



Taxation and foreign direct investment inflows in Nigeria

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Abstract

This study captivates the issue of taxation and foreign direct investment inflows in Nigeria through the influence of company income tax, value added tax, customs and excise duties and petroleum profit tax. Using quasi experimental research design, data is sorted from secondary sources such as journals and Nigeria statistical bulletin for an ordinary least square regression analysis to estimate the models. Based on the analysis of the results of the estimated models, the study indicates that custom and excise duty and its lag exhibits positive relationship with foreign direct investment. Also that company income tax and its lag by one year indicates a positive relationship with foreign direct investment in Nigeria. For petroleum profit tax and value added tax, there is a negative relationship with foreign direct investment. In furtherance, it indicates that apart from customs and excise duty, the other components of taxation are not statistically significant with foreign direct investment. This is also true of income taxes which are duelly related with lower economic growth than taxes on consumption and properties. This however, emphasizes the support for ranking of tax instruments in respect of their relationships with economic growth. In this regard, the study recommends that government adopt more of explanatory fiscal policy measures to boost foreign direct investment in Nigeria.

Keywords: taxation, foreign direct investment, inflows

Introduction

Countries have made efforts towards foreign direct investment arguably due to the fact that it would manifest economic growth positively. By this expression, foreign direct investment is to determine the acceleration of production, growth in technology and its transfer, managerial skill and technical know-how in the domestic market, introduction of new processes, employee training, access to markets and international production networks (Adeleke, Olowe and Fassein, 2014). The vision on these gains from FDI inflows have led to competition for FDI destination between developing countries and others. For this, measures have been put in place by countries to be seen as business-friendly countries and better FDI destinations. Hence the needs for liberalization of the economy, the guarantee on repatriation of profit, tax incentives, and critical infrastructure for industrial layout. In present economies, foreign direct investment is seen as a factor in the economic development of countries. Apart from enhancing capital flows, FDI facilitates the transfer of technology, organizational and managerial practice and access to international markets. Tax incentives makes possible reliefs for firms in other to place them at vantage position thereby facilitating their performance to remain in business. This essence reduces the burden of tax on firms. It takes the form of personal allowance, investment allowance, loss relief, roll-over relief, pioneer relief and exploration relief. Some others are tax holiday, capital allowance, tax rate reduction on profit, reduced tariffs on import equipments, domestic market protection through raw materials or increased tariffs and capital allowance or accounting rule that allows for accelerated depreciation (UNCTAD, 2000) ^[22]. UNCTAD (2000) ^[22] is of the view that the role of tax incentives in promoting FDI has been a subject of study by scholars. The continuous inflow of foreign direct investment (FDI) into a country in one way or the other is linked to inflow of benefits such as technological knowhow and human capital. In this regard, and in other to improve its (FDI) the Nigerian government through its relevant authorities has engaged in series of economic reforms including tax incentives. These incentives are granted to inventors to make the domestic economy better attractive for investment. According to Adegbite and Akande (2017) most tax incentives have been adopted in Nigeria in the form of tax holidays, capital allowances on investments in machinery, budding and loss carry-forward facility, import duties relief and approved user scheme under which import duties are refunded to approved enterprises that import in the export-turned production. In further measure, is petroleum exploration relief exemption from capital gains taxes and benefits depending on the sector of the economy in the Country. In addition, tax policy incentive (TPI) determines the enabling environment conducive to foreign direct investment in other to ensure capital transfer technology spillover, technical know-how transfer and increased employment. However, providing tax incentives to foreign investors do significantly cause reductions in revenue which is generated through taxes thereby making FDI to be counterproductive. Also, that local firms are always made to suffer for the shift in tax liabilities. Meanwhile the award by government for tax exemption to foreign firms poses multiple taxation problems on the local firms. Tax incentives leave a

