

Assessing the Impact of Government Expenditure on Private Investment in Nigeria

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Abstract

This study empirically examines the impact of government expenditure in Nigeria from 1986-2016. Time series data and econometric tools were used to test for the stationarity, and co-integration, while Auto Regressive Distributed Lag Model were adopted to estimate the long-run and short run impact of government expenditure and private investment in Nigeria. The study revealed that at the long run Government Recurrent Expenditure (GRECEXP) and Inflation Rate (INFR) were positively related to Private Investment in Nigeria while Government Capital Expenditure (GCAPEXP) and Interest Rate in Nigeria (INTR) were negatively related to Private Investment. Also, at the short run all the independent variables were positively related Private Investment in Nigeria except interest rate as lag one. Therefore, the study recommends that Government should designed monitoring and evaluating mechanism to improve the efficiency and effectiveness of government capital expenditure and recurrent expenditure in Nigeria since government capital expenditure was statistically insignificant in determining the improvement of Private Investment in Nigeria.

Keywords: *Expenditure, Government, Private Investment*

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Background to the Study

Economic studies have proven that investment is, both empirically and theoretically, the key determinant to economic growth and sustainability. Economic growth refers to an increase in a country's production or income per capita. It is usually measured by gross national product (GNP) or gross national income (GNI), used interchangeably, an economy's total output of goods and services. Investment is the source of manufactured goods that will be used to produce other goods (Mustefa, 2014).

It is the major foundation of enhancement in the level of literacy, improvement in technology and increase in the capital stock (Hashmi, Akram and Hashmi, 2012). A rate of investment is one of the key factors that differentiate developed countries from developing countries. In high-growth countries investment is high, where as it is low in low growth countries. The implication of low investment is that the productive capacity of the economy fails to increase. This in turn leads to lower rates of growth and job creation, and fewer opportunities for the poor to improve their livelihoods (White, 2005).

As of Sackey (2007) countries with high standards of living are those who have shifted the economic structure from traditional and less diversified to a more diversified one. Commitment to investment is the central issue in the process of structural diversification. Investment promotion is one key instrument and primary engine of economic growth (Mustefa, 2014). As a result due attention has been given to development of private sector in developing country like Nigeria to help improve economic growth (Ouattara, 2004).

Reliable and continuous increase in domestic private investment also helps in reduction of poverty. Understanding the status and determinants of private investment is essential for successful and effective implementation of sustainable development goals (SDGs). According UN World Investment Report (UN, 2014) SDGs will require huge levels of private investment in all countries because the private investment play a crucial role in developing country like Nigeria. However, for the private sector investment to increase public finances are considered as central to investment in SDGs, they cannot meet all SDG-implied resource demands.

So far, various studies like Jalloh (2002), Kaputo (2011), Augustine (2014), Agu (2015) and many others were conducted to identify the determinants of private investment has shown that public finance especially public investment expenditure play a very important part in increasing the level of private investment especially in developing countries. Public investment expenditure is an influential variable that determines private investment. The role of public investment is seen from two aspects. On one hand public investment, in the form basic infrastructures, is a complement to private investment and hence promote private sector expansion and development. On the other hand, public expenditure is a competent of private sector and hence, reduces the amount of money available for them. As of Adugna (2013) Ouattara (2004), and Molapo and Damane (2015), Public investment expenditure directly contributes for private investment development. According to them public extensive investments on basic

infrastructures-such as roads, energy and telecommunication creates conducive environment for investment.

In Nigeria, there have been increased level of public investment expenditure toward the improvement of private investment .It has been observed that despite the importance accorded private investment as the prime mover of the economy, government interest and renewed effort in promoting it, after many years of economic adjustment and various economic reform programmes of successive governments, available relevant economic indicators show slow and minimal improvement in private investment in Nigeria. The share of private investment in GDP which was 14.6% in 1973 gradually fell to 5.9% in 1980 and 2.0% in 1985. During the structural adjustment period of 1986 to 1992, there was minimal improvement. In 1994, the share of private investment in GDP reduced to less than 0.5%. With the advent of civilian administration in Nigeria in 1999, the share of private investment in GDP rose to 13.0% and 16.2% in 1999 and 2002 respectively.

