered as dependent variable. They applied finite distributed lag model of time series analysis. The study revealed that foreign portfolio investment flow into Nigeria had a positive long-run relationship with market capitalization and degree of openness. They suggested that it was good to make Nigeria's trade policy as investment welcoming policy for attracting portfolio investment flows.

Finally, Tokunbo, et al., (2010) stressed that despite the increased flow of foreign portfolio investment to developing countries in especially sub Sahara African countries including Nigeria, low level of per capita income, high

unemployment rate, low and falling GDP are still prevalent. In recent times Nigeria government has initiated policies to attract foreign portfolio investment but this has not impacted positively on the growth rate of GDP. The study therefore analyzed the direction and significance of the effect of foreign portfolio investment in the economic growth in Nigeria covering the period 1990-2005. The study revealed that foreign portfolio investment, domestic investment growth and Net Export growth impacted positively and significance on economic growth in Nigeria.

3.0 METHODOLOGY

3.1 Model Specification

Based on the portfolio theory of international capital flows which attempts to explain the relationship between foreign portfolio investment and capital market growth, the study adopts the model of Oladejo (2016) with some modifications; the variables are measured as follows – real gross domestic product, net foreign portfolio investment, inflation rate, market capitalization and trade openness. The functional notations of the model are as indicated below:

RGDP = f(FPI, INFR, MCAP, TDO)……..……1
Where;
RGDP = Log of real gross domestic product
FPI = Log of net foreign portfolio investment.
INFR = Inflation rate
MCAP = Log of market capitalization
TDO = Trade openness

The linear regression equation derived from the functional relationship above is:
$RGDP = \beta_0 + \beta_1 FPI + \beta_2 INFR + \beta_3 MCAP + \beta_4 TDO + \mu$……2
The logarithmic conversion of the equation above yields the structural form of production function as:
$LRGDP = \beta_0 + \beta_1 LFPI + \beta 2 INFR + \beta_3 LMCAP + \beta_4 TDO + \mu$…….3

Where; β_0 is the intercept of the function, β_1 - β_4 is the estimation parameters, L is the natural logarithm and μ is the Stochastic variable. It is expected that $\beta_1>0$, $\beta_2>0$, $\beta_3>0$, $\beta_4>0$. However, if the estimates of the parameters turn up with signs or size not conforming to economic theory, they would be rejected, unless there is a good reason to believe that in the particular instance, the principles of economic theory do not hold.

3.2 Method of Data Analysis

The empirical estimation is in three phases. In the first segment - pre estimation, the unit root test using Augmented Dickey Fuller (ADF) is conducted in order to understand the nature of the series. In the estimation phase, since the stationarity result reveals all the cointegration are of the first order difference I(I), the second phase is the Johansen cointegration test is employed in order examine the long run relationship in the model.

Furthermore, in order to know the existence of possible short-term relationship and the rate of short run adjustment, the Error Correction Model (ECM) technique is deployed. This is because the error correction models directly estimate the speed at which a dependent variable reverts to equilibrium after a shift in other variables.

3.3 Sources of Data

The method of data collection adopted in this study is the secondary method of data collection. This method entails obtaining the required data from the records of institutions that collect and publicize data or statistics as part of their routine duties. Central Bank of Nigeria (CBN) is the most important routine compiler and supplier of statistical data in Nigeria.

Following the method of data collection adopted, the data thus obtained are secondary data sourced from the Central Bank of Nigeria (CBN), Annual Statistical Bulletin and CBN Annual Report (2017). The relevant variables sourced include: real gross domestic product (RGDP), net foreign portfolio investment (FPI), inflation rate (INFR), market capitalization (MCAP) and trade openness (TDO) for the period 1986 to 2017.

4.0 PRESENTATION AND ANALYSIS OF RESULTS

This section discusses the result of the empirical findings. This is done in line with the objectives. It is also explains the various techniques and methods used in analyzing the data collected for this study. It specifies the research design, sources of data, model specification etc. This chapter provides the background against which the study is being carried out and also states the extent to which the findings can be generalized.

4.1 Unit Roots Test Result

The knowledge of the time series properties of the variables of interest is important in order to obviate the possibilities of spurious regression. This was implemented using the conventional – Augmented Dickey-Fuller (ADF) unit root test. For convenience, table 4.1 below shows the summary of the computed Augmented Dickey Fuller unit root test for each of the variables.

Table 4.1: Augmented Dickey-Fuller (ADF) Test for model.

