

# Foreign Direct Investment and Employment Generation in Nigeria

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**Abstract:** FDI as a growth stimulating factor is seen as the largest source of external financing to developing countries and helps to ease capital constraints and contributes to output and employment generation. This paper examined the impact of foreign direct investment on employment generation in Nigeria within the period 1991 to 2021. The variables used in the study include employment rate, foreign direct investment, trade openness and real exchange rate. The paper used the autoregressive distributed lag (ARDL) model for its regression analysis. The data for the analysis was sourced from CBN statistical bulletin and world bank development indicator. The study finds that foreign direct investment and Trade openness have a positive impact on employment generation in Nigeria. Real exchange rate has a negative impact on employment generation in Nigeria. The paper finds that a short run relationship exists between foreign direct investment, real exchange rate, trade openness and employment generation in Nigeria. Based on the findings, the paper recommends that Government should make effort to attract more Foreign Direct Investment into the country to create more employment opportunities through Multi-National Corporations. The Government should encourage trade openness in order to enhance more Foreign Direct Investment in the country as it will increase the standard of living of the citizens by the provision of highly paid employment.

**Keywords:** ARDL, Employment generation, FDI, Trade openness, Nigeria.

**Jel Classification:** C19, E24, F2

## I. INTRODUCTION

Every economic system seeks to achieve full employment which is seen as the main macroeconomic focus of the government in order to attain economic growth and development. The goal of increasing the level of employment among other macroeconomic objectives is important in many developing nations where unemployment and underutilization of resources has led to rising rate of poverty. Therefore, to increase employment in developing nations, some intellectuals believe that trade flows and FDI inflows could drive employment generation in these countries (Kareem, 2010). However, job creation is a crucial problem in Nigeria as the World Bank Group (2013) stated that employment has been insufficient in Nigeria to accommodate the increasing labour force. According to National Bureau of Statistics (2021), the rate of unemployment rose from 9.9% in 2015 to 33% in 2021. The NBS report states that unemployment for people aged 15 to 24 years stood at 53.4% and 37.2% for people aged 25 to 34 years. High unemployment has devastating consequences for individual, society and the economy. It reinforces poverty,

increase in crime, terrorism and decreases aggregate demand and investment as well as brain drain and output loss.

Foreign Direct Investment is an investment into production of goods and services by a citizen of another country, either by buying a company or expanding operations of an existing business in another country (Babasanya, 2018). Foreign Direct Investment represents a veritable source of foreign exchange and technological transfer, especially to a developing economy like Nigeria (Akubueze, 2020). FDI is seen as the biggest means of external finance to developing countries, compared to remittances, private debt and portfolio equity, or official development assistance (UNCTAD, 2019). Higher FDI inflows can ease capital constraints and contribute to output and employment growth as well as a major driver of economic growth and development. Foreign direct investment plays an important role in employment generation. It provides firms with new marketing channels, cheaper production facilities, access to new technology, products skills and financing. For a host country which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development.

Considering the fact that unemployment in Nigeria has assumed an upward trend, the country has more cause to attract foreign direct investment due to its capital base and labour composition so as to accelerate productivity of labour and also give room for a large number of labour forces to be employed (Egbo, 2012 cited in Bisiriyu & Osinusi, 2020). Similarly, Ozughalu and Ogwumike (2013 cited in Bisiriyu & Osinusi, 2020) in their study revealed that all other things being equal, foreign direct investment should reduce unemployment as it increases real gross domestic product. Empirical research has been carried out on the impact of FDI on employment generation. Osabohien, Awolola, Matthew, Itua & Elomien, (2020), Ajayi, Rafiu and Samuel (2019), found positive relationship between FDI and employment creation while Badeji and Abayomi (2011), among others argued otherwise. Also, most studies employed survey research design, vector auto regressive (VAR) and ordinary least square (OLS) techniques which is not adequate in generating consistent and robust coefficient estimates about the study variables, thereby providing a gap in the methodology used. This paper adopted the more advanced ARDL method, which allows for a more robust co-integration that plays well with small sample sizes. Through this method, it becomes methodologically possible to deal with model selection, estimation, inference and to

determine the long run and short run impact of foreign direct investment on employment generation in Nigeria. The findings of this study would be of practical relevance to government and policy makers in Nigeria in determining how best to channel FDI to boost employment in Nigeria. The rest of the paper is structured as follows: Section two is centered on the literature review; Section three concentrates on the methodology; Section four presents the results and Section five is the conclusion.

