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Foreign private capital inflows and real sector growth: evidence from Nigeria

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ABSTRACT

The real sector of any economy is very critical to its growth and development and the beneficial effect of foreign private capital on a host country has remained an issue of discussion. The general notion is that it helps to accelerate growth and development in such a country impacting positively and significantly in those sectors they are channelled into. It is against this background that this paper empirically examined the impact of foreign private capital on three important subsectors of the Nigeria economy (Agriculture, Industry and Building and Construction) from 1987 to 2008. Findings from the study revealed that foreign private capital have not had a significant positive impact on the Nigerian economy vis-à-vis the agricultural, industrial and building and construction sectors and even when it existed, the impact had been non-significant. Therefore, the study recommends re-evaluations of government policies on foreign direct investment in Nigeria. This requires an appropriate mix of proactive government policies to direct foreign private capital inflows to priority sectors of the economy such as agriculture, industrial and building and construction as there are crucial to its sustained growth and development.

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Introduction

The benefits of foreign direct investment (FDIs) to benefiting countries have remained a matter of conjecture. With globalization, there has been renewed freedom of FDIs flows. Much of this new freedom of movement may be attributable to more permissive attitudes towards foreign direct investment (FDI) by host countries which need these funds for developmental purposes. Of much interest has been the flow of foreign private capital and its impact on the economic growth and development on emerging economies. The productivity benefits of foreign private capital inflows through the transfer of technology and management techniques and the stimulation of financial sector development among other benefits have been some of the significant reasons for developing countries like Nigeria to seek these funds. No wonder Borensztein, De Gregorio and Lee (1998) posit that there is a good a priori case to presume that foreign private capital is more productive in enhancing growth of an economy than domestic capital.

Foreign private capital inflows are expected to have linkage effect on investment in the domestic market, engender additional competition and variety of goods and services, expose domestic firms to best practices of foreign firms and boost productivity among other benefits. Hence several studies, theoretical as well as empirical works have been carried out by different scholars on the impact of foreign private capital on economic growth on a macro-economic level. These studies have recognized foreign capital flow as an important resource for economic development. Most studies argue that the flows of foreign capital could fill the gap between desired investments and domestically mobilized saving and also may increase tax revenues and improve management, technology, as well as labour skills in host countries (Stiglitz, 2000). However, the recent global financial crises have led to call for a re-evaluation of foreign capital inflow as a source of fund for development and growth of

emerging economies, though globalization and integration of emerging economies with the rest of the world helped fuel the crisis in emerging economies as most of these economies were open to shocks elsewhere especially from the developed economies where foreign capital inflows get to the emerging economies.

Though Nigeria has been experiencing foreign private capital inflows, the impact of these on the economy real sectors need to be examined. Sanusi (2011) sees the real sector as comprising agriculture, industry, building and construction and services subsectors however most studies on the impact of foreign capital flows on economic growth have been done on an economy-wide level, however in this work we adopted the above definition of the real sector with exceptions of the services sector and examined; the impact of foreign private capital inflows on agricultural productivity in Nigeria; the impact of foreign private capital inflows on industrial output in Nigeria; and the impact of foreign private capital inflows on the building and construction sector of the Nigeria economy utilizing data from the Central Bank of Nigeria Statistical Bulletin for 22years (1987-2008). Foreign private capital inflows into the agricultural, industrial and building and construction sectors of an economy are assumed to remain in a country in the long-run which enhances long-term growth and development.

It is in view of suggestions that foreign private capital inflows have significantly impacted on the Nigeria economy that this paper focus on the provision of an empirical analysis to determine on the impact of foreign private capital inflows on the long-run growth and development of the Nigerian economy vis-a-vis the agricultural, industrial and building and construction sectors which represent a greater part of the collective real sector of an emerging economy like Nigeria. Herein lays the lacuna which this study seeks to fill.

