



## TRADE OPENNESS AND ECONOMIC DEVELOPMENT IN NIGERIA

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### ABSTRACT

The study examined the impact of trade openness on economic development in Nigeria for the period of 1981-2018. Time series data and econometric techniques like ADF Unit Root Test, Cointegration and ARDL model were used. It was found that there is a long run and positive relationship between Trade Openness and economic growth in Nigeria. The study concluded that trade openness is an important determinant of economic growth. The study therefore recommends that government provide sound trade policies that guarantee and enhance, trade openness for national and international economic integration and boost economic development.

**Keywords:** Trade Openness, Economic growth, Cointegration and ARDL Model

### 1.0 INTRODUCTION

Trade openness in Nigeria is one of the most important determinants of economic growth and is becoming increasingly popular among the less developed nations in the recent time. It refers to the degree, in which a country has trade with other countries of the world. The components of openness to trade include import and export, foreign direct investment (FDI), borrowing and lending and repatriation of funds abroad (Godslove & Adaku, 2018). The rate of openness to trade of a country can be measured as the proportion of foreign trade volume to GDP, likewise, the proportion of import to GDP and increase in the rate of export (Romer, 2009).

In the long run, trade openness can potentially boost economic growth by providing access to goods and services, achieving efficiency in the allocation of resources and improving total factor productivity, through technology diffusion and knowledge dissemination (Barro & Sala-I-Martin, 1997). However, it is expected that nations with more trade openness will relatively outperform those nations with less openness to trade. In this regard, developing countries and Nigeria in particular have much to benefit by trading with developed nations. It is in view of these likely gains that international institutions and donor government recommend trade liberalization policies to developing nations in the expectation of opening up and integrating them into the global world. The failure of import-substitution industrialization strategy as well as findings from empirical studies showing that more outward-oriented economies have recorded increase in economic growth rates. In addition, the fantastic success of economies of East Asian was halfway accredited to their trade openness (Stieglitz, 1990). It has been on record that in the late 70s, many less developed

nations have embraced trade liberalization reforms by reduction of tariffs on importation and exportation and reduction of non-tariff barriers (Keho, 2017).

The developing nations, especially Nigeria's inability to fully embrace trade openness in their economic and development process, is making them to participate somewhere within the margin in the global economy. The rapid growth of international trade, foreign direct investment and international flows of capital and information are the indicators of trade openness. It brings about the formation of various regional economic groups around the globe. As Nigeria wants to be part of moving with globalization trend, it has signatory to many multilateral trade agreement (Osabuohien, 2007).

Nigeria, as a part of developing nations, has been struggling with realities of developmental process not only on the basis of political and social issues but also on the basis of economic development. In 1960, agriculture was the major stay of its economy and the foreign earner; and the government was able to execute investment project through domestic savings, earnings from exports of agricultural products and foreign aids (Ezike, Ikpesu & Amah, 2012). However, since the advent of oil as a major source of foreign exchange earnings in the 70s, the picture has almost been that of general stagnation in agricultural export. This has led to loss of Nigeria's position as an important producer and exporter of palm oil produce, groundnut, cocoa and rubber (Central Bank of Nigeria, 2006).

The Nigeria export performance has been boring. Unlike some other oil producing nations like United Arab Emirate, Russia and Saudi-Arabia, Nigeria has not been able to diversify its export-base so that the oil sector continues to dominate almost all merchandise exports and contributes over 70% of its total foreign earnings (Nduka, 2013)

The export base of Nigeria as a country is yet to be diversified and dominance of oil exports have made her to be highly dependent on the world oil market. This impediment forbids it from taking advantage of dynamic opportunities in other sectors of the economy such as manufacturing, construction, services and agriculture which have been neglected since 70s. However, several policies and programme have been rapt towards diversification of the economy but failed to bring in affirmative results (Moyo, Kolisi & Khobai 2017). This study intends to examine the impact of trade openness on the Nigerian economic growth between the periods of 1981 to 2018.

The paper is divided into five subsections with the introduction as section one. Section two contains the conceptual framework and empirical literature. Section three contains the research methodology, while presentation of results is done in section four. Conclusion and recommendations are presented in the fifth section.

## **2.0 LITERATURE REVIEW**

### **2.1.1 Openness to Trade**

Adam Smith (1776) used the principle of absolute cost advantage in explaining trade by using labour as the only input because the absolute cost advantage is determined by comparing the labour productivities between the two countries. It is possible for a country to have no absolute cost advantage in anything, based on the theory of absolute cost advantage trade cannot occur with the other country. It is the ability of a country to produce more of a good product or service than competitor by using the same quantity of resources. Smith had a view

that nations should produce and export goods with lowest cost advantage and the same country should import product which it has highest absolute cost disadvantage. However, involving in foreign trade can promote economic growth.