country worse-off by reducing tax revenue (Edmiston, Mudd and Valav, 2003). In the Nigerian context, government introduced tax incentives as an instrument to woo and induce local foreign investment into areas of manufacturing of goods, exporting oil and gas exploration and utilization and provision of utilities. Taxes constitute a major source of revenue to governments. This is same in both developed and developing countries. Nigeria is one of such. Even after the discovery of oil in the country tax revenue still remained a major source of revenue to successive governments over the years. According to Chigbu, Akujiobi, and Ebimobowei (2012), the economic history of both developed and developing countries reveals that taxation is an important weapon or instrument in the hands of government not only to generate revenue but also to create fiscal goals that influence the direction and production of certain goods and services. But the question is, is this realization truly a blessing or a curse is a matter of concern to most economies and social workers in verifying the adequacy to which it has exhibited growth in the developing nations especially in the Nigerian context. Hence recent studies have turned to investigate the effect of tax revenue on foreign direct investment. For instance in Europe, Sato (2012)^[21] and Gedik (2013)^[13] found strong negative relationship between tax revenue and foreign direct investment. In Nigeria Babatunde and Adepeju (2012) found a positive relationship between taxes and foreign direct investment but kinda (2014)^[14] found no such relationship. However, Demooij and Ederveen (2001)^[9] posits that a substantial variation exists across studies. That is it elicit significant variations across countries. Among the studies carried out in Nigeria there are still some significant variations. This is in terms of methodologies for the analysis of research data. However, this study too does not disaggregate the components of taxation to ascertain the impact of FDI inflows in the country. This is the gap this study fills as it disaggregates the various tax components to ascertain its impact on FDI inflows in Nigeria. The study is carried out in five sections. Section one is introduction. Section two treats theoretical and empirical literature while section three treats methodology. In section four, is the presentation and interpretation and analysis of the study. In section five the summary, conclusion and recommendation are treated.

Theoretical Literature

Internationalization Theory

On international trade, the works of Buckley and Casson (1976) propounded that there is the tendency in an economic system to generate sophisticated information and to transfer such information internationally in the form of FDI. And that cross-border internationalization of market creates multinational companies while calling for knowledge and expertise an important factor in perfect market. This is done to achieve comparative advantage in other to gain control of markets. The basis for this is to organize the international activities of multinational corporations. This is one internationalization theory assumed to having possession of oligopolistic power in most country by FDI led companies (Cockcroft and riddle, 1991)^[8]. This assumption is in agreement with imperfect market theory postulated by Hymer (1976)^[14] which is based on structural imperfections. Which means deviations from purely market determined prices brought about by the presence of monopolistic market characteristics.

Keynesian Taxation Theory

John Maynard Keynes initiated the Keynesian taxation theory in his book "The General Theory of Employment Interest and Money. Keynes through this medium advocated for state intervention in market economy regulations. According to the theory fast economic development must be based on market expansion and associated increase in consumption. The theory postulates that state intervention is achieved at the level of effective demand and also that, economic growth is related to monetary savings only in the conditions of full employment. It further stated that, in the contrary, large amount of savings economic development as they portray passive form of income and are not invested in production. The conclusion of this analysis is that passive form of income are not invested in production as such should, be subtracted through the help of taxation to finance investments and cover state expenditures. Keynes argued that greater level of progressive taxation is necessary while low tax rates lead to reduced state revenues and as a result contributes to economic system of state regulations. High taxes stimulate economic activities, influence the stability of the economy and in the context of economic system, acts as integrated flexibility mechanisms.