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Therefore, this paper is organized into five sections. Section one is the introduction. Section two presents related literature. Section three contains the methodology. Section four shows the empirical analysis of foreign capital flows on these three important sectors of the Nigerian economy and the results. Finally, section five is the conclusion/policy implication and recommendations.

Review of Literature

Foreign private capital inflows through direct investment are viewed as a major stimulus to economic growth in developing countries. Empirical literature on the impact of foreign private capital inflows on economic growth is not scanty. Borensztein, De Gregorio and Lee (1998) hold foreign direct investment as an important vehicle for the transfer of technology, contributing to growth in larger measure than domestic investment. This arose from their work on the effect of foreign direct investment on economic growth in a cross-country regression framework. Their results suggested that foreign direct investment is an important vehicle for the transfer of technology, contributing relatively more to growth than domestic investment. However this view the higher productivity of foreign direct investment holds only when the host country has a minimum threshold stock of human capital in a situation where a sufficient absorptive capability of the advanced technologies is available in the host economy.

According to Lipsey and Chrystal (2003), foreign direct investment is often undertaken by domestic firms which have accumulated some advantages in the local market and such advantages include patents and know-how that bestowed on them advantages when they enter into foreign markets. The consensus in literature seems to be that FDI increases growth through productivity and efficiency gains by local firms. The empirical evidence is not unanimous, however. Available evidence for developed countries seems to support the idea that the productivity of domestic firms is positively related to the presence of foreign firms (Globeram, 1979; Imbriani and Reganeti, 1997). The results for developing countries are not so clear, with some finding positive spillovers (Blomstrom, 1986; Kokko, 1994; Blomstrom and Sjöholm, 1999) and others such as Aitken et. al. (1997) reporting limited evidence. Still others find no evidence of positive short-run spillover from foreign firms. Some of the reasons adduced for these mixed results are that the envisaged forward and backward linkages may not necessarily be there and that arguments of Transnational Corporation (TNCs) encouraging increased productivity due to competition may not be true in practice (Aitken et al., 1999). Other reasons include the fact that TNCs tend to locate in high productivity industries and, therefore, could force less productive firms to exit (Smarzynska, 2002). Cobham (2001) also postulates the crowding out of domestic firms and possible contraction in total industry size and/or employment.

Caves (1996) observes that the rationale for increased efforts to attract more foreign direct investment by host countries emerges from the belief that foreign direct investment are productivity gains, technology transfers, introduction of new processes, management skills, and know how in the domestic market, employee training, international production networks and access to markets. De Gregorio (2003), while contributing to the debate on the importance of foreign direct investment, notes that foreign direct investment may allow a country to bring in technologies and knowledge that is not readily available to domestic investors, and in this way increases productivity and

hence enhances growth throughout the economy. Foreign direct investment may also bring in expertise that the country does not possess, and foreign investors may have access to global markets.

Willmore (1986) argues that foreign direct investment have a beneficial impact on growth because foreign firms are more efficient than their local competitors. He tested this hypothesis on a sample of 282 pairs of firms belonging to 80 industries in Brazil, and finds out that the ratio of added value to output is higher for foreign firms than for their domestic competitors.

Lensik et. al, (1999) examined the impact of uncertain capital flows on the growth of 60 developing countries during the 1990s. They distinguished between total capital flows, official capital flows and private capital flows. For the three types of capital flows, they derived a yearly uncertainty measure. They used the yearly uncertainty measures in Ordinary Least Square (OLS) and also Generalized Method of Moments (GMM) estimates, to explain the impact of uncertain capital flows on growth. They conclude that both types of estimates suggest that uncertain capital flows have a negative effect on financial market and growth in developing countries.

Gentry and Esty (2001) are primarily interested in capital flows and sustainable development. In particular, they examined whether capital flows are consistent with environmental protection. Though the answer depends on the type of capital flow, they find that integrating environmental factors into investment support programmes does not drive investors away except in isolated cases. Regarding economic development, Espinoza-Vega, et al. (2000) argues that the volatility of capital flows exerts a negative impact on development. They show that selected trade barriers are consistent with increased levels of economic development.