Variables	ADF-Statistic	Critical Value			Order of Integration
		1%	5%	10%	
LRGDP	-5.134802	-3.670170	-2.963972	-2.621007	1(1)
LFPI	-6.317242	-3.679322	-2.967767	-2.622989	1(1)

INFR	-4.868997	-3.670170	-2.963972	-2.621007	1(1)
LMCAP	-6.140035	-3.670170	-2.963972	-2.621007	1(1)
TDO	-5.298318	-3.670170	-2.963972	-2.621007	1(1)

Source: Author's Compilation Using E-views 9 Output

The unit root test results showed that all the variables (real gross domestic product, net foreign portfolio investment, inflation rate, market capitalization and trade openness) were not stationary at levels but were significant at first difference. Hence, by taking their first difference they became stationary. The next step after finding out the order of integration is to establish whether the non-stationary variables could be co-integrated. The co-integration of two time series suggests that there is a long-run or equilibrium relationship between them.

4.2 Johansen Co-Integration Test

A necessary but not sufficient condition for co-integrating test is that each of the variables be integrated of the same order. The Johansen co-integration test uses two statistics tests namely; the trace test and the likelihood eigenvalue test. The first row in each of the table test the hypotheses of no co-integrating relation, the second row test the hypothesis of one co-integrating relation and so on, against the alternative of full rank of co-integration. The results are presented in table 4.2 below.

Table 4.2: Co-integration Test Result

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	Critical Value 0.05	Prob.**
None*	0.828239	169.8080	69.81889	0.0000
At most 1*	0.770423	120.4818	47.85613	0.0000
At most 2*	0.718068	79.27936	29.79707	0.0000
At most 3*	0.557249	43.82881	15.49471	0.0000
At most 4*	0.527901	21.01587	3.841466	0.0000
Trace test indicates 5 co-integrating eqn(s) at the 0.05 level *denotes rejection of the hypothesis at the 0.05 level **Mackinnon-Haug-Michelis (1999) p-values				
Unrestricted Cointegration Rank Test (Maximum Eigenvalue)				
Hypothesized No. of CE(s)	Eigenvalue	Max-Eight Statistic	0.05 Critical Value	Prob.**
None*	0.828239	49.32619	33.87687	0.0004
At most 1*	0.770423	41.20244	27.58434	0.0005
At most 2*	0.718068	35.45055	21.13162	0.0003
At most 3*	0.557249	22.81295	14.26460	0.0018
At most 4*	0.527901	21.01587	3.841466	0.0000
Max-eigenvalue test indicates 5 cointegrating eqn(s) at the 0.05 level * denotes rejection of the hypothesis at the 0.05 level **MacKinnon-Haug-Michelis (1999) p-values				

Source: Author's Compilation Using E-views 9 Output

From table 4.2 above, both the Trace statistic and Max-Eigen statistic reported that there was presence of five (5) co-integration equation among the variables. This means that a long run interaction existed among these relevant variables. Both the Trace statistic and Max-Eigen statistic were greater than their respective critical values and significant at 5 percent level. As such, it was concluded that a long run equilibrium relationship rightly existed among these variables of interest used in the study.

4.3 Discussion of Results based on Research

Research Question 1: What is the trend and composition of foreign portfolio investment in Nigeria? Table 4.1 and chart 4.1 below show the trend of the net Foreign Portfolio Investment of Nigeria between 1986 and 2017.

