



Oversea Investment Inflows and Trade Policies in Sub-Saharan African Countries

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Received: 10-04-2024

Reviewed: 20-04-2024

Accepted: 08-05-2024

Abstract

The paper ascertained the dynamic linkage between overseas investment (Foreign direct investment-FDI & Foreign Portfolio Investment-FPI) inflows and trade openness with emphasis on the SSA Economy. The regressor is overseas investment while the regressed is trade policy measured by trade openness. The study adopted the longitudinal research design. The paper collated data from the World Bank data base, 2021. Specifically, the study sampled 30 SSA countries out of the 48 countries in SSA over the reviewed period of 1992 to 2021. Meanwhile, the study adopted the Robust panel Regression (Panel Corrected Standard Error). The study reported that, FDI inflows has a positive (coefficient value = 0.977169) yet significant effect (prob. value = 0.0007 < 0.05) on trade openness. By implication, FDI inflows are a major predictor of trade openness. In like manner, exchange rate has a positive significant effect on trade openness. However, FPI inflows has a positive (coefficient value = 0.005328) yet insignificant effect (prob. value = 0.7399 > 0.05). By implication, FPI inflows have direct yet minimal effect on trade openness. Similarly, high INFR dissuade foreign investors from investing in the economy. On the overall outcomes of the paper conform to cross-country analysis. Hence, the paper concludes that, foreign direct investment is a major overseas investment predictor which causes the SSA economy to be more open to trade. Premised on this, the paper submits that, government agencies and other relevant stakeholders in the SSA economy need to collaborate put in place flexible regulatory laws that guarantee the flows of more foreign direct capital investment into the SSA economy. The study developed a robust economic policy model for African economic policy makers desiring to improve the economic development of their economies through overseas investment inflows and trade openness. The model thus confirmed that, if policies are targeted at addressing the counter-productive effect of inflation and exchange rate interaction on both overseas investment inflows and trade openness, the African economy would be highly developed.

Keywords: Oversea Investment Inflows, Trade Policies, Sub-Saharan African Countries

Introduction

Over time, overseas investment inflows remain one of the most paramount tools through which countries of the world achieve sustainable economic development. Being a major policy tool, overseas investment, according to Osuji, Erhijakpor and Oliogu (2023), ensure that the receiving country to gain the needed capital for investment, increases competition in the originating country industries while ensuring that, indigenous firms are highly productive. Worth to note is that, overseas investment is typically an efficient means through which countries can bridge their savings-investment gaps (Oshiobugie, 2022). Generally speaking, overseas investment may flow into an economy through three (3) major channels which include: (i) foreign direct investment (FDI), (ii) foreign portfolio investment (FPI) and (iii) foreign institutional investment (FII). However, out of these three overseas investment channels, foreign direct investment and foreign portfolio investment are the most common overseas investment channels. Specifically, FPI as defined by the International Monetary Fund (2018), as cross-border transactions that involve stocks and bonds debt or equity securities, other than those included in direct investment or reserve assets (Sokang, 2018). FPI inflows entail investing in financial assets (stocks, bonds) by foreign investors on short term basis though on an exchange (Agbogun & Ehiedu, 2022). The major advantage of this investment approach/strategy is that, it is most favourable on a short term basis but on the long run, it may be undesirable. This is because such financial assets are sold off easily i.e. they are highly liquid.

Furthermore, Oshiobugie (2022) added that, FPI are not considered as short-term investments but an attempt to make short term profits. Again, FPI may be unfavourable especially if the receiving country is faced with financial turmoil and currency uncertainty. Meanwhile, foreign direct investment inflows are direct flow of foreign capital by foreign investors with the sole intent not just to own a substantial amount of the stocks of the receiving country but also to build a long lasting commitment to invest in the receiving country. According to the World Bank (2023), FDI involves the net inflows of investment into receiving country by foreign investor with the intent to acquire management interest say at least 10% voting rights on a long-term basis. In other words, it is the sum of equity capital, other long-term capital, reinvestment of earnings, and short-term capital as stated in the receiving country's balance of payments. Unlike FPI, most domestic investors in developing countries like Sub Saharan Africa prefer FDI since FDI is less vulnerable to crises. Consequently, participants in emerging and developing economies typically see FDI inflows reduce the receiving country's savings-investment gaps (Giwa, George, Okodua & Adediran, 2020). However, the extent to which foreign capital flows into an economy affects the degree of the country's openness to trade.