However, there have been a progressive declined since then to 12.0% in 2005. Also in 2008 the share of private investment in GDP declined to 6.3%. But from 2010 to 2016 the average private investment in GDP is about 8.4%. The perceptible slide in the ratio of private sector investment to GDP despite the emphasis on private sector following the initiation of public sector reform is worrisome. Therefore, the main objective of the study is to examine the impact of government expenditure on private investment in Nigeria. While the specific objectives are to:

- i. Investigate the impact of government capital expenditure on private investment in Nigeria.
- ii. Evaluate the impact of government recurrent expenditure on private investment in Nigeria.

Literature Review

Conceptual Review

Investment can be defined as the outlay of money for future use. It is a venture in real asset; real assets consist of physical things such as factories, land, capital goods, infrastructure, inventories etc. (Tawiri, 2012). Also, Fakiyesi (2008) described investment as “the process on incremental change in capital stock whereby a society set aside part of its current productive resources to create material and human capital. This incremental change is usually purposive in the sense that it is designed to enhance the future stream of earnings. For investment to take place, certain amount of wealth must be transferred from one ownership or employment to another. It involves trading off of present consumption for the future.

Private domestic investment refers to gross fixed capital formation plus net changes in the level of inventories, whereas public investment includes investment by government and public enterprises on social and economic infrastructure, real estate and tangible assets (Bakare, 2011). The combination of both private and public investments is referred to as gross fixed capital formation in order to distinguish them from their counterpart, foreign

investment. When foreign investment is on tangible asset, it is referred to as direct foreign investment and called portfolio investment when it is on shares, bonds and securities.

While, According to Oziengbe (2013) government expenditure refers to expenses incurred by the government for the maintenance of itself and provision of public goods, services and works needed to foster or promote economic growth and improve the welfare of people in the society. Government (public) expenditures are generally categorized into capital and recurrent components. Capital expenditure refers to the amount spent in the acquisition of fixed (productive) assets (whose useful life extends beyond the accounting or fiscal year), as well as expenditure incurred in the upgrade/improvement of existing fixed assets such as lands, building, roads, machines and equipment, etc., including intangible assets. Expenditure in research also falls within this component of government expenditure. Capital expenditure is usually seen as expenditure creating future benefits, as there could be some lags between when it is incurred and when it takes effect on the economy. Recurrent expenditure on the other hand refers to expenditure on purchase of goods and services, wages and salaries, operations as well as current grants and subsidies (usually classified as transfer payments). Recurrent expenditure, excluding transfer payments, is also referred to as government final consumption expenditure.

Empirical Review

Several empirical studies have been carried on public expenditure and investment among them are Voss (2002) explored the short- and long-term interactions between government investment and private investment with reference to Canada and the USA in 1947:Q1-1988:Q1 period by using VAR analysis based on Jorgensen's Neo-classical model of investment. He demonstrated that there is no evidence of crowding-in due to complementarities between government and private investment in both the USA and Canada. His findings, on the contrary, suggested that innovations to government investment tended to crowd-out private investment. Quattara (2005) explored the long-term determinants of private saving in Senegal for the period of 1970-2000. He explored that private investment is positively affected by government investment while credit to private sector and terms of trade affect negatively it. Based on his findings, he argued that the positive impact of public investment on private investment, triggering public sector resources to the end of capital accumulation, is a useful channel to boost private sector development in Senegal.

Khan and Gill (2009) performed a study by using exactly the same models as Majumder (2007). They estimated the relationship between public borrowing, GDP, and lending in Pakistan with time series data of 34 years covering fiscal year of 1971-1972 to 2005-2006. Their empirical findings did not corroborate the crowding-out hypothesis in Pakistan due to the market imperfections and substantial amount of excess liquidity. On the contrary, their findings provided evidence of crowding-in effect, which could be explained by the direction of government expenditures towards private sector through contractors, politicians and bureaucrats, instead of public projects.

