



## INSECURITY AND FOREIGN DIRECT INVESTMENT IN NIGERIA

Owolabi Adesegun<sup>1†</sup> --- Ayenakin, Olabanjo, Olumide<sup>2</sup>

<sup>1</sup>Department of Banking and Finance, School of Business Studies, The Federal Polytechnic, Ado, Ekiti, Nigeria

<sup>2</sup>The Federal Polytechnic, Ado – Ekiti, Nigeria, Department of Business Administration, The Federal Polytechnic, Ado, Ekiti, Nigeria

### ABSTRACT

Nigeria has joined the league of countries that spend a higher proportion of their budgetary allocation on security. Thus, this paper empirically investigates the impact of insecurity on foreign direct investment (FDI) covering the period of 2003 to 2012. The study employed Least Square technique (OLS) to analyze the secondary data collected from Central Bank of Nigeria Statistical bulletin of various issues. Vote on security and defense (VSD) was used as a proxy for insecurity. The paper reveals a negative relationship between Foreign Direct Investment (FDI) and insecurity. The paper recommends that strong policy stance must be taken to address the state of insecurity in Nigeria so as to attract more foreign direct investment essential for economic growth and development.

**Keywords:** Insecurity, Security vote, Vote on defense, Foreign direct investment, Economic growth, Economic development.

### Contribution/ Originality

This study contribute to existing body of literature on effect of insecurity on growth, it used OLS technique to estimate data collected, vote on security was used to form a new formula, it is one of the few studies that investigated the activities of Boko Haram on FDI in Nigeria.

## 1. INTRODUCTION

Considering what is going on in Nigeria, there is legitimacy for getting jittery for the future of this nation as she manifests all the traits of a failed state. It is incomprehensible and disheartening to record the pervading wave of kidnappings, killings, robbery, and corruption ravaging Nigeria today. Of late, chilling accounts of mayhem unleashed on the people by men of

the underworld, the Boko Haram Islamist Sect and other agents of darkness have become a dominant issue in the media. The current state of insecurity poses serious challenges and threat to the stability of Nigeria macroeconomic environment. The nation has not only suffered colossal loss in terms of infrastructures, properties, and human lives especially in the Northern part of Nigeria, but also economic disruption leading to pushing out effect of foreign direct investment. The role of foreign direct investment as an engine of economic growth and development in developing economies like Nigeria cannot be overemphasized.

Generally, no business or enterprise can thrive in tense and insecure environment. This has serious implication for foreign direct investment and economic growth and development. For instance, the cold blooded murder of over forty students at Mubi in Adamawa state and four students of the University of Port Harcourt in Rivers State, the killing of over thirty two students in Yobe state, United Nation Building and Police Headquarters were attacked, Kaduna, Jos, Plateau, and other states in the North are now dreaded places for both domestic and foreign investors, tourists and many others. Over 7000 Nigerians have reportedly lost their lives in political, religious, and ethnic conflicts amid post-election violence from 2000 to 2013. It is an incontestable fact that Nigeria has gradually turned into a killing field, but who knows whose turn it will be the next moment?

Domestic terrorism and social unrest do not only breed uncertainty in the investment and financial climates but also increase security cost, reduction in output and productive capacity, reduces tourism, damage to infrastructure, damage the image of the nation, and displacement of foreign direct investment which has implication for economic growth and development of developing economies. The essence of this paper is to examine the effect of insecurity on foreign direct investment in Nigeria, with particular focus on the impact of mounting security concerns on foreign direct investment in order to improve the nation economic growth and development.

The first section of the paper is the introductory part, section two reviews literature on FDI and National security. The section also contains the connection between FDI and National security. Section three discusses the method of research. Section four presents the empirical result. Section five concludes the paper.