According to David Ricardo (1772-1823), openness to trade can be understood by using trade volume rather than the use of trade policy, he opposed to tariffs and other restriction of trade. Ricardo stipulated the theory of comparative cost advantage in explaining trade. The theory stated that comparative advantage is a specialization technique used to create more efficient production and describes opportunity cost between producers with perfect competition and undistorted markets where countries that tend to export goods in which they have a comparative advantage. In addition, a country should specialise in producing and exporting only those goods and services in which it can produce more efficiently at lowest opportunity cost than those goods and services it can import. The country should concentrate and specialize on those products in which it has the highest comparative advantage at a least comparative cost.

Heckscher-Ohlin (1919, 1933) contended that for a country to engage in trade with each other they must maintain the same level of technology, constant returns to scale, and a given factor-intensity relationship between final products. The nation with better factor endowment should produce goods at a larger quantity and trade with the other nation by which it will boost economic growth.

Rodriquez and Rodrik (2001) contended that trade policy does affect the volume of trade; there is no strong reason to expect the effect of growth to be quantitatively similar to the consequences of change in trade volumes that arise as reductions in transport cost or increase in the world demand. Trade restrictions should represent policy responses to real or perceived market imperfections or are used as mechanism for rent extraction. They believed that trade policy works differently from natural or geographical barriers to trade and other exogenous determinants.

The outward-oriented economic strategies believe that trade openness among countries of the globe can as well benefits the economies of the less nation through growing their activities by trade that would not been possible from their local economies only. It can also be seen as a way of assisting them via specialization and technological transfer and as such their citizen welfare can increase as a result of improvement in their total national income (Osabuohien, 2007). Trade openness is very vital to any economy due to the differences in technology, proportion of potential mobile resources (capital and labor) and availability of particular non-movable factors of production (land and other natural resources). The gains of trade are in two forms, the production and consumption gain. In this regard, the degree of countries trade openness can develop the country through economic of scale; externalities connected with information and transmission of knowledge likewise the spillover effect that can improve the productive activities of an economy. In this case, in the long run the country can perform better economy.

According to Akinlo (2003), trade openness could be seen as multi-dimensional process that do not only take place within the context of economic, social, cultural and environmental factor but also on the basis of relationship among government and country of the globe. Thus process of openness to trade can integrate national economies through capital flow, trade, and harmonization of economic policies among countries and formation of worldwide market

frameworks. It is the process of integration of a whole system of interdependence among sovereign states by reducing barriers to trade, capital flow and the transfer of technology among others.

Osabuohien (2007) contended that openness could be seen as where countries of the world coming together in order to have free movement of labour, capital and free trade. Moreover, the effect of trade can increase competition and boost efficiency. Trade openness is believed to be an imperative source of economic growth. The gain from trade liberalization has not been achieved by the developing nations as a result of protectionist trade policies of the developed countries.

### 2.1.2 Economic Growth

Economic Growth could be defined as the yearly increase in real per capita income of a nation over a sustained period of time Ahuja (2008). Similarly, Jhingan (2002) assert that the standard of a living of a citizen can increase overtime in a country if its economic capacity to produce goods and services is increasing in numbers and diversity.

IMF (2009) contended that economic growth is the increase in the production of goods and services over time in an economy. Traditionally, economic growth can be measured as the rate of percentage change in Real Gross Domestic Product. Growth can be computed in actual term so that the inflation – adjusted term can rule out the effect of inflation on the price of goods and services produced in a nation.

The economic growth has some determinants which were identified by Ahuja (2008). These determinants include:

**(a) Capital Formation:** The capital formation can influence economic growth if labour is combined with capital to produce goods and services in the economic. The employees need some machines and tools to work so as produce goods and services that can bring about increase in economic growth and development.

**(b) Natural Resources:** The availability and supply of natural resources play a vital role in nation economic growth. The quantity and quality of natural resources available in the country can boost economic activities in the nation. The level of an output of goods can be attained if the quality of natural resources put a limit.

**(c) Technological Progress:** The level of technology in the country can determine the economic growth. The use of advance and modern technology in the production process can led to imperative increase in per capita output.

**(d) Foreign Capital:** This could be in the form of Foreign Aid and Foreign Investment which can be serving as the determinant for economic growth. Since the domestic savings are not sufficient enough to make desired capital accumulation, borrowing from abroad play a significant role for economic growth and development in the country

### 2.1.3 Nexus between Trade Openness and Economic Growth.

Prior to the beginning of new trade theories, a number of postulates in the global trade theories were as a result of, among others, the contributions by Ricardo, Heckscher Ohlin and Samuelson. The Ricardian model of trade ponders on technological differences as the major factor causing international trade (Krugman, 1987). The Heckscher-Ohlin-Samuelson model

on the other hand, ascribes international trade to differences in factors endowments. Thus, the increase in international trade opportunities is probably to support growth in labour intensive export industries (Ahmed & Sattar, 2004). Although, the classical theories of global trade brought into being the models of international trade, these theories were developed under the assumption of perfect competition and constant returns to scale. For perfect competition to take place the gains from trade would bring about an increased efficiency (Havrylyshyn, 1990). However, the legitimacy of perfect competition was though challenged by new theories of international trade of which Krugman (1979) was inclusive.