In recognition of the various advantages inherent in the inflows of overseas investments to the African economy, majority of African countries liberalized their trade regimes in the early 1980s. It is interesting to note that almost all countries adopted their biggest trade liberalization policies on their own. In other words, the policies were not implemented in line with an agreement with trading partners. However, a number of agreements with trading

partners have "locked in" the reform attempts. Most brazenly, during the multilateral Uruguay Round of the General Agreement on Tariffs and Trade (GATT), which resulted in the establishment of the World Trade Organization in 1995, African countries made vows to liberal trade practices. Through a series of regional trade agreements, some more significant than others, African countries have agreed to more open trade with one another. Openness and trade are presently African countries' top policy goals.

Tahir, Hasnu and Estrada (2018) posits that trade openness propels economic growth. Therefore, the policy makers and government authorities who are development oriented must have a critical understanding of the factors that affects trade openness and make policies that eliminate or reduce trade barriers that exist in the country. Trade policies that stimulate overseas investment inflows should be encouraged as it contributes towards economic growth. This further suggests that, the more an economy is open to trade, the more foreign investors are motivated to invest in the SSA economy.

Nevertheless, SSA countries are under-developed despite the huge inflows of overseas investment into the African economy. Even when some SSA countries have been exceptions to the trend and performed very well, the overall SSA performance still calls for concern. Justifiably, the Africa region's share of world merchandise trade, in terms of both exports and imports has drastically declined between 1990 and 2000. Since 2000, it has relatively not been stable (World Bank Report 2021). One major reason that may be attributed to this is that, most of the funds which flows from overseas are not used for developmental purposes and that some flows to the economy through unconventional means. This may be attributed to the poor trade policy formulation based on Agbogun and Ehiedu (2021) submissions. This submission is lay credence to the Lucas Paradox capital flight theory.

To the best of the researchers' knowledge, studies of this nature in the African context are relatively few. Secondly, the cover period of research is 2000—2017 study period is a great improvement in the above literature. Lastly, the choice of the research variables and recent econometrics techniques is a significant stride in the literature in finding factors affecting the patterns of attracting foreign direct investment in emerging sub-Saharan African countries. Hence, the main objective of the study is to empirically examine the effect of overseas investment inflows on trade policies in SSA countries. Specifically, the paper seeks to:

1. examine the effect of FDI inflows on trade policy in selected SSA countries;
2. Determine the effect of FPI inflows on trade policy in selected SSA countries.
3. Evaluate the mediating roles exchange rate has on overseas investment and trade policy in selected SSA countries.
4. Ascertain the mediating roles inflation rate has on overseas investment and trade policy in selected SSA countries.

The paper is divided into five (5) sections. The first section was tagged introduction while the second section was tagged the literature review. Further, the third section was tagged the research methodology while the fourth section was tagged the results and discussions. The last section dealt is dedicated to the concluding remarks and recommendations.

Literature Review

Conceptual Review

The term “oversea investment inflows” account for the movement of capital into the home country through international nations either in the form of foreign investment (FDI or FPI), loans from multilateral agencies, including the World Bank, or loans from the governments of International countries. Osuji, Erhijakpor and Oliogu (2023) noted that oversea investment inflow is the increase in the quantity of money transferred from overseas sources to a country in order to promote financial performance across the board as well as wealth creation. In this study, oversea investment inflows are measured by: FDI inflows and FPI inflows. According to Ngouhouo, Nchofoung and Kengdo (2021), FDI accounts for investments which are made outside the residential country of the investor to acquire a long lasting interest in an enterprise operating abroad. In other words, it is a foreign financial flow with the investor’s intention of either controlling or participating in the management of a firm in a foreign country.