## II. LITERATURE REVIEW

Foreign Direct Investment and employment generation have inspired a lot of theoretical and empirical effort. This section examines the review of some related literatures on FDI and employment generation in Nigeria.

### *Conceptual Framework*

#### *Foreign Direct Investment (FDI)*

Babasanya (2018) defined foreign direct investment as an investment into production of goods and services by a citizen of another country, either by buying a company or expanding operations of an existing business in another country. Todaro and Smith (2003) defined Foreign Direct Investments as an overseas investment by private multinational corporations. Foreign direct investment also includes opening of a subsidiary, acquiring an existing foreign business, or through a means of merger or joint venture with a foreign company (Aladelusi & Olayiwola, 2021). Okafor (2019) defined FDI as a multinational issue whereby an investor who resides in the domestic country, seeks for a long-term influence in the control of an affiliate firm in the recipient country. This definition has been widely accepted because; it was conceptualized by IMF/OECD in 2011 with the purpose of giving a basis to domestic department of statistics, charged with the responsibility of gathering FDI statistics.

#### *Unemployment*

Unemployment can be defined as the situation whereby those who are willing and able to work are unable to find job. According to Ozughalu and Ogwumike (2013), unemployment is a situation where people who are willing and able to work at the prevailing wage rate and cannot find jobs. According to International Labour Organization (ILO) (2009), unemployment is a situation whereby one does not work for pay or profit but as actually sought work within a pre-specified period. That is, unemployed workers are those who are currently not working but are willing and able to work for pay, currently available to work and have actively searched for work.

### *Review of Basic Theories*

#### *(a) Theory of Eclectic Paradigm*

This paper adopts the theory of eclectic paradigm developed by John Dunning (1993). The theory combines the main components that are significant to other assumptions of FDI; Location-specific advantages (L), Internalization advantages (I), and Ownership-specific advantages (O) (Aladelusi & Olayiwola, 2021). According to them, the latter refers to those assets of a firm that allow successful competition in foreign

markets despite lack of knowledge and the costs of setting up of a subsidiary abroad. Right advantage must be present in a host country that is sufficient enough to counter challenge competition with firms in their home country (Sean-Leigh, 2007 cited in Aladelusi & Olayiwola, 2021). This also explains the benefits in terms of effective productivity and marketing and at the same time having foreign competitive advantage over local companies. On the other hands, location advantages involve those benefits that a host country can offer a business. These include large markets, good infrastructure, low labour or production costs or both. In the view of Wall & Ress (2004) cited in Aladelusi & Olayiwola (2021), there must be rise in profits from exploiting a firm's ownership advantage in a distinguished location than its local market and thereby leading to either cultural, economic, or market prospects benefits. Internalization advantage involves transaction costs and arises when it is cheaper to exploit ownership and location advantages through FDI rather than exporting. With internalization, firms have opportunities to fully exploit the ownership advantage which emanate from the knowledge of marketing a commodity. Succinctly, internalization and ownership advantages are investor specific determinants while the location advantage is specific to the host country (Aladelusi & Olayiwola, 2021).

#### *(b) Institutional FDI Fitness Theory*

This theory was developed by Saskia Wilhelms and Morgan Witter (1998) and postulates that it is institutions, their policies and implementation, rather than generic inflexible variables that gives a country a competitive advantage in the global FDI market. The term FDI fitness focuses on a country's potential or resources to attract absorb and retain FDI. It is a country's ability to meet the internal and external expectations of its investors that gives it the advantage in exploiting FDI inflows. The theory itself made an attempt to illustrate the meaning of uneven distribution of FDI between the countries concerned. The institutional FDI fitness theory is built on these fundamentals which are; Government, size of the market, educational skills and socio-cultural fitness. First on the pyramid are socio-cultural factors which according to them are the oldest and also most complex of all institutions. Next comes education, which according to the authors, is necessary to ensure an attractive environment for FDI as educated human capital enhances creativity and information processing ability (Ugwuanyi, Efang & Okanya. 2020). Also, the actual level of education is not the requisite for the inflow of FDI into a given region but on the essential skills needed for the projects to be undertaken. However, educational skills may affect productivity positively, effectiveness and the efficiency of FDI operations in the country it is operating. These influences from education such as the ability to speak, hear, and understand and other educational skills are keys for attracting FDI. The third on the pyramid is the market which accounts for a large percentage of both the economic and financial aspects of institutional FDI fitness, in the form of machinery (physical capital) and credit (financial capital). Well-developed and functioning financial markets are hence a prominent feature in the MNC's investment decision-making process. The fourth

and very important on the pyramid is the Government. The role of a country's political strength plays a big role in attracting FDI (Ugwuanyi, Efang & Okanya 2020).