## **2. LITERATURE REVIEW**

The study relates to the extensive literature on the connection between economic conditions of the nation (Nigeria) and the issue of insecurity. The study is partially interested in the effect of insecurity on foreign direct investment in Nigeria. [Bayer and Rupert \(2004\)](#) estimate that the total bilateral trade reduced by a third in the presence of a civil war. [Martin et al. \(2008\)](#) show that foreign direct investment destruction due to terrorism is very large and persistent and increases with the severity of the conflict. According to [Orok \(2008\)](#) the Nigerian state is a confluence of nationalists made up of people associating involuntarily in the pursuit of uncommon interests. It

is characterized by the absence of justice and is held together with impunity by its armed forces which are controlled by elements from two principal nationalities bound together by a common agreement, sharing the national cake on certain unwritten principles. It lacks the essential ingredients of legitimacy that is, certain nationalities have not consented to the association and the country is being ruled unjustly with elements within the three most populous nationalities showing an unbridled state of "libido dominandi".

### 2.1. Concept of FDI

Nigeria is a country with arable land and abundant natural resources. Government policies have been directed towards ensuring that what nature has provided is harnessed and utilized to the fullest for the benefit of citizenry. Thus, government policies and strategies towards foreign investment in Nigeria are usually shaped by two principal objectives: the desire for economic independence and the demand for economic development (Garba, 1998).

Todaro (1994) notes that the primary factors which stimulate economic growth are investment that improve the quality of existing physical and human resources, that increase the quantity of these same productivity resources and that raise the productivity of all or specific resources through invention, innovation and technology progress. Foreign direct investment contributes to Gross Domestic Product Rates and is seen a vital tool for economic progress.

Oseghale and Amenkhieman (1987) conducted an investigation to determine whether foreign capital inflows, oil revenues and foreign borrowing had any positive impact on the economic growth of Nigeria. They found that Nigeria's revenue from oil export increased between 1970 and 1982 and that there was a substantial growth in her total foreign debts and foreign direct investment and gross domestic product. The study conclude that the economy would perform better with greater inflow of foreign direct investment; and recommended that less developed counties should create more conducive environments for foreign direct investment.

Aremu (2003) observes that foreign firms can raise the level of capital formation, promote exports and generate foreign exchange. Indeed, the role of foreign direct investment in capital formation in Nigeria has been increasing over the years. Foreign direct investment over gross capital formation rose from 7.3% in 1974 to about 17% in 1985, though it was generally low in the late 1970s and early 1980s. For example, foreign direct investment only contributed 1.5% to gross domestic product growth in 1976 and 0.5% in 1982. The relatively low level of foreign direct investment in total capital formation in these periods was similar to that of Korea and Taiwan, which had emphasized minimal levels of reliance on foreign investment. In contrast to this, were some South East Asian countries which had the policy of attracting foreign direct investment (FDI), for example, Indonesia, Nigeria retarded the contribution of foreign direct investment to gross capital formation during this period using infant industry protection, local content rules, foreign direct investment restrictions and other restrictive policies. The relatives

rise in the share of foreign direct investment in capital formation since 1993 has been due to rapid loosening of controls and regulation on the activities of multinational corporations in Nigeria. As a result, foreign direct investment over gross capital formation ratio rose from 6.4% in 1986 to 32% in 1993 and 49% in 1998 (Fabayo, 2003).

Many studies, however, indicates that the impact of foreign direct investment is limited or even negative sometimes. In a study of Nigeria, (Onimode, 1983) found that where foreign direct investment was directed at import substituting firms, the value of imports was observed to be greater than the value added produced. This type of foreign direct investment would give rise to outflows of investment income and high cost of imported inputs which adversely affect growth. Ohiorheman (1993) asserts that with the research and development (R&D) concentrated in the head offices of multinational corporations (MNCs), technology transfer was limited. He added that even though the MNCs provided local training programs, Nigerians were neither exposed to the development stage of a product or process nor were they made to know the intricacies of machinery construction or installation. Consequently, their innovation ability was not enhanced. He concluded that, to the extent the MNCs, dominated the manufacturing sector, their activities generated little multiplier effects and the linkages effects were generally low in the (manufacturing) sector.

Using indices of dependence and development as a mirror of Nigeria's economic performance, (Oyaide, 1977) concluded that foreign direct investment engineer both economic dependence and growth. In his opinion, foreign direct investment causes and catalyzes a level of growth that would have been impossible without such investment. This is, however, at the cost of economic dependence.