In times past, Africa compared to other continents of the world was not a major recipient of FDI inflows. Recently, the FDI inflows into Africa countries have increased to a large extent. According to Ezeanyej and Ifeako (2019) FPI inflows account for transfer of financial assets such as bonds, stocks, and cash across different countries of the world with the sole intent to maximize profit. Specifically, FPI occurs when investor(s) buy non-controlling interests in foreign companies or purchase short-term assets or notes, foreign government or corporate bonds (Onuora, 2019). FPI does not confer direct right of ownership on the investor for the financial asset purchased or control over the company invested in. Hence, FPI inflows is considered as a form of indirect investment. Accordingly, just as how the trade flows emanates from individuals and countries desiring to optimize their wellbeing by exploiting their own comparative advantage, so too, are capital flows as individuals and countries seeking to make themselves better off.

Meanwhile, trade policy accounts for policies that are directed at improving the flows of goods within and outside the shores of a country. A conventional measure of trade policy is degree of openness to trade. This parameter being degree of openness to trade according to Agobgun and Ehiedu (2022) accounts for how a country’s trade policies supports trade interactions/negotiations with the rest of the world. It therefore accounts for the proportion of a country’s aggregate exports and imports in relation to the country’s GDP.

Theoretical framework

The work's foundation is the Dunning eclectic model. John Dunning created the theory in 1976 (Dunning, 1977). It investigates the connections between the various business components. The Dunning theory offers a foundation for growth via FDI, or foreign direct investment. It significantly contributes to the development of global strategy as well as the separation of international business studies (IBS) and international economics.

Cantwell (2015) asserts that Dunning's Eclectic Paradigm is employed to account for the rise of multinational operations. Due to its inclusiveness, Dunning's Eclectic Model allowed

organizational studies and business strategy to have a greater influence on the study of multinational corporations. The Eclectic Model offers a framework for both descriptive and normative analyses of individual organizations but is intended for the study of multinational firms rather than judging individual corporate actions.

The theory postulated that a company's level and structure of foreign value-adding activities will depend on meeting three conditions: (1) unique and sustainable ownership of specific advantages compared to other firms (Ownership Advantages-"O"); (2) the extent to which the company perceives it is useful to add to its O advantages rather than selling them to other foreign firms (Internalization Advantages-"I"); and (3) the degree to which companies are interested in a foreign location (Location Advantages – "L"). From the perspectives of location endowments, the degree of control over the foreign investment, and the kinds of ownership advantages firms must have &/or develop to attract FDI (Dunning, 1977).

Although Dunning's approach has gained a lot of traction, for a very long time, IB literature has placed a lot more emphasis on ownership or internalization advantages than on location (Cantwell, 2009). Researchers have studied the determinants of FDI using a range of geographic parameters (Jain, Kothari & Kumar, 2016), methodological approaches, degrees of analysis, and forms of empirical evidence (Nielsen, Asmussen, & Weatherall, 2017).

Empirical Review

Using bilateral data, Ding, Jin, Liu and Xie (2019) studied the relationship that exists between foreign trade and capital flow from 2001-2016. It was discovered that on the long-run, positive relationship exists between trade and capital flow but on the short-run capital flow has a predictive power on trade.

Gbalam and Timipere (2020) considered the effect foreign direct investment has on stock market development in Nigeria. The researcher adopted the after effect research design using historical data culled from the Nigerian exchange group spanning from 1985-2018. Results from the Engle Granger error correction method indicated market capitalization and value of deals exert a positive effect on FDI inflows while all share index exert a negative effect on FDI.

In a study by Osuji, Erhijakpor and Oliogu (2023), the macroeconomic drivers of foreign investment inflows in SSA for forty (40) years from 1982-2021 were examined. The data used for the analysis was generated from CBN statistical bulletin (2021). The result showed inflation rate, exchange rate and degree of trade openness as measures of international inflow in SSA countries.

In a similar study Ewubare and Ezekwe (2017), studied the existing link between trade liberalization and capital flows in Nigeria from 1986 to 2015. The data for study were culled from World Bank development indicators, United Nations conference on trade and development and CBN statistical bulletin. On the long run the result evidenced that trade openness exert a negative influence on FDI while tariffs and exchange rate reduces FDI flows into Nigeria.

Ehigiamusoe and Lean (2019) examined foreign capital inflows impact on economic growth in Nigeria for 1980 to 2015. The researchers adopted the autoregressive distributed lag

(ARDL) test and found a relationship between foreign capital inflows and growth. FPI exerted a positive effect on growth, while foreign loans exerted a negative impact. On the other hand, FDI and foreign aid had an insignificant effect on growth, implying reliance on FDI and foreign aid does not stimulate growth of the Nigerian economy rather FPI and foreign loans tend to growth of the economy.