Carkovic and Levine (2002) have noted that the economic rationale for offering special incentives to attract foreign direct investment frequently derives from the belief that foreign investment produces externalities in the form of technology transfers and spillovers. However, the consensus in the literature appears to be that foreign direct investment spillovers depend on the host country's capacity to absorb the foreign technology and the type of investment climate. Further, the role of foreign direct investment in export promotion remains controversial and depends crucially on the motive for such investment (World Bank, 1998).

Balasubramanian, et al. (1996) report positive interaction between human capital and foreign direct investment, they found significant results supporting the assumption that foreign direct investment is more important for economic growth in export-promoting than import-substituting countries. This implies that the impact of foreign direct investment varies across countries and that trade policy can affect the role of FDI in economic growth. In summary, UNCTAD (1999) submits that foreign direct investment has either a positive or negative impact on output depending on the variables that are entered alongside it in the test equation. These variables include the initial per capita GDP, education attainment, domestic investment ratio, political instability, terms of trade, black market exchange rate premiums, and the state of financial development. Examining other variables that could explain the interaction between FDI and growth, Olofsdotter (1998) submits that the beneficiary effects of foreign direct investment are stronger in those countries with a higher level of institutional capability, emphasizing the importance of bureaucratic efficiency in enabling FDI effects.

Methodology

The *ex-post facto* research design was adopted in this work. This study relies on data from the Central Bank of Nigeria Statistical bulletin for the period 1987 to 2008. The choice of 1987 as base year was premised on its being the full year after the Nigerian economy was largely de-regulated. Our propositions that the foreign private capital inflows into Nigeria have not impacted on the Nigerian economy is analyzed by employing the Ordinary Least Square (OLS) Regression techniques. Therefore, given our intention to examine the impact of foreign private capital inflows on a sector by sector basis rather than on macroeconomic-wide analysis of an emerging economy like Nigeria, we adopted a two variable model in analyzing various cases. The general form of the model is one in which Y , the dependent variable, is a function of X , the independent variable and is given as;

$$Y = f(X) \dots \dots \dots (1)$$

Therefore, modifying equation 1 to conform to the ordinary least square regression model (see, Onwumere, 2009); we have:-

$$Y = \alpha_0 + \alpha_1 X + \mu \dots \dots \dots (2)$$

where

- α_0 = constant which is the value of Y when $X = 0$
- α_1 = coefficient of the dependent variable
- μ = error term

In adopting the above model, we used the following symbols to represent our respective variables;

- rgdpA = real gross domestic product contribution of agriculture sector
- rgdpI = real gross domestic product contribution of the industrial sector
- rgdpBC = real gross domestic product contribution of the building and construction sector
- fpiA = foreign capital inflows into the agricultural sector
- fpiI = foreign capital inflows into the industrial sector
- fpiBC = foreign capital inflows into the building and construction sector

Here rgdpA, rgdpI and rgdpBC represent our relevant dependent variables while fpiA, fpiI and fpiBC are the independent variables, hence rewriting equation 2, we propose that *foreign private inflows into the agricultural sector have not had significant positive impact on agricultural output in Nigeria*, It is represented as:

$$\text{rgdpA} = \alpha_0 + \alpha_1 \text{fpiA} + \mu \dots \dots \dots (3)$$

The proxy for the independent variable, foreign capital inflows into the agricultural sector is measured by foreign private capital inflows into the agricultural sector divided by total foreign capital inflows. The measure represents the contribution of foreign capital inflows into the agricultural sector per unit of total foreign private capital inflow while the dependent variable, agricultural output, is measured by agricultural real gross domestic product divided by total gross domestic product. The measure succinctly captures per unit contribution of agricultural output to total real gross domestic product.