Although a lot of studies that there exists a positive relationship between foreign direct investment and economic growth in Nigeria, there is a consensus among economist that the country's growth rate would have a positive impact on foreign direct investment. The prospect of that foreign direct investment will be profitable is brighter if the nation's economic health is better and the growth rate of gross domestic product is higher (Onu, 2012).

As Biersteker (1978) observes, the best way to assess the role and impact of foreign direct investment in developing countries is to study the objectives of foreign investors and host economies for their involvement in foreign direct investment. Although foreign direct investment has some potential risk, both economic theory and empirical evidence suggest that foreign direct investment has likely potential positive impact on developing host countries. The question to be addressed, therefore, should be how developing economies can maximize the benefits of foreign direct investment to their advantage. If foreign direct investment is to truly be a positive – sum game for both foreign investors and host economies, costs and benefits of foreign direct investment should be weighed carefully, particularly by the host countries in search of economic growth.

Foreign direct investment means the direct investment of a company or country on the productive asset of the domestic economy. According to [Graham and Spaulding \(1995\)](#) foreign direct investment in its classic definition is as a company from one country making physical investment into building a factory in another country. Given the rapid growth and changes in global investment patterns, the definition has been broadened to include the acquisition of lasting management interest in a company or enterprise outside the investing firm's home country. As such, it may take many forms, such as direct acquisition of a foreign firm, construction of facilities, or investment in a joint venture or strategic alliance with a local firm with attendant input of technology and licensing of intellectual property.

[Graham and Spaulding \(1995\)](#) posit that foreign direct investment plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies and management skills and as such can provide a strong impetus to economic development.

In literature, many factors have been identified to determine the flow of FDI in the host country. [Chakrabati \(2001\)](#) and [Tarzi \(2005\)](#) identify market size, market size growth rate, economic competitiveness, trade openness, infrastructure, and worker productivity as critical to the determinant of foreign direct investment. The most profound effect of foreign direct investment has been seen in developing countries, where yearly foreign direct investment flows have increased from an average of less than \$10 billion in the 1970's to a yearly average of less than \$20 billion in the 1980's, to explode in the 1990's from \$26.7 billion in 1990 to \$179 billion in 1998 and \$208 billion in 1999 and now comprise a large portion of global FDI. Driven by mergers and acquisitions and internationalization of production in a range of industries, foreign direct investment into developed countries last year rose to \$636 billion, from \$481 billion in 1998. [Oriakhi and Osemwengie \(2012\)](#).

## 2.2. Insecurity

Insecurity does not really have a generally accepted concept in literature. The term insecurity for this study will be proxy with the concept of national security for us to have an ideal on what insecurity is all about in Nigeria. National security defined in terms of national survival is an illusion. It is an illusion because it is an erroneous perception of the African reality. It is used by the milling elite as a fine transparent concept for deluding populace into thinking that government policies in this regard represent action designed actually to protect them from hunger, disease, injustice, and violation of human dignity and life. Thus, in Nigeria the concept 'national security' has given rise to two dangerous doctrines of illusionism and militarism which is self-defeating. However, scholars are yet to agree on the definition of the term "national

security". This is not surprising because, the phenomenon of security is hardly precise. Yet two fundamental perspectives have emerged in the attempt to defend national security. One perspective focuses on the strategic definition and the other, on the non-strategic definition by laying emphasis on socio-economic factors. The strategic – “realist” perspective conceptualizes national security in terms of self-defense arms to deter aggression. This perspective sees conflict between men and states as being endemic. To a great or lesser degree, therefore, the international political system can be seen as anarchic, power and struggle for power and the control of resources is central to this manner of thinking. In this environment, states will only be constrained by pacts, audience, treaties and tenets of international law that they see as being in their own interests. Security in this context concentrates in the military, military values, strategies and the survival of the state (Eme and Anyadike, 2013).