Anetor (2020) analyzed the role foreign capital inflows play in the growth of developing countries using Nigeria as a case study from 1986 to 2016. The outcome of the impulse response function-IRF and forecast error variance decomposition-FEVD showed the existence of a significant positive association between FDI and financial development.

Similarly, Ngouhouo, Nchofoung and Kengdo (2021) analyzed factors that determine trade openness in 36 sampled SSA countries with focus on domestic institutions from 1996-2017. The result from the generalized methods of moments (GMM) estimation showed that domestic institutions is a major determinant of trade openness. Also, regulatory quality, government effectiveness and rule of law enhances trade openness. It was discovered that FDI had a positive influence on trade openness.

In another study, Tsaurai (2021) examined trade openness determinants in transitional economies with focus on FDI and human capital development. Using panel data collated from 2000 to 2018 the result from the regression unveiled a positive significant effect between FDI and human capital development, economic growth and mining sector growth on trade openness in a transitional economy.

Again, Naz, Akram and Khan (2023) explored using panel data from 1996 to 2020 macroeconomic determinants of trade openness. The findings revealed that GDPG and FDI had significant and direct relationship with trade openness while lending rate, political stability index, control of corruption and population exert a negative effect on trade openness.

Rao, Sethi, Dash and Bhujabal (2023) investigated foreign aid, FDI and economic growth in south East Asia and south Asia. It was discovered that foreign aid had negative effect on FDI and growth while FDI exerted a negative effect on growth.

Research Method

The study adopted the longitudinal research design since the variables under investigation exist over a long period of time. The study collated from the World Bank data base, 2021. The essence is that, it may be time consuming and clumsy for the researchers to sort data from the individual country. Evidently, the study sampled 30 SSA countries out of the 48 countries in SSA. The basis for choosing 30 SSA countries out of the 48 countries in SSA is informed on the basis of data availability over the reviewed period of 1992 to 2021. Hence, the sample was purposively selected by the researchers. Meanwhile, the estimation technique considered is the Robust Panel regression estimation technique (Panel Corrected Standard Linear Model). This is because unlike the conventional panel regression approach (Random or Fixed Effect Model), the Robust Panel regression estimation addresses both normality and variable perturbation issues. Justifiably, the reviewed variables exhibited both

time series (1992 to 2021) and cross-sectional data (48 countries). Various preliminary analyses considered are correlation analysis, variance inflation factors, Heteroskedasticity test and Ramsey Reset Test (RRT).

In consonance with findings from empirical work done by Osuji, Erhijakpor & Oliogu (2023), Ngouhouo, Nchofoung and Kengdo (2021); Nga (2020) and Ehigiamusoe and Lean (2019) the functional model is represented by Eqn 1.

$$\text{TROP} = f(\text{FDI}, \text{FPI}, \text{EXR}, \text{INFR}) \dots \text{eqn. 1.}$$

In this study degree of trade openness is used as a surrogate for trade policy (TOP) while foreign direct investment-FDI inflows, foreign portfolio investment-FPI inflows are the surrogate for overseas investment inflows. Econometric form of the model in equation 1 is shown in equation 2:

$$\text{TROP} = \beta_0 + \beta_1 \text{FDI} + \beta_2 \text{FPI} + \beta_3 \text{EXR} + \beta_4 \text{INFR} + \mu \dots \text{eqn. 2.}$$

Where:

FDI = Foreign direct investment inflows

FPI = Foreign portfolio investment inflows

EXR = Exchange rate

INFR = Inflation rate

TOP = Trade Openness

Table 1: Operationalization of Study Variables

Denotations	Target Variables	Measure & Nature of Variables	Apriori Expectation
EXR	Exchange Rate	Official exchange rate (Control Variable)	Positive
INFR	Inflation Rate	Consumer prices (annual %) (Control Variable)	Negative
TROP	Trade Openness	Trade(% of GDP) (Dependent Variable)	Nil
FDI	Foreign Direct Investment inflows	Annual FDI inflows to GDP (Independent Variable)	Nil
FPI	Foreign Portfolio Investment inflows	Annual FPI inflows to GDP (Independent Variable)	Nil