Eclectic Paradigm

This theory proposed by Dunning (1993) suggests that the main factors that facilitate FDI inflows is to secure market access, large scale privatization processes and the degree of political and economic stability. This theory proposes that FDI is determined by the realization of three groups of advantages of ownership which comes from the size of firms, access to markets and resources. That FDI determined by firm's ability to co-ordinate complementary activities of manufacturing, distribution and the ability to exploit differences between countries. These are also information by locational advantages including differences in the country's natural endowments, transport costs, macroeconomic stability, cultural factors and government regulations. Host country policies are seen from the dimension of macroeconomic stability and taxation policies. This frame work highlights the need to account for considerations in the mix to account for considerations in the mix of relevant taxes to relevant costs of relying on alternatives when assessing theoretically or empirically the importance of tax among other factors influencing foreign direct investment. However, there is the evidence that tax incentive may affect net foreign direct investments via its effect in both inward and outward investments. Leibfritz, thornton and Bibbee

(1997) are of the view that there is a positive relationship between taxation and investment only if tax rates on retained earnings are considered. In this regard, home country's taxation can influence a firm foreign direct investment decision, to the extent that domestic and foreign investment are alternative methods of serving same objective hence the size of foreign direct investment can be affected by the substitutability between investment locations. The magnitude of FDI, therefore may be affected not just by the effective tax rate on its income but also by the effective tax rate on the income from the same type of investment in the home country (Jun, 1994).

Empirical Literature

Babatunde and Adepeju (2012) investigated the determinant factors of FDI and analyzed if some selected factors as tax incentives, availability of natural resource, macroeconomic stability, market size, trade openness, infrastructural development and political risk have impact on FDI in the oil and gas sector. Using secondary data, the study was analyzed through Karl Pearson coefficient of correlation statistical method. The result of the investigation indicates that tax incentives, availability of natural resources and trade openness significantly influence FDI in the Nigerian oil and gas sector. However, there was no significance found on market size, infrastructural development, macroeconomic stability and political risk on FDI.

Gedik (2013) ^[13] carried out a study on foreign direct investment inflows and the framework of fiscal, economic, political and institutional dimensions using dynamic panel data model estimation technique. The results shows that FDI does not prefer high tax environments. High tax rates are evaluated as cost components for foreign investors.

Effiong, Tapang and Efon (2013) carried out a study on the impact of tax policy and incentives on foreign direct investment and economic growth. Using questionnaire for data collection the analysis was done with ordinary least square technique. The study indicates that tax rate has significant relationship with foreign direct investment.

Peters and Kiabel (2015) examined the influence of tax incentives decisions of an investor in locating FDI in Nigeria. Engaging data from Central Bank of Nigeria annual statistical bulletin and the World Bank Development indicators data base, and with also the employment of the model of multiple regression using static Error Correction Model (ECM) indicates that FDI response to tax incentives is significantly negative when tax revenues as percentage of gross domestic product (GDP) and FDI are captured. That is FDI response to tax incentives is significantly negative that is increase in tax incentives does not bring about corresponding increase in FDI. Saidu (2015) ^[20] carried out a study between corporate taxation and foreign direct investment in Nigeria between 1970 and 1980. Using ordinary least square technique the result indicates a negative significant relationship between company income tax rate and foreign direct investment while exchange rate and FDI indicate a negative insignificant relationship.

George and Bariyima (2015) ^[16] studied the influence of tax incentives in the decision of an investor to locate FDI in Nigeria. Making use of the model of multiple regression and static error correction model the study shows that there is a negative response of FDI to tax incentives.

Olaleye, Riro and Memba (2016) ^[19] carried out a study on the effect of reduced company income tax on FDI in listed companies in Nigeria. Using descriptive research design, data were collected for the deviation and inferential statistics leading to data analysis. The study discovered a strong positive relationship between reduced company income tax incentives and foreign direct investment. Akinwunmi, Olotu and Adegbe (2017) examined the relationship between multiple taxes and foreign direct investment inflow into Nigeria. Using the ordinary least square technique for the estimate of time series data, findings indicate that there is a significant inverse relationship between multiple taxes and foreign direct investment in Nigeria. Amuka and Ezeudeka (2017) ^[2] carried out a study on tax incentive and pattern of flow of direct investment to the non-oil sector. Using multiple regression model, the outcome of the study indicates that tax incentive policy changes the flow of FDI into the non-oil sector.