Another study done by Afonso and Aubyn (2010) also used a VAR model but for 14 EU countries, Canada, Japan, and the USA for the sub-period of 1960-2005. Their empirical findings indicated that both government and private investments have a positive effect on output; whereas, government investment crowds-out private investment in a significant number of countries. On their findings, they argued that government investment can either crowd-in or crowd-out private investment. In strong crowding-out cases, it is possible that an increased government investment could lead to a decrease in GDP. Besides, government investment had a contractionary effect on output in the cases of Belgium, Ireland, Canada, the UK and the Netherlands with positive government investment impulses, creating a crowding-out effect. On the other hand, expansionary effects and crowding-in prevailed in the cases of Austria, Germany, Denmark, Finland, Greece, Portugal, Spain and Sweden.

The provision of subsidy, transfer payments, and the substantial amount of micro-credit also explain the phenomenon of crowding-in effect in this country. One of these studies belongs to Kollamparambil and Nicolaou (2011). They employed unit root test and VAR analysis to South Africa for three different periods, 1946-2005, and 1960:Q1-2006:Q1, and 1965-2005. They found that government investment does neither crowd-in nor crowd-out private investment, but it creates an indirect effect on private investment through accelerator.

In Nigeria, Chude and Chude (2013) investigated the effects of public expenditure in education on economic growth in Nigeria over a period from 1977 to 2012, with particular focus on disaggregated and sectoral expenditures analysis. The results indicated that Total Expenditure on Education is highly and statistically significant and have positive relationship on economic growth in Nigeria in the long run. The result has an important implication in terms of policy and budget implementation in Nigerian. They conclude that economic growth is clearly impacted by factors both exogenous and endogenous to the public expenditure in Nigeria.

Also, Kareem, Bakare, Ademoyewa, Bashir, Ologunla and Arije (2014) investigated the impact of public sector spending on economic growth in Nigeria for the period spanning from 1960-2010. The result shows that recurrent and capital expenditure contributed positively to economic growth in Nigeria with particular reference to the period under review, the result also revealed that capital and recurrent expenditures are statistically significant at 1% level. The study concluded that the government recurrent and capital expenditure have significant influence on economic growth in Nigeria.

Finally, Udo (2016) Examined issues on and determinants of private investment in Nigeria. The study established that the expected sustained improvement in the level of private investment has been greatly constrained by the adverse impacts exerted by most of the determinants of private investment. The study has identified determinants of private investment in Nigeria to include domestic inflation rate, size and growth rate of market, availability and access to bank credit, interest rate, fiscal deficits, public

investment rate, poor provision of infrastructure, political and economic stability, investment climate and institutional factors.

Theoretical Framework

The adopted the Wagner's Law of Increasing State Activity and government expenditure as a theoretical framework. The Law of increasing State activity was propounded by Adolf Wagner a nineteenth century German Economist to explain the growth of the share of public expenditures in Gross National Product (GNP). He divided government expenditures into three categories, namely, administration and defense; cultural and welfare, and provision of direct services by government in case of market failure. It is well known that rather than allow for monopoly to emerge, government usually creates Statutory Corporations such as Hospitals, Schools, Nigerian Telecommunications Limited (NITEL), Post Office, Water Boards, and Power Holding Company of Nigeria (PHCN) to cater for the welfare of the people.

Wagner's Law states that as per-capita income increases, the relative size of the public sector will grow. According to Wagner as the economy becomes industrialized, population tends to concentrate in the urban areas. This in turn leads to externalities (market failure) and congestion which require government intervention and regulations. Legal authorities and the police emerge to address problems of law and order, peace and security. Banking services by the State arise to link surplus funds with those who have the investment opportunities. The increase of public expenditures on education, recreation, health, and welfare services is explained in terms of the high population in the urban centers. Wagner argued that as real income increase, public expenditures on education, health etc. would increase more than the increase in real income. This explains the increasing ratio of government expenditure to Gross National Product (GNP).