### III. REVIEW OF EMPIRICAL LITERATURE

Several researchers have carried out studies on the impact of foreign direct investment on employment creation in Nigeria. Aladelusi and Olayiwola (2021) investigated the impact of foreign direct investment on employment creation in Nigeria from 1985-2019. The study employed five regressors (foreign direct investment, trade openness, government expenditure, infrastructural development, and exchange rate) and one explanatory variable (employment rate). The data were gotten from the World Bank Development Indicators and analysis was carried out using unit root test, ordinary least square and granger causality test. The findings revealed that there is negative and insignificant relationship between trade openness, government expenditure, infrastructures and employment rate. However, positive relationship exists between foreign direct investment, exchange rate and employment but statistically insignificant at 5% level of significance. Based on the f-statistic result, the study concluded that foreign direct investment played a crucial role in creating employment for the citizens of Nigeria.

Osabohien, Awolola, Matthew, Itua and Elomien (2020) carried out research on Foreign Direct Investment inflow and employment in Nigeria for the period of 1985-2017. The study used the Fully Modified Ordinary Least Squares (FMOLS) and the Johansen co-integration econometric approach on the data, which were gathered from the World Development Indicators (WDI) and the Central Bank of Nigeria (CBN) statistical bulletin. The results obtained show that foreign direct investment is statistically significant and positively related to the employment level in Nigeria. The study therefore recommended that policies should be formulated to exploit the role of FDI on employment in Nigeria, in an attempt to reduce the unemployment rate. Ajayi, Rafiu and Samuel (2019) investigated the impact of Foreign Direct Investment on employment and unemployment rate in Nigeria for the period of 1980-2014. The study sourced data from CBN Statistical Bulletin, National Bureau of Statistics and World Bank Indicators and the data were analyzed by E-view 9.5. The findings revealed that FDI has a significant role on employment rate in Nigeria. Thus, it was recommended that policies should be implemented to exploit the impact of FDI on employment in an attempt to reduce the unemployment rate in Nigeria.

Johnny, Timipere, Krokeme and Markjackson (2018), assessed the impact of Foreign Direct Investment on unemployment rate in Nigeria between 1980 and 2015. The study was carried out using unit root test, co-integration test, and ordinary least square. It was revealed that negative and insignificant relationship exists between Foreign Direct Investment and unemployment rate in Nigeria while positive and significant relationship occurs between capital formation and unemployment rate. The study therefore suggested that government should implement policies that will attract foreign

investors to Nigeria to make more investments and should also ensure that all resources for productive activities are fully employed before embarking on savings. Babasanya (2018), examined the relationship between Foreign Direct Investment and employment generation in Nigeria covering the period of 1999 to 2016. The study considered employment rate (as dependent variable) and gross domestic product, foreign direct investment, exchange rate as independent variables. The ordinary least square estimation technique was used in the study and it was discovered that foreign direct investment has a positive relationship with employment rate in Nigeria. It was therefore recommended that government should make concrete efforts in attracting foreign investors into Nigeria to increase production and thereby create employment opportunities.

Ugwu (2014) examined the impact, causality and long run relationship between foreign direct investment and employment in Nigeria. The study employed multiple regression analysis, Johansen co-integration and Granger causality to ascertain the specific objectives of the study. The study employed data from CBN Statistical Bulletin, National Bureau of Statistics, and the World Bank indicators. The findings of the study suggest that FDI has a significant and positive impact on employment, and other significant determinants of employment include; GDP and wage. Also, the results show that there exists a significant long run relationship between FDI and employment. Finally, the results suggest that FDI granger causes employment but employment does not granger cause FDI. This means that FDI has a significant role on employment in Nigeria and this should not be minimized. Abaukaka (2014) examined the relationship between foreign direct investment and employment generation in Nigeria using multiple linear regression models for data which covers the period from 2002 to 2012. To empirically establish the relationship, some variables were incorporated into the econometric model which includes Employment level as the dependent variable while the explanatory variables are FDI, GDP (annual GDP growth rate) and the nominal interest rate. From the empirical results, FDI exhibit negative relationship with the level of employment in Nigeria while GDP, interest rate is positively related with the level of employment but none of the explanatory variables significantly impact on the level of employment in Nigeria within the period of the study.