In general, Braithwaite (1988) quoting the encyclopedia of the social sciences defines insecurity as “ability of a nation to protect its internal values from external threat and also the ability to protect lives and properties of its citizens and residence in such countries”. Also, Oladesun (2012) defines it by stating that “a nation has security when it does not have to sacrifice its legitimate interest to avoid war, and is able, if challenged, to maintain them by war”. Morgenthau (1948) posits that national security and national interest are inter-related; where the former are seen in terms of power and therefore are the essence of politics. Imobighe (1981) refers to it as the defense and survival of the state. The danger of looking at national security from this narrow angle according to Nweke (1988) is three-fold: First is the tendency to equate “defense” with “security” and to bestow undue responsibilities to the military as if the armed forces alone are the guardians of national security. This tendency in turns creates in the minds of the armed forces that it is only through them that security, stability and progress can be achieved. Second, national security has been used by civilian statesmen as political rhetoric or slogan for rallying the citizen in the face of perceived internal or external threats to the government in power and for bolstering their local influence and political base (Adamu, 1990).

The most serious danger is the tendency to equate national security with the security of the state. The state in a capitalist state like Nigeria is an instrument for the preservation of capitalist socio-economic formation, which protects the interests of a privileged class vis-à-vis the rest of us (Ake, 1984). Dyke (1966) concludes as follows: There is no doubt that national security embodies the sovereignty of the state, the inviolability of its territorial boundaries, and the right to individual and collective self-defense against internal and external threats. But the state is secure only when the aggregate of people organized under it has a consciousness of belonging to a common sovereign political community; enjoy equal political freedom, human rights, economic opportunities, and when the state itself is able to ensure independence in its development and foreign policy. The non-strategic thesis thinks anew about security from armed aggression in the light of humankind’s failed effort to find it. This is because the strategic path has not brought us

to a consistently secure place, it is only prudent to consider alternative, less – or availed paths to security. These possible thesis including limiting or even abandoning our weapons altogether, creating international security force and standards of pacifism. (Nnoli, 2006)

If security is focused on the survival of the state, then logically security has first call of the resources of the state. It is very noticeable that the first act of newly independent states is to create an armed force and that even in the poorest of states the military are well equipped and enjoy a high status in society. In this situation, to have a problem or issue labeled a “security issue” ensures that there is a flow of resources to solve the perceived threat or problem. Astute politicians, therefore, begin to promote essentially non-security issues as being matters of high security significance (Carey, 2000).

Insecurity; According to Maier (1990) is best described as a capacity to control those domestic and foreign conditions that the public opinion give community believes necessary to enjoy its own self-determination or autonomy, prosperity and wellbeing. In a holistic perspective, the U.S. Secretary of Defense under the Carter administration from 1977 to 1981, Harold Brown, broadened the definition of insecurity to include factors such as economic and environmental security.

According to Oriakhi and Osemwengie (2012) insecurity refers to a state where the unity, well-being, value, and beliefs, domestic process, mechanism of governance and welfare of the nation and her people are perpetually threaten and insecure continual fighting, bombing, kidnapping etc. by the aggrieved parties. In other words, the absence of continuous improvement in the socio-political and economic well-being of the people and state are tagged insecurity. Insecurity is not only limited to communal crisis; ethnic and religious violence, and political conflict but also include the presence of natural disasters such as flood, earthquakes, etc.

Some security experts argue that the concept of security has always been associated with the safety and survival of the state and its citizens from harm or destruction or from dangerous threats. For some others, security measures the absence of treats to acquire values in a subjective sense, the absence of fear that such values will be attacked. Thus, a nation is secure to the extent to which it is not in danger of having to sacrifice her values if it wishes to maintain them by victory in such a war (Maulaye, 2006). Those conceptions generally hold that the state is the only institution on which primary responsibility and power for the safety of its people reposes (Zabadi, 2005). Therefore, for some others, security consists of a functional and independent body of supervisory services and institutions.

In the views of Otto and Ukpere (2012) security relates to the presence of peace, safety, happiness, and the protection of human and physical resources or the absence of crisis, threats to human injury among others. What was formerly common in Nigeria was internal conflict, ethnic and religious crises; political conflict, resource control agitations and military intervention in politics. The current wave of suicide bombings brought in another dimension to internal crisis.