Wagner's theory of increasing State activity has many defects. First, it is not a well-articulated theory of public wants; rather it is an organic theory of the State where the State behaves as if it were an individual and takes decisions independent of members of the society. Secondly, the predictive power of the theory is very much in doubt. It is not always true that as par-capita income grows, the share of public expenditures in GNP increases. The share of public expenditure may actually decrease as the economy grows particularly when the private sector is strong and dynamic.

Methodology

Sources of Data and Method of Analysis

The study to utilized annual time series data spanning from 1986 to 2016. Data were obtained mainly from the Central Bank of Nigeria (CBN) Statistical Bulletin and National Bureau of Statistics (NBS) Publications. The data are Private Investment, Government Capital Expenditure, Government Recurrent Expenditure, Inflation Rate in Nigeria and Interest Rate in Nigeria See regression data in Table 4.1 and Appendix I. The study used the Auto Regressive Distributed Lag Model techniques were used to examine the short run and long run impact and relationship between Government Expenditure and Private Investment in Nigeria.

Model Specification

The most important concern of the paper is to quantify the factors that influence the behaviour of private investment in Nigeria. Udo (2016) analyzed the determinants of private investment. The instrument to be linked to private investment in Nigeria thus include: Private investment in Nigeria, government expenditure (capital and recurrent), inflation and Interest Rate in Nigeria. The model is specified below:

$$LPINV = \alpha_0 + \beta_1 LCAEXP + \beta_2 LRECEXP + \beta_3 LINFR + \beta_4 LINTR + Ut \quad (1)$$

Where: Ut is the error term and $\beta_1 - \beta_3$ represents the various parameters. While $PINV$ is the Private investment, which is composed of all domestic investment in Nigeria. It excludes foreign direct investment, $GCAEXP$ is the Government capital expenditure, $GRECEXP$ is the Government recurrent expenditure, $INFR$ is the inflation rate in Nigeria and $INTR$ is the interest rate in Nigeria which is the commercial bank lending rate to private investors.

To formulate Error Correction Model (ECM) it will begins with the Ordinary Least Squares (OLS) stated in equation 1. From the equation above, the Error Correction Model (ECM) is formulated as follows:

$$\begin{aligned} \Delta LPINV_t = & \alpha_0 + \sum_{i=1}^m \alpha_{1i} \Delta LGCAEXP_{t-i} + \sum_{j=0}^n \alpha_{2i} \Delta LRECEXP_{t-j} + \sum_{k=0}^o \alpha_{3i} \Delta LINFR_{t-k} \\ & + \sum_{l=0}^p \alpha_{3i} \Delta LINTR_{t-l} + ECM_{t-1} + \varepsilon_t \quad (2) \end{aligned}$$

The model above is used to adjust the estimation until the ECM turned negative. The negative sign of coefficient of the error correction term ECM (-1) shows the statistical significance of the equation in terms of its associated t-value and probability value.

Presentation and Discussion of Results
Descriptive Analysis of Variables
Table 1: Descriptive Analysis of Variables

	PINV	GCAPEXP	GRECEXP	INFR	INTR
Mean	464.1407	488.4337	1420.929	18.91000	23.59556
Median	248.2000	438.7000	984.3000	12.60000	22.51000
Maximum	1360.300	1152.800	4178.590	72.80000	36.09000
Minimum	4.700000	24.05000	36.22000	5.400000	18.36000
Std. Dev.	449.3240	355.6934	1424.743	17.71365	4.199184
Skewness	0.579217	0.308325	0.682838	1.901352	1.199716
Kurtosis	1.883372	1.827143	1.926255	5.397003	4.210046
Jarque-Bera	2.912432	1.975333	3.395252	22.73195	8.124174
Probability	0.233117	0.372445	0.183118	0.000012	0.017213
Sum	12531.80	13187.71	38365.09	510.5700	637.0800
Sum Sq. Dev.	5249194.	3289463.	52777238	8158.104	458.4619
Observations	27	27	27	27	27

Source: Output from E-views 9.0 (2018)