From the empirical studies reviewed, it is observed that almost all the work made use of OLS estimation technique which is not adequate in generating consistent and robust coefficient estimates about the study variables. This study adopted the more advanced Autoregressive distributed lag (ARDL) method, which allows for a more robust co-integration that play well with small sample sizes. Through this method, it becomes methodologically possible to deal with model selection, estimation, inference and to determine the long run and short run impact of FDI on employment generation in Nigeria.

### IV. RESEARCH METHOD AND PROCEDURE

This study employed annual secondary data between 1991 and 2021. The data were collected from Central Bank of Nigeria (CBN) and World Bank open data database.

**Model Specification**

The main focus of this study is to examine the impact of FDI on employment generation in Nigeria. From our Analytical Framework and Literature review, the model is hereby specified following the work of Babasanya (2018) with some modifications in a functional form as follows:

$$EMPR_t = f(FDI, TOPN, EXR) \dots\dots\dots (1)$$

Where:  $EMPR_t$  - Employment rate; FDI - Foreign direct investment; TOPN - Trade Openness; EXR - Exchange rate.

The econometric form of this model is therefore specified thus;

$$EMPR_t = \beta_0 + \beta_1 FDI_t + \beta_2 TOPN_t + \beta_3 EXR_t + U_t \dots\dots\dots (2)$$

Where:  $u_t$  is the error term that is assumed to be normally distributed with the mean of zero and constant variance;  $\beta_0$  = Constant term/intercept;  $\beta_1$ ;  $\beta_2$ ;  $\beta_3$  = Slope coefficient.

**Estimation Technique**

The study employed the Autoregressive Distributed Lag (ARDL) methods to examine the relationship between FDI and employment generation in Nigeria. ARDL is a long-established method of estimating co-integrating relationships among the variables by computing the Bounds F-statistic (bounds test for cointegration). Also, estimates provided by ARDL method avoid problems such as autocorrelation and endogeneity, they are unbiased and efficient and can accommodate greater number of variables in comparison to vector autoregressive (VAR) models and more flexible with respect to lag structure since it can accommodate different optimal lag structure for different variables in the model (Rahman & Islam, 2020).

$$\Delta \ln EMP_t = \alpha_0 + \sum_{i=1}^p \alpha_{1i} \Delta \ln EMP_{t-i} + \sum_{i=1}^q \alpha_{2i} \Delta \ln FDI_{t-i} + \sum_{i=1}^q \alpha_{3i} \Delta \ln TOPN_{t-i} + \sum_{i=1}^q \alpha_{4i} \Delta \ln EXR_{t-i} + \alpha_5 \ln EMP_{t-1} + \alpha_6 \ln FDI_{t-1} + \alpha_7 \ln TOPN_{t-1} + \alpha_8 \ln EXR_{t-1} + \mu_t \dots\dots\dots (3)$$

Where,  $\Delta$  is the first difference operator,  $p$  is the optimal lag length for the dependent variable,  $q$  is the optimal lag length for the regressors,  $\alpha_1, \alpha_2, \alpha_3, \alpha_4, \dots$  represent short-run dynamics of the model,  $\alpha_5, \alpha_6, \alpha_7, \alpha_8$ , represent the long-run elasticity.

**V. PRESENTATION AND INTERPRETATION OF RESULT**

**Descriptive Statistics**

Table 1: Summary of Descriptive Statistics

	EMPR	FDI	REXR	TOPN
Mean	55.85203	1.645042	109.3246	35.27185
Median	57.92800	1.552115	100.5197	36.37749
Maximum	58.16000	5.790847	273.0089	62.75538
Minimum	48.25200	0.195183	49.74980	17.01075
Std. Dev.	3.406290	1.217951	49.69457	10.16477
Skewness	-1.119728	1.792001	1.851577	0.178075
Kurtosis	2.598566	6.575894	6.286829	3.151727
Jarque-Bera	6.686074	33.10811	31.66727	0.193574
Probability	0.035329	0.000000	0.000000	0.907749
Sum	1731.413	50.99631	3389.064	1093.427
Sum Sq. Dev.	348.0844	44.50218	74086.52	3099.679
Observations	31	31	31	31

The result of the descriptive statistics shows that the employment rate, foreign direct investment, real exchange rate and trade openness are normally distributed. FDI, real exchange rate and trade openness are all highly skewed. The distribution for FDI and real exchange rate are leptokurtic while employment rate and trade openness are platykurtic.