Researcher's Compilation (2023)

Results and Discussion

Preliminary Analysis

Prior to presenting the main regression, the preliminary analyses are presented in Table 2 and 3:

Table 2: Descriptive Statistics

	FDI (\$'000)	FPI (\$'000)	EXR (\$)	INFR (%)	TROP (%)
Mean	4,130,000	1,200,000	290.89	11.80	66.88
Maximum	10,000,000	2,320,000	3727.07	38.82	78.46
Minimum	7,400,890	800,811	0.0028	13.06	44.20
Std. Dev.	1,200,000	780,000	505.58	20.44	23.00
Observations	900	900	900	900	900

*Observation 30 Periods*30 SSA countries*

Source: E-Views 9.0 (2023)

Table 2 evidenced that, the average FDI inflows is \$4,130,000,000 but deviated by \$1,200,000,000. Meanwhile, the highest FDI which flows into the SSA economy within the reviewed periods of 1992 to 2021 was \$10,000,000,000 while the least FDI which flows into the SSA economy within the reviewed periods of 1992 to 2021 was \$780,000,000. On the other hand, the average FPI inflows is \$1,200,000,000 but deviated by \$780,000,000. Meanwhile, the highest FPI which flows into the SSA economy within the reviewed periods of 1992 to 2021 was \$2,320,000,000 while the least FPI which flows into the SSA economy within the reviewed periods of 1992 to 2021 was \$800,811,000.

Additionally, Exchange rate (EXR) had an average value of 290.89/\$1 but fluctuated by 505.58/\$1. This signals that, EXR deviated far away from its mean value throughout the studied periods since its standard deviation value is far higher than its mean value. Also, all the countries in SSA reported maximum EXR of 52.07 and minimum EXR of 0.0028/\$1. Meanwhile, the highest inflation rate was 38.82% but fluctuated by 20.44%. This signals that, EXR deviated far away from fluctuated within it mean value.

Lastly, trade openness expressed by the proportion of exports and imports to GDP was 66.88% on the average but deviated by 23.00%. Meanwhile, the highest TOP which flows into the SSA economy within the reviewed periods of 1992 to 2021 was 44.20% while the least TOP which flows into the SSA economy within the reviewed periods of 1992 to 2021 was 78.46%.

Table 3: Correlation and Multi-collinearity Test

Variables	TROP	FDI	FPI	EXR	INFR	VIF	TOV=1/VIF
TROP	1.0000						
FDI	0.7943	1.0000				2.0339	0.4917
FPI	0.5103	0.1109	1.0000			1.0987	0.9102
EXR	0.3999	-0.2238	0.3582	1.0000		2.0490	0.4880
INFR	-0.2103	0.0959	0.2744	-0.4650	1.0000	2.0248	0.4939
Average						1.8016	0.5959

Note: VIF is Variance Inflation Factors; TOV is Tolerance

From the correlation analysis in table 2, FPI ($r=0.7943$) and FDI ($r=0.5103$) and EXR ($r=0.3999$) are positively related with TOP. By implication, the more the SSA economies are open to trade, the more FDI and FPI flows into the SSA economy. However, INFR ($r=-0.2103$) are negatively related with TOP. By implication, higher the inflation rate, the lower the TOP.

On the overall, none of the independent variables are highly correlated since none of their correlation coefficient were up to 70%. When tested further the average VIF was $1.8016 > 10$ while the $0.5959 > 0.10$ is free from multi-collinearity issues.

Regression Estimate

To ensure that, the regression estimate is critical to policy formulation, the robust regression estimate is presented thus:

Table 4: Robust Regression (Panel Corrected Standard Error)