Anichebe (2019) ^[4] carried out a study on the impact of tax revenue on foreign direct investment in Nigeria. Using the ordinary least's square (OLS) technique the result of the study indicate that tax revenue has a long run relationship with foreign direct investment in Nigeria. Secondly company income tax and personal income tax both have negative impact on foreign direct investment in the long run. However, value added tax, custom and exercise duty have positive relationship with foreign direct investment in the long run.

Research Methodology

This study by its nature employs quasi-experimental research design. This method of research is relevant for the social sciences due to the complexities and nature of relationships between variables. This is done to determine the relationship between taxation and foreign direct investment in Nigeria.

The Model

In view of the ability to pay theory of taxation and eclectic model of foreign direct investment, this study presents with modification, the empirical model of Anichebe (2019) ^[4]. In this form therefore, the study presents

$$FDI = f(PPT, CIT, VAT, CED) \quad 3.1$$

And the OLS form of the equation is given as

$$FDI = \beta_0 + \beta_1 PPT + \beta_2 CIT + \beta_3 VAT + \beta_4 CED + U_t \quad 3.2$$

Which form variables of the model for both the dependent and independent variables.

FDI: is foreign direct investment which is measured by investment inflow to a country other than the investors country. The activities revolve around long term interim interest and management contract over firms operating in a host country.

PPT: Is profit gained through taxes on income or profits of petroleum companies which serves as personal income of oil firms.

CIT: represent taxes on profits of incorporated business organizations

VAT: as value added tax which is collected at the federal level.

CED: Which is customs and exercise duty collected by government.

The log form of this model is thus expressed as

$$\text{LogFDI} = \beta_0 + \beta_1 \log PPT + \beta_2 \log CIT + \beta_3 \log VAT + \beta_4 CED + U_t = \quad 3.3$$

$$\beta_1 < 0; \beta_2 < 0; \beta_3 < 0; \beta_4 < 0$$

$$\beta_0 = \text{Constant}$$

$$\beta_1 - \beta_4 = \text{Coefficient of regressor Variables}$$

$$U_t = \text{Stochastic or Residual Term.}$$

To determine the investigation data is sorted from secondary sources such as journals, books, Central Banks of Nigeria statistical bulletin, NNPC blueprint and World Bank publications. In other to give answers to the problem so far envisaged, the study used the ordinary least square (OLS) regression technique to estimate the model. This technique is preferred because of the BLUE properties of the said technique which is premised as best estimator, linearity, Unbiasedness and efficient. The qualities mentioned make the parameter estimates not to be spurious. Therefore, the technique, OLS is useful. Other tests followed by the OLS test are the R^2 , t-test, DW-tests, unit root test and Johansen and Error Correction Mechanism. E-View 10.0 is used to convey to the estimation procedures.

Data Analysis

In analyzing o study hypothesis is stated and to be tested as stated; that is

HO₁: There is no significant relationship between petroleum profit tax and FDI inflows in Nigeria.

HO₂: There is no significant relationship between company income tax and FDI inflows in Nigeria

HO₃: There is no significant relationship between value added tax and FDI inflows in Nigeria.

HO₄: There is no significant relationship between custom and exercise duties and FDI inflows in Nigeria.

These hypotheses are tested at 5percent or 0.05 level significance with t-statistic which indicates that customs and exercise duties (CED) is significantly prone to foreign direct investment but petroleum profit tax (PPT) company income tax (CIT) and value added tax (VAT) are not significantly related to foreign direct investment in Niger This is indicated by the values of their t-Statistic of 2.569965, - 1.278965, 0.492977 and - 0.964855 respectively. This shows that there is significant relationship between CED and FDI in Nigeria but that there is no significant relationship between PPT, CIT, VAT, and Foreign direct investment in Nigeria Another test carried out for this study is the Augmented Dickey Fuller Unit Root Test. The table below shows the unit root stationary test.