**Test for Stationarity**

Table 2: Summary of ADF Unit Root Test

Variables	ADF Statistics	Probability	5% Critical value	Order of Integration
EMPR	-4.2301	0.0120	-3.5742	I(1)
FDI	-3.8622	0.0272	-3.5742	I(0)
TOPN	-4.1417	0.0015	-3.5683	I(0)
REXR	-5.0964	0.0143	-3.5742	I(1)

Source: Author’s computation using Eviews 10

The first step to analyze time series data is to ensure the variables are stationary so as to avoid misleading result. To do this, ADF unit root test was conducted, and the result is shown in the table above. From the result, FDI and trade openness (TOPN) are stationary at level with a probability value of 0.0272 and 0.0015 respectively. More so, employment rate (EMPR) and real exchange rate (REXR) are all stationary at first difference, that is, integrated of order one I(1). In order to test for cointegration among the variables, bound test was carried out through autoregressive distributed lag model as proposed by Pesaran et al (2001).

**Cointegration Test**

Table 3: Summary of ARDL Longrun Form and Bounds Test

F-Bounds Test		Null Hypothesis: No levels relationship		
Test Statistic	Value	Signif.	I(0)	I(1)
			Asymptotic: n=1000	
F-statistic	1.723280	10%	2.37	3.2
k	3	5%	2.79	3.67
		2.5%	3.15	4.08
		1%	3.65	4.66

Source: Author’s computation using Eviews 10

The result of the ARDL Bounds test is presented in Table 3. The result shows that the F-Statistic is 1.723280 which is less than the lower bound of 2.79 at 5 per cent level of significance. This shows that there is no long run relationship among all the variables. Based on this, the ARDL Error correction model was carried out and the result is presented in table 4 below.

**ARDL Error Correction Model**

Table 4: Summary of ECM Test

t-Bounds Test		Null Hypothesis: No levels relationship		
Test Statistic	Value	Signif.	I(0)	I(1)
t-statistic	-2.437009	10%	-1.62	-3
		5%	-1.95	-3.33
		2.5%	-2.24	-3.64
		1%	-2.58	-3.97

Source: Author’s computation using Eviews 10

The ECM result presented in Table 4 above shows that the t-statistics is 2.437009 which is greater than the lower bound of 1.95. This shows that a short run relationship exists between the variables.

**ARDL Model Result**

Table 5: Summary of ARDL Estimate

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
EMPR(-1)	0.992309	0.068130	14.56485	0.0000
FDI	0.000886	0.173159	0.005117	0.9960
REXR	-0.000434	0.003339	-0.130002	0.8976
TOPN	0.026735	0.023620	1.131894	0.2684
C	-0.775644	3.326811	-0.233149	0.8175
R-squared	0.957734	Mean dependent var	55.77510	
Adjusted R-squared	0.950971	S.D. dependent var	3.437020	
S.E. of regression	0.761039	Akaike info criterion	2.442749	
Sum squared resid	14.47953	Schwarz criterion	2.676282	
Log likelihood	-31.64123	Hannan-Quinn criter.	2.517458	
F-statistic	141.6226	Durbin-Watson stat	1.536235	
Prob(F-statistic)	0.000000			

\*Note: p-values and any subsequent tests do not account for model selection.

Source: Author's computation using Eviews 10

Dependent Variable: EMPR  
 Method: ARDL  
 Date: 07/19/22 Time: 21:05  
 Sample (adjusted): 1992 2021  
 Included observations: 30 after adjustments  
 Maximum dependent lags: 2 (Automatic selection)  
 Model selection method: Akaike info criterion (AIC)  
 Dynamic regressors (2 lags, automatic): FDI REXR TOPN  
 Fixed regressors: C  
 Number of models evaluated: 54  
 Selected Model: ARDL (1, 0, 0, 0)  
 Note: final equation sample is larger than selection sample

The result in Table 5 indicates that foreign direct investment (FDI), trade openness (TOPN) and real exchange rate (REXR) are not statistically significant at 5% level of significance since their Pvalues are greater than 0.05. Also, the result shows that real exchange rate has a negative relationship with employment generation in Nigeria while trade openness and FDI have a positive relationship with employment generation in Nigeria. The adjusted R-squared is approximately 0.95. This implies that FDI, trade openness and real exchange rate explains about 95% variations noticed in the rate of employment. The F-statistics is to know the overall significance of the model. The probability of F-statistics is 0.0000 which indicates that the model is statistically significant and has a good fit. The durbin watson statistics result (DW) is 1.53 indicating there is no presence of autocorrelation in the model.