The summary of descriptive statistics of relevant variables of study is as reported in Table 1, as may be observed from the table, the mean, median, standard deviation as well as the skewness and kurtosis measures of our variables of interest are given. The mean values of PINV, GCAPEXP, GRECEXP, INFR and INTR are 464.1407, 488.4337, 1420.929, 18.91000 and 23.59556 respectively. Their respective standard deviations are 449.3240, 355.6934, 1424.743, 17.71365 and 4.199184. The Jarque-Bera test of normality shows that the error term in our specified equation is normally distributed. This is evidenced by the respective insignificant Jarque-Bera statistics of the relevant variables.

Trend Analysis of the Variables

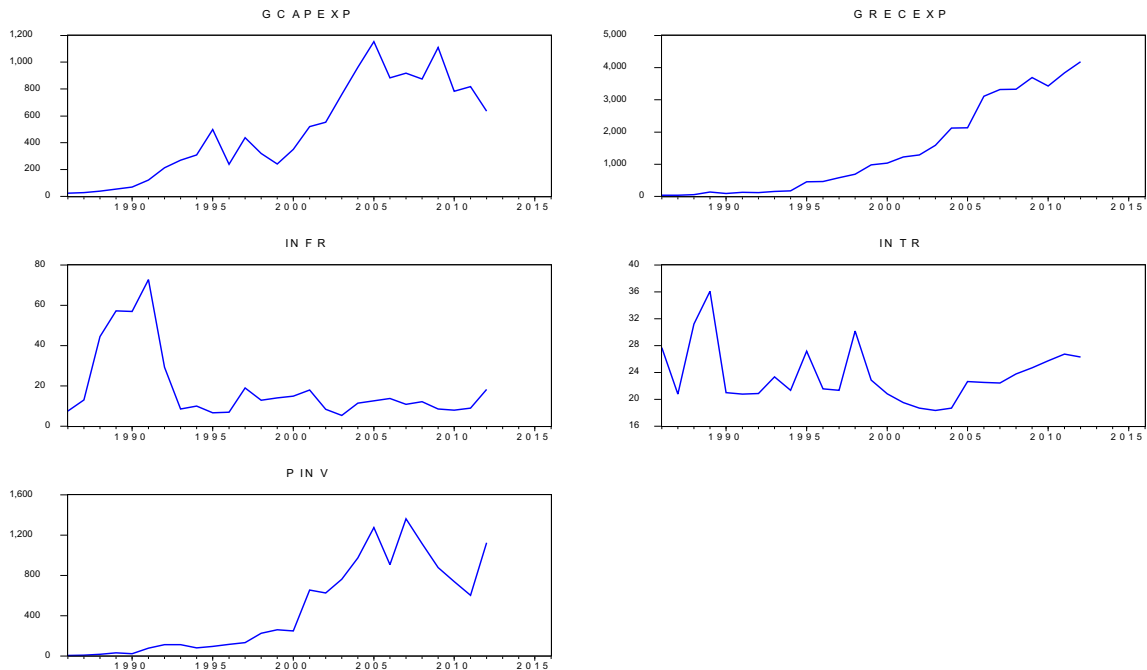


Figure 1. Trend Analysis

Graphically, the trend analyses showed that the variables fluctuates at one point or the other during the period under review. This was attributed to the effects of government expenditure and private investment conditions that would have had attendant effects on some of the variables

Stationarity Test of Variables

Table 2: Augmented Dickey-Fuller Test

Variables	ADF Statistics	Critical Value	Stationary Status
PINV	-6.095209	-3.724070(1%) -2.986225(5%) -2.632604(10%)	I(1)
GCAPEXP	-6.406894	-3.724070(1%) -2.986225(5%) -2.632604(10%)	I(1)
GRECEXP	-5.515830	-3.724070(1%) -2.986225(5%) -2.632604(10%)	I(1)
INFR	-4.048171	-3.724070(1%) -2.986225(5%) -2.632604(10%)	I(1)
INTR	-3.732564	-3.711457(1%) -2.981038(5%) -2.629906(10%)	I(0)

The critical values for rejection of hypothesis of unit root were from MacKinnon (1991) as reported in e views 9.0.