Also we propose that, *foreign private inflows into the industrial sector have not had significant positive impact on industrial output in Nigeria*. This is represented as:

$$\text{rgdpI} = \alpha_0 + \alpha_1 \text{fpiI} + \mu \dots \dots \dots (3)$$

The proxy for foreign capital inflows into the industrial sector is measure by foreign private capital inflows into the

industrial sector divided by total foreign capital inflows which shows per unit contribution of foreign capital inflows into the industrial sector to total foreign private capital inflow. Industrial output is measured by industrial contribution to the real gross domestic product divided by total gross domestic product. This measure captures per unit contribution of industrial output to total real gross domestic product.

Lastly, we propose that, *foreign private inflows into the building and construction sector have not had significant positive impact on building and construction output in Nigeria*, Represented as:

$$\text{rgdpBC} = \alpha_0 + \alpha_1 \text{fpiBC} + \mu \dots \dots \dots (3)$$

To measure the independent variable, foreign capital inflows into the building and construction, we used foreign private capital inflows into the building and construction sector divided by total foreign capital inflows. This measure represents the contribution of foreign capital inflows into the building and construction sector per unit of total foreign private capital inflow while the dependent variable, building and construction output is measured by building and construction real gross domestic product divided by total gross domestic product. The measure succinctly captures per unit contribution of agricultural output to total real gross domestic product.

Analysis/Results

Using data (see appendix) embodied in various tables, the SPSS package was used in testing the various propositions, the summary results of which are presented in table 4.1.

From table 4.1, it is evident that foreign private capital inflows into the agricultural sector have not had significant positive impact on agricultural output in Nigeria. This is revealed by the coefficient of foreign private capital inflows (-3.477) which is negatively signed and with a t-value of -4.4598. The coefficient of determination R^2 indicates that 51.4% of the variations in the dependent variable are explained in the independent variable.

From table 4.1 and with respect to our second proposition that foreign private capital inflows into the Industrial sector have not had significant impact on the industrial sector in Nigeria, the result reveals that the impact of foreign private capital inflows into the industrial sector in Nigeria had been positive though not significant. A t-value of 0.424 indicates non-significant impact; however as was revealed by the coefficient of foreign private capital inflows of 0.100, the result indicates that the impact was positive.

For our last proposition that, foreign private capital inflows into the building and construction sector have not had significant positive impact on building and construction sector of the Nigerian economy, the result table 4.1 shows that foreign private capital inflows into the building and construction sector have not had a significant positive impact on the building and construction sector of the Nigerian economy. In fact, the impact had been negative. These are revealed by a t-value of -0.92 and a coefficient of foreign private capital inflows into the building and construction of -0.010.

Policy Implications and Conclusion

Ayanwale (2007) posits that the adoption of the structural adjustment programme in 1986 initiated the process of termination of the hostile policies towards foreign direct investment in Nigeria. Also, he noted that the industrial policy introduced in 1989 with the debt to equity conversion scheme as a component of portfolio investment was established as a one-step agency for facilitating and attracting foreign investment

flow. This was followed in 1995 by the repeal of the Nigeria Enterprises Promotion Decree and its replacement with the Nigerian Investment Promotion Commission Decree 16 of 1995. All these measures were put in place to encourage foreign private capital inflows into Nigeria. However their effects have not been really felt as demonstrated from our findings. This is against argument for foreign direct investment which suggested that such investment brings with it not only resources, but technology, access to markets, valuable training and improvement in human capital (Stiglitz, 2000). It was observed from our findings that private capital inflows from 1987-2008 when Nigeria adopted and embraced the structural adjustment programme have not had a significant positive impact on the Nigerian economy, even when it exist, the impact had been non-significant. Thus a policy rethink is necessary at this time in the nation's history if its vision 2020 (being one of the 20 largest economies in the world by the year 2020) is to be achieved. This requires an appropriate mix of proactive government policies to direct foreign private capital inflows to priority sectors of the economy such as agriculture, industrial and building and construction; effective enabling environment to make Nigeria an attractive host for foreign private investment and addressing human resources development in a new and innovative way through increased funding of the educational sector.