**Diagnostic Tests**

This subsection shows the results of the residual diagnostic tests conducted after estimation.

**Serial Correlation Test**

Table 6: Breush-Godfrey Serial Correlation LM Test

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	1.006517	Prob. F(2,24)	0.3804
Obs*R-squared	2.321567	Prob. Chi-Square(2)	0.3132

Source: Author's computation using Eviews 10

From the result in table 6, the probability of F-Statistic and Obs\*R-squared are greater than the critical values of 0.05 level of significance. Hence, we conclude that there is no serial correlation in the model.

**Heteroscedasticity Test**

Table 7: Heteroscedasticity Test: Breusch-Pagan-Godfrey

Heteroskedasticity Test: Breusch-Pagan-Godfrey			
F-statistic	0.564003	Prob. F(4,25)	0.6910
Obs*R-squared	2.483136	Prob. Chi-Square(4)	0.6477
Scaled explained SS	4.338195	Prob. Chi-Square(4)	0.3622

Source: Author's computation using Eviews 10

The result in Table 7 indicates that the Probability values of F-statistics and Obs Rsquared are greater than the critical value of 5% level of significance. It means that the model is free from heteroscedasticity, that is, the mean, variance and covariance are constant over time.

**Stability Test**

To test whether the model is stable or not, both the cumulative sum and the cumulative sum of squares tests are conducted.

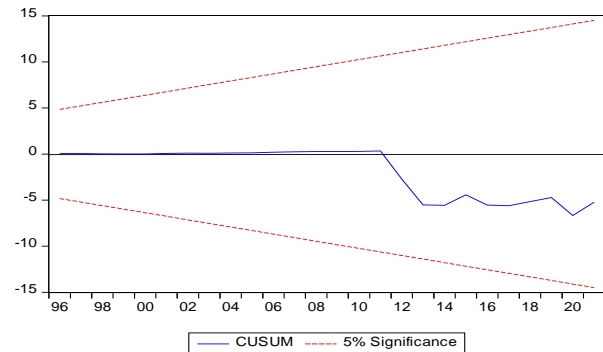


Figure 1: Cumulative Sum Plot

Source: Author's computation using Eviews 10

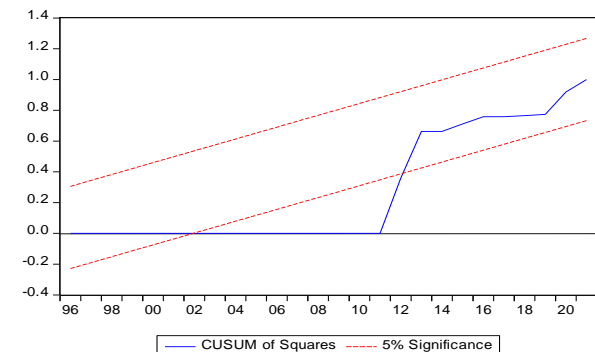


Figure 2: Plot of Cumulative Sum of Squares

Source: Author's computation using Eviews 10

From the results in figures 1 and 2, Figure 1 shows that the model and the estimated parameters are stable given that the graph moves within the 0.05 critical values. Similarly, figure 2 is the cumulative sum of square test which shows that the model and the estimated parameters are largely not stable throughout the period under investigation since the blue line veers outside the two red lines indicating 5% level of significance.

## VI. CONCLUSION AND POLICY RECOMMENDATIONS

The main aim of this paper is to examine the impact of foreign direct investment on employment generation in Nigeria within the period 1991 to 2021. The paper used the autoregressive distributed lag (ARDL) model for its empirical analysis. The study finds that foreign direct investment and trade openness have a positive impact on employment generation in Nigeria while the real exchange rate has a negative impact on employment generation in Nigeria. Also, the paper finds that a short run relationship exists between foreign direct investment, real exchange rate, trade openness and employment generation in Nigeria. Based on the findings, the following recommendations are proffered:

- a. Government should make effort to attract more foreign direct investment into the country to create more employment opportunities through Multi-National Corporations.
- b. The government should encourage trade openness in order to enhance more foreign direct investment in the country as it will increase the standard of living of the citizens by the provision of highly paid employment.
- c. The government should control and/or regulate the exchange rate to favour foreign direct investment in the country.

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