Table 1: Unit Root Stationary Test at levels

Variables	ADF Stat. at levels	1% Critical Value	5% Critical Values	Order of Integration	Remarks
D(FDI)	-1.155390	-3.679322	-2.967767	I(0)	NS
D(PPT)	-1.902532	-3.670170	-2.963972	I(0)	NS
Log(CIT)	-0.986019	-3.670170	-2.963972	I(0)	NS
D(CED)	-1.193565	-3.670170	-2.963972	I(0)	NS
D(VAT)	2.222954	-3.661661	-2.960411	I(0)	NS

Table 2: Unit Roof Stationary Test at 1st Difference

Variables	ADF Stat. at 1 st Diff	1% Critical Value	5% Critical Values	Order of Integration	Remarks
D(FDI)	-5.349640	-3.711457	-2.981038	I(1)	S
D(PPT)	-7.151197	-3.679322	-2.963972	I(1)	S
Log(CIT)	-5.646856	-3.679322	-2.963972	I(1)	S
D(CED)	-1.193565	-3.679322	-2.963972	I(1)	S
D(VAT)	2.222954	-3.679322	-2.963972	I(1)	S

Source: Computed from E-view 8.0

Note: S = Stationary, NS = Not Stationary

The unit root test in table 1 above indicates that at levels, all the variables are not stationary at 1 percent and 5percent levels of significance. From the result in table. 2 all the variables are stationary at first difference, hence the time series are stationary in this study.

Johansen Co-Integration Test

The basis for co-integration test is to find out whether there exist a long run equilibrium relationship between the regressed and regressor variables in the study.

Table 3: Johansen Co-integration Test

Unrestricted Cointegration Rank Test (Trace)				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob. **
None*	0.828300	78.87922	69.81889	0.0079
At most 1	0.647972	41.87710	47.85613	0.1622
At most 2	0.477350	19.95218	29.79707	0.4261
At most 3	0.242962	6.326486	15.49471	0.6569
At most 4	0.022659	0.481313	3.841466	0.4878

Trace test indicates 1 cointegrating eqn(s) at the 0.05 level

*denotes rejection of the hypothesis at the 0.05 level

**Mackinnon-Haug-Michelis (1999) P-Values

Table 4

Unrestricted Cointegration Rank Test (Maximum Eigenvalue)				
Hypothesized		MaxEigen	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob. **
None*	0.828300	37.00212	33.87687	0.0205
At most 1	0.647972	21.92491	27.58434	0.2243
At most 2	0.477350	13.62570	21.13162	0.3965
At most 3	0.242962			
5.845173	14.26460	0.6332		
At most 4	0.022659	0.481313	3.841466	0.4878

Max-eigenvalue test indicates 1 cointegrating eqn(s) at the 0.05 level

*denotes rejection of the hypothesis at the 0.05 level

**Mackinnon-Haug-Michelis (1999) P-Value

Source: Computed from E-view 10.0

From the above table, the Johansen co-integration test indicates that Trace statistic and Maximum Eigen value show one (1) co-integrating equations at 5percenta level of significance. This indicates that a long run relationship do exist between the dependent and independent variables.

Error Correction Mechanism (ECM)

The test for short run adjustments call for the confirmation of the existence of co-integration among variables. Hence the result of the Error Correction Mechanism in the table 5.