Nigeria requires heavy dose of foreign private capital if it must accelerate its rate of development. There is no doubting the beneficial effect of this development vehicle which the country is yet to fully realize. Appropriate policies such as on granting tax holiday, security of investment, immigration requirements, macro economically stabilizing the economy, improved infrastructures (electricity, transportation, health etc) among others must be put in place in order to attract investors. The real sectors of the country's economy must be developed and at a faster rate. This can be fastened through the injection of foreign private capital. It is only through well developed real sector that Nigeria as well as other emerging economies can experience sustained real economic growth and development.

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Table 4.1: SPSS Model Summary of Results

Particulars	Proposition 1	Proposition 2	Proposition 3
R (Correction Coefficient)	0.719	0.094	0.192
R ² (Coefficient of Determination)	0.514	0.009	0.037
t-value of independent variable	-4.598	0.424	-0.92
Un-standardized Coefficient β (fpiA) i.e independent variable Std Error (fpiA)	-3.477 0.756	0.100 0.237	-0.010 0.012
Standardized Coefficient B	-0.717	0.094	-0.192

Source: Researchers' SPSS Summary Results computed from Tables 3 and 4 (see, Appendix)

Appendix

Table 1 Cumulative Foreign Private inflows in Nigeria from 1987-2008

Years	fpiA (₦, m)	fpiI (₦, m)	fpiBC (₦, m)	Total fpi(₦, m)
1987	117.3	5382.5	462.6	9993.6
1988	128.9	7040	492.7	11339.2
1989	134.8	6043.1	481.8	10899.6
1990	334.7	7430.6	743.6	10436.1
1991	382.8	7882.4	1471.6	12243.5
1992	386.4	16163.5	1406.6	20512.7
1993	1214.9	40572	71.2	66787
1994	1208.5	40739.9	1707	70714.6
1995	1209	84416.1	1553	119391.6
1996	1209	86606.6	1864.3	122600.9
1997	1209	90518.6	1259.8	128331.9
1998	1209	94474.4	3888.3	152410.9
1999	1209	95137.5	3995.9	154190.4
2000	1209	98044.5	3995.9	157508.6
2001	1209	99391.5	4211.9	161441.6
2002	1209	101565.5	4293.9	166631.6
2003	1209	107528.5	4545.8	178478.6
2004	1209	165141.5	5194.1	249220.6
2005	1209	214683.9	6713.3	324656.7
2006	1209	318397.8	10461.1	481239.1
2007	1329.9	351597.5	12030.2	552498.6
2008	1397.2	370261.7	12702.5	586309.8

Source: CBN Statistical Bulletin, 50th Years Special Anniversary Edition

Note: fpi= foreign private inflows; fpiA= foreign private inflows (Agriculture) fpiI= foreign private inflows (Industrial); fpiBC= foreign private inflows (Building and Construction)

TABLE 2 Aggregate Real Gross Domestic Product in Nigeria for the period 1987-2008

Years	rgdpA (₦, m)	rgdpI (₦, m)	rgdpBC (₦, m)	Total rgdp (₦, m)
1987	69608.1	81596.5	3610.3	204806.5
1988	76753.7	85146.6	3978.1	219875.6
1989	80878	93971.6	4143.6	236729.6
1990	84344.6	115591.4	4350.8	267550
1991	87503.5	108081	4524.8	265379.1
1992	89345.4	109682.6	4701.3	271365.5
1993	90596.5	109344.2	4936.3	274833.3
1994	92833	106747.6	5084.4	275450.6
1995	96220.7	108162.7	5221.7	281407.4
1996	100216.2	114992.2	5284.3	293745.4
1997	104514	116576.9	5622.5	302022.5
1998	108814.1	117870.3	5959.9	310890.1
1999	114570.7	110558.6	6186.4	312183.5
2000	117945.1	121756.6	6433.8	329178.7
2001	122522.3	128418.6	7205.9	356994.3
2002	190133.4	123553.5	7518.9	433203.5
2003	203409.9	149878.7	8176.8	477533
2004	216208.5	156486.8	7622.5	527576
2005	231463.6	159161.4	8544.5	561931.4
2006	248599	155165.5	9654.8	595821.6
2007	266477.2	151699.1	10912.6	634251.1
2008	283913.1	148390.7	12337.5	674889