Source: Output from E-views 9.0 (2018)

Table 2 shows the Augmented Dickey-Fuller stationarity test results of the eleven economic variables used in this study. From the results, all the economic variables were stationary at various levels but Interest Rate was stationary at level while Private Investment, Government Capital Expenditure, Government Recurrent Expenditure and Inflation Rate in Nigeria were at first difference. This implies that the economic variables are fit and suitable to be used for the analysis.

Pairwise Granger Causality Tests

Table 3: Pairwise Granger Causality Tests

Null Hypothesis:	Obs	F-Statistic	Prob.
GRECEXP does not Granger Cause PINV	25	9.02417	0.0016
PINV does not Granger Cause GRECEXP		2.69648	0.0919
GCAPEXP does not Granger Cause GRECEXP		5.40132	0.0133
GCAPEXP does not Granger Cause INFR		1.78091	0.1942
INTR does not Granger Cause GCAPEXP	25	5.60542	0.0117
INTR does not Granger Cause INFR	25	7.24644	0.0043

Source: Output from E-views 9.0 (2018)

The table 3 shows the Pairwise Granger Causality Tests, from the results all the listed pair of variables have causal relationship among them. That is there is a causal relationship among the variables given the probability values of the variables at 5 percent level of significance. Therefore, the null hypotheses which stated that there are no causal relationships among variables are rejected

Co-integration

Table 4: ARDL Bounds Test of Co-integration

Null Hypothesis: No long-run relationships exist		
Test Statistic	Value	K
F-statistic	10.34331	4
Critical Value Bounds		
Significance	I0 Bound	I1 Bound
10%	2.45	3.52
5%	2.86	4.01
2.5%	3.25	4.49
1%	3.74	5.06

Source: Output from E-views 9.0 (2018)

The Co-integration test was done using the ARDL Bound test equation in table 4. This became necessary to avoid a spurious regression result. Using the ARDL Bound test with critical value from Narayan (2005), the variables were co-integrated at 1per cent level of significance since the Wald F- statistics is greater than the critical lower and upper bound.

Discussion of Regression Results

Table 5: Long-Run Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
GCAPEXP	-0.208064	0.383065	-0.543156	0.5970
GRECEXP	0.296425	0.076068	3.896848	0.0021
INFR	6.179647	2.363958	2.614110	0.0226
INTR	-66.799151	20.871705	-3.200464	0.0076
C	1467.948098	518.779937	2.829616	0.0152

Source: Output from E-views 9.0 (2018)

From the long-run regression results obtained in Table 5 the following interpretation can be inferred; a unit increase in Government Recurrent Expenditure (GRECEXP) and Inflation Rate (INFR) on the average holding other independent variables constant will lead to 0.296425 and 6.179647 unit increase in Private Investment respectively. A unit increase Government Capital Expenditure (GCAPEXP) and Interest Rate in Nigeria (INTR) on the average holding other independent variables constant will lead to 0.208064 and 66.799151 unit decrease in Private Investment respectively. Finally, based on the probability value, the Government Recurrent Expenditure (GRECEXP), Inflation Rate (INFR) and Interest Rate in Nigeria (INTR) were statistically significant in explaining the variation in Private Investment in Nigeria while the Government Capital Expenditure (GCAPEXP) were statistically insignificant in explaining the variation in Private Investment in Nigeria.