Table 5: Error Correction Model (ECM)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	9.740228	1.700871	5.726613	0.0001
LOG(CED)	1.032654	0.401816	2.569965	0.0245
LOG(CED(-1))	0.913854	0.461927	1.978352	0.0713
LOG(PPT)	-0.458348	0.332386	-1.378965	0.1931
LOG(PPT(-1))	-0.394024	0.259779	-1.516764	0.1552
LOG(CIT)	0.600367	1.217840	0.492977	0.6309
LOG(CIT(-1))	-2.905407	1.567574	-1.853442	0.0886
LOG(VAT)	-1.632568	1.692035	-0.964855	0.3537
LOG(VAT(-1))	3.571522	1.137190	3.140657	0.0085
ECM(-1)	-0.349469	0.222998	-1.567135	0.1431
R-squared	0.734489			
Adjusted R-squared	0.535355		Mean dependent var	10.63359
S.E. of regression	0.819583		S.D. dependent var	1.202355
Sum squared resid	8.060604		Akaike info criterion	2.742914
Log likelihood	-20.17205		Schwarz criterion	3.238842
F-statistic	13.68823		Hannan-Quinn criter.	2.859740
Prob(F-statistic)	0.019358		Durbin-Watson stat	1.795412

Source: Computed from E-view 10.0

The adjusted R^2 in the table shows 0.525255. This indicates that about 53 percent of the variation in the dependent variable (FDI) is due to the result of the variations in regressor variables. The remaining 47 percent may be attributed to the variable or included in the model. The f- statistic of 13.68823 indicates that the overall model is statistically significant at 5 percent level. The Durbin Watson – DW statistic of 1.795412 shows the absence of autocorrelations of the error term. This affirms that the estimates based on the OLS is not spurious. The ECM coefficient of - 0.349469 shows that about 34 percent speed of adjustment on a priori customs and exercise duty (CED) and its lags, and company income tax (CIT) and its lags by one year indicates a positive relationship with foreign direct investment and did not conform to theoretical expectations. Petroleum profit tax (PPT) and value Added Tax (VAT) show negative relationship with economic growth which is in conformity with economic theory. The analysis reveals also that the variables are not statistically significant.

Discussion of Findings

Based on the analysis of the results of the estimated models the study found out that Customs and Excise Duty (CED) and its lags exhibit positive relation with foreign direct investment. Also that company income Tax (CIT) and its lag by one year indicates a positive relationship with foreign direct investment in Nigeria. For Petroleum Profit Tax (PPT) and Value Added Tax (VAT), there is a negative relationship with foreign direct investment (FDI). In furtherance it indicates that apart from Customs and Exercise Duty (CED), the other components of taxation are not statistically significant with foreign Direct Investment. This is also true of income taxes which are dually related with lower economic growth than taxes on consumption and properties. Specifically this emphasis supports the ranking of tax instruments in respect of their association with economic growth.

Summary Conclusion and Recommendation

Summary

An enabling environment, conducive to foreign direct investment needs capital transfer among technology spillover, technical knowhow and increased employment. These are in addition to tax policy incentives. In these regards this study examines the impact of taxation on foreign direct investment in Nigeria through the technic of the Ordinary Least Square (OLS) method. The estimated model on this analysis reveals that Custom and Exercise Duties (CEO) has positive relationship with foreign direct investment. In addition, is that company income tax (CIT) and its lag by one year indicates a positive relationship with foreign direct investment in Nigeria. However, Petroleum Profit Income Tax (PPT) and VAT show negative relationship with economic growth. There is significant relationship between customs and exercise duties and foreign direct investment. However another insignificant relationship gears up between Petroleum Profit Tax, Company Income Tax (CIT), Value Added Tax (VAT) and Foreign Direct Investment (FDI) in Nigeria.

Conclusion

By the findings from this investigation, conclusion is drawn that; if government directs policy on tax reduction in all tax structures, foreign direct investment will be encouraged, employment will be created with increases in the level of productivity leading to economic growth of the country. The indication is that expansionary monetary policy action of the government, while reducing taxes can boost foreign direct investment inflows through the creation of employment and this can lead to rapid economic growth in the country

Recommendation

Based on the analysis, summary of finding and conclusions the study is recommended that;

Government adopt more of explanatory fiscal policy to boost foreign direct investment through reduction in tax rates.

Aggregate demand should be boosted through commendable performance through disposal income.

Private investment should be encouraged through improved foreign direct investment.

Productive activities and public investment infrastructural development could enhance private foreign investments.

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