Source: CBN Statistical Bulletin, 50th Years Special Anniversary Edition

Note: rgdp= real gross domestic product; rgdpA= real gross domestic product (Agriculture) rgdpI= real gross domestic product (Industrial); rgdpBC= foreign private inflows (Building and Construction)

Table 3 Foreign Private inflows Rates in Nigeria from 1987-2008

Years	fpiA/fpi	fpiI/fpi	fpiBC/fpi
1987	0.011737512	0.538594701	0.046289625
1988	0.011367645	0.620855087	0.043451037
1989	0.012367426	0.55443319	0.044203457
1990	0.032071368	0.712009275	0.071252671
1991	0.031265569	0.643802834	0.120194389
1992	0.018837111	0.787975254	0.068572153
1993	0.018190666	0.607483492	0.001066076
1994	0.017089823	0.576117237	0.024139287
1995	0.010126341	0.707052255	0.013007615
1996	0.009861265	0.706410801	0.015206251
1997	0.009420884	0.705347618	0.009816733
1998	0.007932504	0.619866427	0.025511955
1999	0.007840955	0.617013121	0.025915362
2000	0.007675771	0.622470773	0.025369408
2001	0.007488776	0.61564987	0.02608931
2002	0.007255527	0.609521243	0.025768822
2003	0.006773921	0.602472789	0.02546972
2004	0.004851124	0.662631821	0.020841375
2005	0.003723934	0.661264345	0.02067815
2006	0.002512265	0.661620803	0.021737843
2007	0.002407065	0.636377178	0.021774173
2008	0.002383041	0.631512044	0.021665167

Source: Researchers' Computation

Note: fpi= foreign private inflows; fpiA= foreign private inflows (Agriculture) fpiI= foreign private inflows (Industrial); fpiBC= foreign private inflows (Building and Construction)

Table 4 Aggregate Real Gross Domestic Product in Nigeria for the period 1987-2008

Years	rgdpA/rgdp	rgdpI/rgdp	rgdpBC/rgdp
1987	0.339872514	0.398407765	0.017627858
1988	0.349077842	0.387248972	0.018092503
1989	0.341647179	0.396957541	0.017503515
1990	0.315247991	0.432036629	0.016261633
1991	0.329730186	0.407270203	0.017050325
1992	0.329243769	0.40418771	0.017324605
1993	0.329641641	0.397856446	0.017961069
1994	0.337022319	0.387538092	0.018458482
1995	0.341926687	0.384363382	0.01855566
1996	0.341166874	0.391468939	0.017989388
1997	0.346047066	0.385987468	0.018616163
1998	0.350008251	0.379138158	0.01917044
1999	0.366997936	0.354146199	0.01981655
2000	0.358301129	0.369879947	0.019545007
2001	0.3432052	0.35972171	0.020184916
2002	0.438900886	0.285208915	0.017356508
2003	0.425959881	0.313860403	0.017123005
2004	0.409814889	0.296614706	0.014448155
2005	0.411907219	0.283239911	0.015205593
2006	0.417237307	0.260422751	0.016204179
2007	0.42014464	0.2391783	0.017205488
2008	0.420681179	0.219874231	0.018280784

Source: Researchers' Computation

Note: rgdp= real gross domestic product; rgdpA= real gross domestic product (Agriculture) rgdpI= real gross domestic product (Industrial); rgdpBC= foreign private inflows (Building and Construction)