Table 6: The Error Correction Model Results

Selected Model: ARDL(1, 2, 2, 1, 2)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(GCAPEXP)	0.385430	0.196740	1.959085	0.0738
D(GCAPEXP(-1))	0.249217	0.208910	1.192940	0.2559
D(GRECEXP)	0.260432	0.117190	2.222308	0.0462
D(GRECEXP(-1))	0.594845	0.108100	5.502725	0.0001
D(INFR)	8.113494	2.867937	2.829035	0.0152
D(INTR)	-15.910028	6.757315	-2.354490	0.0364
D(INTR(-1))	27.758435	9.671131	2.870237	0.0141
ECM(-1)	-0.820775	0.158862	-5.166594	0.0002

Source: Output from E-views 9.0 (2018)

From the short-run regression results obtained in Table 4.7 the following interpretation can be inferred; Since the variables were found to be cointegrated implying that they have longrun equilibrium relationship, it is necessary to test for shortrun relationship. From table 4.7, the ECM parameter is negative (-) and significant which is -0.820775, this shows that 80 percent disequilibrium in the previous period is being corrected to restore equilibrium in the current period. It has been established that the variables are

cointegrated and also have short run relationship established from the ECM. All the independent variables were positively related Private Investment in Nigeria except interest rate as lag one. Finally, all the independent variables were statistically significant in explaining the variation in Private Investment in Nigeria while the Government Capital Expenditure (GCAPEXP) current and lag periods were statistically insignificant in explaining the variation in Private Investment in Nigeria.

Cumulative Sum test for Model Stability

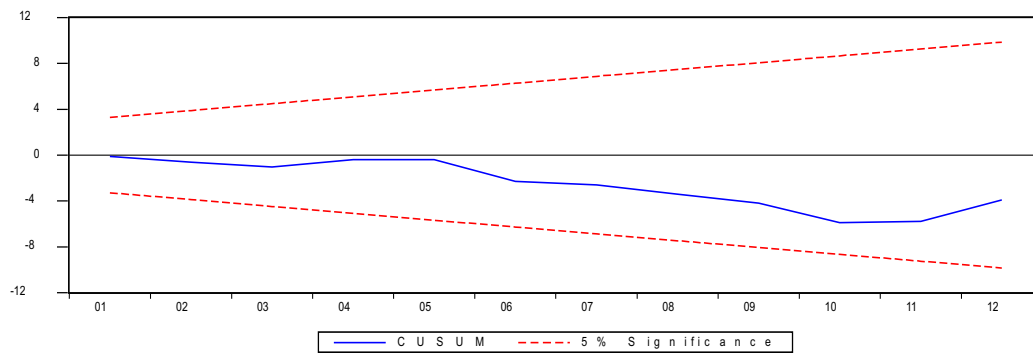


Figure 2. CUSUM Test

The cumulative sum (CUSUM) test shows that the CUSUM falls within the critical region. This shows that the parameters are stable over the sample period studied (1986– 2016) as such there is no structural break in the parameters.

Conclusion and Recommendations

In conclusion, the study revealed that at the long run Government Recurrent Expenditure (GRECEXP) and Inflation Rate (INFR) were positively related to Private Investment in Nigeria while Government Capital Expenditure (GCAPEXP) and Interest Rate in Nigeria (INTR) were negatively related to Private Investment. Also, at the short run all the independent variables were positively related Private Investment in Nigeria except interest rate as lag one. Finally, all the independent variables were statistically significant in explaining the variation in Private Investment in Nigeria while the Government Capital Expenditure (GCAPEXP) current and lag periods were statistically insignificant in explaining the variation in Private Investment in Nigeria. The finding was similar to the work of Kareem, Bakare, Ademoyewa, Bashir, Ologunla and Arije (2014) investigated the impact of public sector spending on economic growth in Nigeria which shows that recurrent and capital expenditure are positively and significantly related to economic growth in Nigeria. Based on the findings the study recommends the following policies.

- I. Government should designed monitoring and evaluating mechanism to improve the efficiency and effectiveness of government capital expenditure and recurrent expenditure in Nigeria since government capital expenditure was statistically insignificant in determining the improvement of Private Investment in Nigeria.

- ii. Inflation rate targeting and policies should be geared towards increasing production in doing this the Private Investment in Nigeria can improve.
- iii. Interest rate was negatively related to Private Investment in Nigeria because increased interest rate crowd out Private Investment in any economy. Therefore, government should reduce deficit budgeting in order to reduce domestic borrowing by the government this will help in the improvement of Private Investment in Nigeria.

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