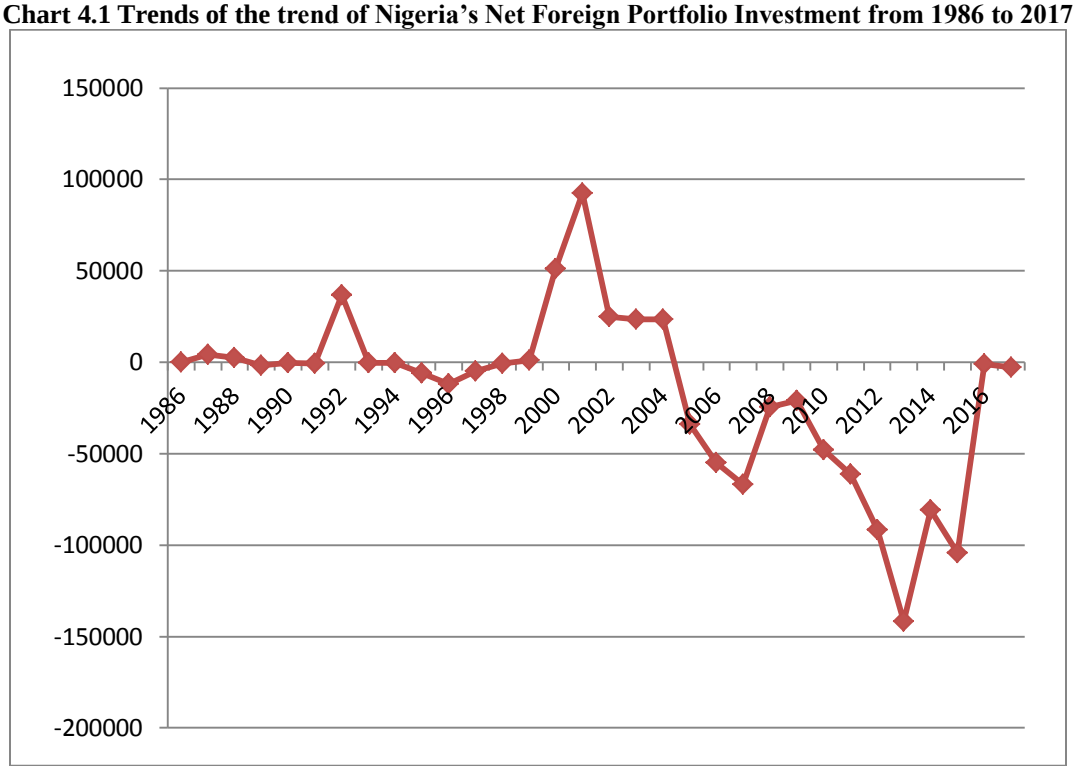
Table 4.1: Trend of Nigeria's Net Foreign Portfolio Investment from 1986 to 2017

Year	Net Foreign Portfolio Investment (N'm)
1986	151.6000
1987	4353.100
1988	2611.800
1989	-1618.800
1990	-435.2000
1991	-594.9000
1992	36851.80
1993	-377.0000
1994	-203.5000
1995	-5785.000
1996	-12055.20
1997	-4785.800
1998	-637.5000
1999	1015.700
2000	51079.10
2001	92518.90
2002	24789.20
2003	23555.50
2004	23541.00
2005	-33903.78
2006	-54956.90
2007	-66881.34
2008	-24398.43
2009	-20872.58
2010	-48097.19

2011	-61364.83
2012	-91534.25
2013	-141805.94
2014	-80691.49
2015	-104467.08
2016	-1151.38
2017	-2919.41

Source: Central Bank of Nigeria Statistical Bulletin, 2017

Chart 4.1 Trends of the trend of Nigeria's Net Foreign Portfolio Investment from 1986 to 2017



Source: Central Bank of Nigeria Statistical Bulletin, 2017

It is evident from the chart above that there has been inconsistency in the trend of Nigeria's Foreign Portfolio Investment flow since 1986. The Net Foreign Portfolio Investment was relatively low before year 2000 with a sharp increase in 1992. Negative Net Foreign Portfolio Investment was recorded between 1989 and 1991 and between 1993 and 1998. It is apparent that the implementation of SAP did not boost Foreign Portfolio Investment in the country. Even the internationalization of the country's money and capital markets in 1995 did not yield any immediate positive impact. The reason for these is not far-fetch; the country was under military rule and there was political uncertainty in the country during these periods. No sensible investor would want to invest heavily in such a politically tensed country.

However, Foreign Portfolio Investment into the country skyrocketed with the country's return to democratic governance in 1999. It is necessary to point out that the net Foreign Portfolio Investment of the country has been positive since the enthronement of democratic rule. Although, drastic fall in the Foreign Portfolio Investment was recorded in 2002 and 2008, the flow of Foreign Portfolio Investment has been on the increase since 1999. However, the net Foreign Portfolio Investment in the country has been on a sharp downward trend from 2009 to 2015 due to effects of the Global Economic Meltdown which has spur international investors to seek for less risky investments in other countries. The dwindling net Foreign Portfolio Investment in Nigeria can also be attributed to tapering in the United States (the reduction of the Federal Reserve's quantitative easing, or bond buying programme, which ended in October, 2014). The commencement of tapering led to higher yield in the US, a situation which attracted portfolio investors back to the US.

It is therefore evident that political stability and democratic governance are important determinants of flow of Foreign Portfolio Investment into a country. Political unrest in the country does not only scare away foreign investment, it also causes capital flight. This was why negative net Foreign Portfolio Investment was recorded during the political tensed periods, and of course not forgetting other Pull factors.

Research Question 2: How has foreign portfolio investment impacted on economic growth of Nigeria? The impact of foreign portfolio investment on the economic growth of Nigeria was examined using Error Correction Model (ECM) result below.