Dependent Variable: TROP				
Method: Panel Corrected Standard Error				
Total Panel Observation : 900 (time scope : 1992 -2021 over 30 SSA Countries)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	14.44932	1.803918	8.009964	0.0000
FDI	0.977169	0.152010	6.428327	0.0007
FPI	0.005328	0.015324	0.347721	0.7399
EXR	0.341987	0.136039	2.513884	0.0307
INFR	-0.610904	0.123435	-4.949188	0.0008
Robust Panel Parameter Estimates				
R-squared	0.687746	Adjusted R-squared		0.548966
Mean dependent var	15.55786	S.D. dependent var		2.130602
F-statistic	13.86716	Prob(F-statistic)		0.000908
Durbin-Watson stat				2.023406
Panel Diagnostic Test Estimates				
Panel Diagnostic Test	F-statistic	Prob Value	Interpretation of Panel Diagnostic Tests	
1. Hausman Test	1.866103	0.1992	Random Effect Model is Preferred	
2. Ramsey Reset Test	5.024669	0.1700	None of the Variables are omitted	
3. Heteroskedasticity Test	0.509074	0.9169	Residual of the series spread Evenly	

Source: Researchers' Compilation based on E-Views 9.0 Output (2023)

From the regression estimate, the study reported that, R-squared value of 0.687746 and adjusted R-squared value of 0.548966. This reveals that, the model has a high predictive power. This further suggests that, overseas investment alongside the control variables (EXR & INFR) accounted for 68.77% while the remaining 31.23% is accounted for the error term. Although, the model has a high predictive power but caution must be taken as it may not suggest that, the model is devoid of serial correlation. When tested further, the model reported Durbin-Watson stat value of 2.023406 suggesting that, the model is free from serial auto-correlation. Again, the prob. joint statistics (Prob(F-statistic)) of 0.000908 suggests that, the overseas investment jointly have high statistical significant effect on trade openness. This suggests that, overseas investment jointly are major predictors of trade openness

When tested further, the Hausman Test reported a prob. value of 0.1992 suggests that, Random Effect Model is Preferred. However, to avoid variable perturbation issue, the model was subjected the Ramsey Reset Test (RRT). The RRT reported a p-value of 0.1700 which suggests that, none of the variables are omitted. Meanwhile, the Heteroskedasticity test reported a prob. value of 0.9169 suggests that the residual of the series spread evenly. On this basis, the individual variables were discussed

Firstly, the study reported that, FDI has a positive coefficient value of 0.977169, positive t-value of $6.428327 > 1.96$; and a prob. value of $0.0007 < 0.05$. By implication, the more FDI flows into the SSA countries, the more the SSA economy open to trade. This further suggests that, FDI inflows are a major predictor of trade openness. This hold credence to the Hamod-Domar and cheery theory which states that, through FDI inflows countries can bridge their development gaps. Hence, the study suggests that, FD inflows are one of the best forms of foreign finance. This is rationalized on the ground that, through FDI multinational companies can take advantage of their technological superiorities over their domestic counterparts. In like manner, EXR has a positive significant effect on TROP. This suggests that, the more the cost of exchange dollar for the domestic currency increases, the SSA economy will be more open for foreign investors to invest in the SSA economy. This supports the currency devaluation policy.

Furthermore, the study reported that, FDI has a positive coefficient value of 0.005328, positive t-value of $0.347721 < 1.96$; and a prob. value of $0.7399 > 0.05$. By implication, the more FPI inflows into the SSA countries has a direct yet minimal effect on TROP. This further suggests that, the volumes of FPI inflows are not a major predictor of TROP. However, INFR dissuade foreign investors from investing in the economy. This justify why FPI inflows is considered not advantageous to foreign investors during macroeconomic upheavals. This is in tandem with the Apriori Expectation of this Study.

Conclusion

The current paper attempts to ascertain if exchange rate and inflation rate matter in the dynamic linkage between overseas investment (FDI & FPI) inflows and trade openness in the case of the SSA Economy. The overall outcomes of the paper conform to cross-country analysis. Hence, the paper concludes that, foreign direct investment is a major overseas investment predictor which causes the SSA economy to be more open to trade. Premised on this, the paper submits that, government agencies and other relevant stakeholders in the SSA economy need to collaborate put in place flexible regulatory laws that guarantee the flows of more foreign direct capital investment into the SSA economy. Again, the government of SSA economy need to re-evaluate its foreign exchange policies since the domestic currencies in SSA continues to devalue. Lastly, government in SSA economy should invest more of the revenue from overseas investment on infrastructural development, human capital development and technology. This would reduce the rising case of inflation rate recorded over the years

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Oversea Investment Inflows and Trade Policies in Sub-Sahara African Countries

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