Terrorism is generally becoming a phenomenon in most developing economies. With the shift from Niger Delta militants to Boko Haram insurgency, Nigeria and other developing countries are void of clear and well-coordinated security arrangement and structure to tackle this new development (Oriakhi and Osemwengie, 2012)

Terrorism whether domestic or transnational has devastating effects. For instance, the Boko Haram menace in Nigeria has led to the loss of many lives, property worth billions of naira destroyed, severe damaged structure, less of investment and income. Terrorism as a premeditated use of threat or use of violence by individuals or sub-national groups to obtain political or social objectives through the intimidation of a large audience beyond that of the immediate victims. Although, the motives of terrorists may differ, their actions follow a standard pattern with terrorist incidents assuming variety of forms: airplane hijackings, kidnappings, assassinations, threats, bombings, killings; and suicide attacks. Sandler and Enders (2008) these acts have a positive impact on the FDI of any nation.

### **2.3. Foreign Direct Investment and Insecurity**

Insecurity and terrorism have a huge economic, socio and physical cost. It is obvious that the loss of human lives and the suffering of survivors in the aftermath of an attack can be tremendous. Apart from the loss of lives, terrorist attacks are likely to have negative consequences on the investment behavior (Montclair Kimberley Academy, 2005). Withdrawal of Foreign Direct Investment (FDI) by countries and companies may occur due to the direct destruction of infrastructure, the rise of operational costs as a result of high demand for security (Frey *et al.*, 2007).

According to Andyopadhyay *et al.* (2011) the economic dimension of terrorism concerns losses in Foreign Direct Investment (FDI), damaged infrastructure, output losses, security costs, reduced economic growth, reduced tourism, trade losses, higher insurance premiums, and longer waits in airports (Keefer and Loayza, 2008). Terrorist are well aware of the potential economic harms that their attacks can cause and view these consequences as pressuring besieged government to concede to their demand. A country (developing nation like Nigeria) plagued with an intense long-term terrorist campaign can suffer significant losses in Gross Domestic Product (GDP), Foreign Direct Investment (FDI) and Gross Domestic Product Growth (GDPG) (Abadie and Gardeazabal, 2003).

Insecurity may also direct economic resources for highly productive sectors to less productive sectors thereby crowding out investment. No meaningful growth and development can take place in the continuous face of insecurity.

This will not only reduce GDP and fuel inflation but also the flow of foreign direct investment. Oriakhi and Osemwengie (2012) and Mckenna (2005) argue that the increase in government expenditure due to rising insecurity especially in less developed countries like



Nigeria may likely result in the sales of foreign reserves and espionage, as a consequence, inflation in those countries will rise.

### 3. METHOD OF THE STUDY

Along the lines of *Asiedu et al. (2009)* their study considered a foreign firm operating in a developing host nation and producing output  $F(k)$  from capital  $k$ ; which it rents at a given rate  $r$ . This firm suffers from damages or lost output caused by terrorism, which reduces its revenue. With the good produced through Foreign Direct Investment (FDI) as the numeral, the profit of the foreign firm is:

$$\Pi = (1 - t) r(k) - rk, 0 < t < 1, f' > 0, f'' < 0 \text{ -----(I)}$$

Where  $r$  = fraction of output lost by firms due to terrorism.

This paper deviates from previous studies by focusing on the relationship between insecurity (Boko Haram Islamic sect's activities) and foreign direct investment (FDI). The model for this study is in line with equation one above is specified as:

$$I = B_0 + B_1 \text{ VSD} + B_2 \text{ GDP} + U_t \text{ -----(II)}$$

Where

- I = Foreign Direct Investment,
- VSD = Vote on Security & Defense,
- GDP = Gross Domestic Product,
- $U_t$  = Error terms, and
- $B_i$ 's are the unknown parameters.

Gross domestic product (GDP) proxy for economic growth was included in the model in order to be able to determine the impact on foreign direct investment as well as the combined effects of GDP and VSD on FDI, because FDI is very important to developing nations like Nigeria. The paper used vote on security and defense as a proxy for National security because insecurity can not be captured in quantitative term. All the expenditure pattern of government on the security sector reflects the amount of security in place and the perception of government about the weight of security issues in Nigeria especially if the spending pattern is effective. This is in line with the work of *Otto and Ukpere (2012)*.