Table 4.3: Result of Error Correction Model (ECM) for model

Dependent Variable: D(LRGDP) Method: Least Squares Date:02/28/19 Time: 11:03 Sample (adjusted): 1988 2017 Included observations: 30 after adjustments				
Variable	Coefficient	Std. Error	t-statistic	Prob.
C	0.135295	0.038517		0.0021
D(LFPI)	0.035704	0.016792	3.512636	0.0455
D(INFR)	0.003745	0.001876		0.0591
D(LMCAP)	0.244706	0.096569	2.126327	0.0195
D(TDO)	-0.004062	0.003633		0.2761
D(ECM(-1))	-0.038578	0.135042	1.995790	0.7779
			2.533997	
			-	
			1.118194	
			-	
			0.285674	
R-Squared: 0.548242; F-statistic: 5.097016; Prob(F-statistic): 0.003250; Adjusted R-squared: 0.440681; Durbin-Watson Stat: 1.840940				

Source: Author's computation with the use of E-view 9.

4.4 Interpretation of Result

From table 4.3, the coefficient of foreign portfolio investment (LFPI) is found to be statistically insignificant at 1 percent level as indicated by its probability value 0.0455 and rightly signed (positive). This therefore, implies that 1 percent increase in foreign portfolio investment raises the real gross domestic product by 4.55 percent. Furthermore, the coefficient of inflation rate is found to be statistically insignificant at 1 percent level as indicated by its probability value 0.0591 and rightly signed (positive). This therefore, implies that 1 percent increase in inflation rate raises real gross domestic product by 0.37 percent.

The coefficient of market capitalization (LMCAP) is found to be statistically insignificant at 1 percent level as indicated by its probability value of 0.0195 and rightly signed (positive). This therefore, implies that 1 percent increase in market capitalization raises the real gross domestic product by 24.5 percent. Again, the coefficient of trade openness is found to be statistically significant at 1 percent level as indicated by its probability value 0.2761and rightly signed (negative). This therefore, implies that 1 percent decrease in trade openness reduces the real gross domestic product by 0.4 percent.

Table 4.3 reports the long run error correction model results. The error term tells us the speed with which our model returns to equilibrium following an exogenous shock. A negative sign shows a move back towards equilibrium whereas a positive sign indicates a movement away from equilibrium. The coefficient should lie between 0 and 1. 0 suggests no adjustment whereas 1 indicates full adjustment. The error correction term shows the speed of adjustment to restore equilibrium in the dynamic model. In particular, the ECM coefficients show how quickly or slowly the variables converge to equilibrium. As observed by Gujarati, (2004) a highly significant error correction term is a strong confirmation of the existence of a stable long run relationship. The result of the error correction model indicates that the error correction term ECM (-1) is well specified and the diagnostic statistics are good. The ECM (-1) variable has the correct sign and is statistically insignificant. The speed of adjustment of -0.038578 shows a low level of convergence. In particular, about 3.86 percent of disequilibrium or deviation from long run of GDP in the previous period is corrected in the current year.

The statistical significance of the parameter estimate can be verified by standard error test; the adjusted R squared and Durbin Watson statistics. For the model, when compared half of each coefficient with its standard error, it was found that the standard errors are less than half of the values of the coefficients of the variables. This shows that the estimated values are all statistically significant. The F-statistics 5.097016, which is a measure of the joint significance of the explanatory variables, is found to be statistically significant at 1 percent level as indicated by the corresponding probability value 0.003250. This indicates that the models are of good fit and significant. The result obtained from the model indicates that the overall coefficient of determination (R^2) shows that 54.8 percent of changes in real GDP are explained by the variables in the equation. As the adjusted (R^2) tends to purge the influence of the number of included explanatory variables, the adjusted R^2 of 0.440681 shows that having removed the influence of the explanatory variables, the dependent variable is still explained by the equation with 44.1 percent. When governance variables are considered, the adjusted R^2 indicates that a reasonable amount of variation in real GDP is being explained by the model. The value of Durbin Watson is 1.8 in the model. By implication, there is evidence of positive serial correlation among the explanatory variables in the models.

4.5 Policy Implications

From the above analyses, the empirical analysis in this study showed that foreign portfolio investment impact significantly on the economic growth in Nigeria, This could be attributed to the fact the impact of foreign portfolio investment has largely been confined within the secondary market without any spill-over effect on the economy. Besides, most of

Foreign Portfolio Investors engage in speculative trading for short-term gains and so, this does not allow for a one-to-one relationship with real investment. Although, it may be counterproductive to formulate a policy that will discourage speculative trading, the government should initiate policies that will promote the long-rum growth of the capital market and the economy at large. This will go a long way in attracting long-term fund that will be available for productive purposes.

However, it was revealed in the analysis that political stability is more important that favourable policies in attracting foreign portfolio investment into Nigeria. Neither the implementation of SAP nor the internationalization of the country's money and capital markets had any immediate positive impact on foreign portfolio investment into Nigeria due to the political uncertainty in the country during these periods. The political unrest in the country did not only scare away foreign investment, it also caused capital flight.

Lastly, the empirical analysis showed that the level of capital formation and mobilisation in Nigeria is low and its labour force is not qualitative enough to stimulate economic growth and industrial production. It is therefore imperative for the government to set machinery in motion to increase local investment and improve the quality of the labour force through improved educational system, and qualitative and continuous manpower training.

5.0 SUMMARY, RECOMMENDATIONS AND CONCLUSION

5.1 Summary of Findings

The study was designed to evaluate the impact of foreign portfolio investment on the economic growth in Nigeria from 1986 to 2017. It was argued that foreign capital is needed to supplement domestic resources of developing economies, in view of growing the mismatch between their domestic capital stock and capital requirements. Although many authors have argued that foreign investment is beneficial to the host country, several others cautioned that it could also be detrimental to the growth of the host economy.

The motivation for this study is driven by the new attention being given to the drive for foreign capital especially in developing economies in an attempt to augment balance of payment problems and stimulate economic growth. The study employed Augmented Dickey Fuller (ADF) unit roots test, Johansen Co-Integration test and Error Correction Model (ECM) for the analysis. The major findings of the study are highlighted below:

i. The empirical analyses showed that although foreign portfolio investment impacted significantly on the economic growth in Nigeria.
ii. It was revealed in the analysis that political stability is more important that favourable policies in attracting Foreign Portfolio Investment into Nigeria. Neither the implementation of SAP nor the internationalization of the country's money and capital markets had any immediate positive impact on Foreign Portfolio Investment into Nigeria due to the political uncertainty in the country during these periods. The political unrest in the country did not only scare away foreign investment, it also caused capital flight.
iii. Lastly, the empirical analysis showed that the level of capital formation and mobilisation in Nigeria is low and its labour force is not qualitative enough to stimulate economic growth and industrial production.

5.2 Recommendations

Based on the findings of this study, the following recommendations are thereby suggested in order for Nigeria to attract more foreign portfolio investment and harness its benefits better.

1. Since foreign portfolio investments have a feedback effect on the economic growth in Nigeria, the government should initiate policies that will promote the long-rum growth of the capital market and the economy at large. This will go a long way in attracting long-term fund that will be available for productive purposes. Again, efforts should be made to reduce inflation to a single digit as shown from the study the relationship between inflation and economic growth is positive.
2. The government must create a conducive business environment by providing constant power supply, good roads, security of life and property and maintains policy consistency in order to boost local investment in the country. It should also set machinery in motion to improve the quality of the labour force through improved educational system, and qualitative and continuous manpower training.
3. The capital market should be further deepened through the introduction of derivatives as stock index future, interest and currency future as well as options on individual stock. Furthermore, the regulators of the capital market must continue to strengthen the transparency of the market through effective oversight, professionalism and improved operational facilities so as to boost the confidence of both local and foreign investors in the market.
4. A stable political environment is fundamental in attracting foreign investment to an economy. Therefore, the government should focus on maintaining political stability before formulating favourable policies that will attract long-term funds into the country.

5.3 Conclusion

In this study, attempt was made to ascertain the impact of foreign portfolio investment on the economic growth of

Nigeria. In essence, the study sought to answer the questions: (1) What is the trend of foreign portfolio investment in Nigeria? (2) How has foreign portfolio investment impacted on economic growth and development of Nigeria?

The empirical results confirmed a feedback impact between Foreign Portfolio Investment and economic growth in terms of real Gross Domestic Product in support of the widely acclaimed postulation that foreign investments fuel local productivity. Furthermore, the study also specified and estimated a dynamic structural model for foreign portfolio investment in Nigeria. It was shown that there is a long-run equilibrium relationship between the Gross Domestic Product (GDP) and the factors affecting it which were considered in this study (i.e. Foreign Portfolio Investment, real gross domestic product, inflation rate, market capitalization and trade Degree of Openness). Furthermore, the enthronement of democracy and political stability in Nigeria has not only changed the global perception but has indeed unfolded a new climate of hope for economic development. Already, foreign interest in the country has been rekindled. The privatization exercise should provide an added avenue for foreign participation in the Nigerian economy. The capital market should be further deepened by the exercise as some divestments would be effected through it. Consequently, more portfolio investment opportunities would be available to both foreign and domestic investors.

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