The study made use of secondary data, which was sourced from Central Bank Statistical Bulletins of various issues. The data used showed the pattern of government expenditure on security, the flow of foreign direct investment (FDI) and the Gross domestic product rate in Nigeria from 2003 to 2012. The study adopted regression analysis in estimating the equation II above.

### 4. RESULT

The regression result of equation II above shows that:

$$I = -60197.14 - 0.002VSD + 1.15GDP$$

$$= (-2.13) \quad (-33) \quad (12.33)$$

$$R^2 = 0.90$$

$$F^* = 84.88$$

$$D.W = 2.07$$

From the regression result above, the constant variable terms differ significantly from zero at 95% degree of confidence, that of vote on security and defense (VSD) has a negative significance with foreign direct investment (FDI) and it is not significantly different from zero at 95% level of confidence. This simply shows that the Nigeria Federal government spending on security has negative relationship on the inflow of foreign direct investment, i.e. it was not enhancing the inflow of FDI during the period of investigation. The fact that the coefficient of vote on security and defense (VSD) being negative may be explained in terms of institutional failing, corruption and inefficient allocation of defense and security votes which compromise the effectiveness of the security system in the country. This will result in increase in unrest and brings about uncertainty which directly reduce economic growth rate and also directly discourage foreign direct investment inflow in Nigeria.

The regression result shows that Gross Domestic Product (GDP) have positive relationship with Foreign Direct Investment (FDI) and its coefficient estimate is significantly different from zero at 95% level of confidence. The combined effect of vote on security and defense (VSD) and gross domestic product (GDP) on foreign direct investment (FDI), the adjusted  $R^2$  shows that over 90% systematic changes in foreign direct investment are explained by the systematic variation in vote on security and defense (VSD) and gross domestic product (GDP).

The paper concluded that the research model adopted is suitable because the hypothesis of a significant linear relationship between foreign direct investment and combination of vote on security and defense and gross domestic product is accepted at 1% level of significance. This is based on the high observe  $F^*$  value of 84.88. and another important thing, the Durbin – Watson Statistic shows that the residuals are not serially correlated, as a consequence, the regression parameters are relevant and statistically significant.

## 5. CONCLUSION & RECOMMENDATIONS

The paper investigates the effect of insecurity, in terms of the killings, Boko Haram activities, bombing, etc. on the inflow of foreign direct investment (FDI) as they relate to the growth of the economy in Nigeria from 2003 to 2012, making use of regression method.

Based on this model, insecurity has a negative effect on the inflow of foreign direct investment. It was also observed that insecurity proxy by vote on security and defense discourages foreign direct investment in Nigeria. Based on a known fact that foreign direct investment is a very important source of savings for developing nations like Nigeria and, thus, an

engine of growth, the relationship between insecurity and foreign direct investment is of a great concern.

The study recommends that government of Nigeria should take proactive measures in tackling the insecurity in the country, especially, the Boko Haram activities, brought about by political reasons, government at all levels in Nigeria and policy makers should formulate and effectively execute strong policy measures aim at confronting the state of insecurity in the nation, the political gladiators should be reoriented to separate political aims from macroeconomic benefits and lastly the government and its agents responsible in allocating security funds should ensure that security votes and defense votes are effectively allocated and utilized for the purpose they are meant in order make them meet up to the world standard.

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## APPENDIX

**Table-1.** Vote on Security and Defense (in ₦M) FDI & GDP in Nigeria 2008 to 2012.

Year	VSD	FDI	GDP
2003	307973.3	258388.6	311399.7
2004	306830.6	248224.5	381217.5
2005	434661.1	654193.2	467614.2
2006	458282.7	624520.7	481393.6
2007	564512.4	759380.4	520400.1
2008	731000	460222.6	677752.9
2009	233 billions	572546.8	594168.96
2010	264 billions	543448.7	610561.05
2011	348 billions	571164.6	565648.18
2012	921.91 billions	586014.9	529831.34

Source: Central Bank Nigeria Bulletins of various issues.

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