The new theories of international trade rebut the idea of perfectly competitive market and that the market is assumed to operate under the condition of imperfect competition. The imperfect competition occurred as a result of economies of scale and that the economics of scale makes it possible for the nations to recognize some of the gains from trade. The gains from trade take place from economic of scale which could be in the form of increased in the welfare of the nations that are involved in trade (Krugman, 1979). The endogenous growth theory is the new theory which support the view that trade openness can influence economic growth positively. Romer (1990) contends that free international trade can likely speed up economic growth. One of the ways under the endogenous growth theory which trade openness affect economic growth is the technological transmission. Hence, the transfer of technology and other factor movements are more possible in an open economy than the closed economy. Based on the endogenous growth theory Adikhary (2011) put forward that trade openness can influence economic growth by facilitating flows of international capital and redirecting factor endowments into more productive sectors of the economy.

For the fact that facilitating factor movement and capital flows can influence trade openness, it can also affect economic growth via its effect on labour productivity and export capability. In this regard, the economy that is more open to trade is inclined to have increased specialization and division of labour which in turn improves productivity and export capability (Constant & Yaoxing, 2010). The connection between trade openness and economic growth however has been linked with effect of trade openness on foreign investment. In line with this, a higher degree of trade openness attracts more foreign investment inflows (Osabuohien, 2007). Due to development in trade and literature of economic growth several means that connect openness to trade with economic growth have been identified such as: reduction in restrictiveness of trade regime, tariffs and the reduction of embargo on trade has led to rapid economic growth. In line with this economic growth, developing nations in part depend on their ability to import, the capital goods, investment and intermediate goods and services (Krueger, 1998). This situation offers a possible explanation to why several developing countries over the past decades introduced measures that aimed at relaxing the restrictiveness of their trade regimes towards more open to trade. According to Klasra (2011) trade openness is that when an economy is more open to trade, the national per capita income may increase. This can bring about increased in openness to trade that encourage investment which in turn leads to increased economic growth in the long run.

## **2.2 Empirical Literature**

Yakubu and Akanegbu (2018) investigated the impact of trade openness on economic growth in Nigeria between the periods of 1981 to 2017. The econometrics techniques and the method used were OLS, Granger causality test and cointegration test. The result showed that there was cointegration relationship between trade openness and economic growth in Nigeria. Also, there was unidirectional relationship between economic growth and trade openness in

Nigeria. The study recommend that the policy makers need to established trade policy of trade liberalization such as tariffs and non-tariff that might enhance economic growth and development in the country.

Malefane and Odhiambo (2018) examined the impact of trade openness on the economic growth in South Africa. The study used the Autoregressive Distributed Lag (ARDL) bound test in order to find out the dynamic impact of trade openness on economic growth, and the result of the study showed that trade openness has positive impact and statistically significant on the economic growth. The study recommends that there is need for promotion of policies that can support international trade in the economy of South Africa.

Keho (2017) examined the impact of trade openness on economic growth in Cote'dlvoire between the periods of 1965 to 2014. The techniques and the model used was Autoregressive Distributed Lag bound test and the Toda Yamamoto Granger causality tests. The results showed that there was a positive effect of trade openness on economic growth in Cote'dlvoire and there was short and long run relationship between trade openness on economic growth. In addition, the study discovered a positive and robust relationship between trade openness and capital formation in enhancing economic growth in Cot'dlvoire.

Tsaurai (2017) investigated the relationship between financial developments, economic growth and trade openness in Argentina between the periods of 1994 to 2014. The techniques and the method used were Granger causality and Error Correction Model. The study reported that there was positive impact of trade openness on economic growth in Argentina and also there was unidirectional relationship between trade openness and economic growth in Argentina.

Moyo, Kolisi and Khobaia (2017) investigated the relationship between trade openness and economic growth in Ghana and Nigeria between the periods of 1980 to 2016. The study used the Autoregressive Distributed Lag (ARDL) model and the result showed that there was a long run relationship between trade openness and economic growth for both countries and that trade openness has positive impact on economic growth and significant. The study recommended that there is a need for different policy measures to be put in place for each of these countries.

Lawal, Nwanji, Asaleye and Ahmed (2016) examined trade openness on Nigerian economic growth with the used of time series data. The method and the model used were Granger causality technique and Autoregressive Distributed Lag. The result showed long run relationship and positive impact on economic growth in Nigeria. Also, the Granger causality result showed bidirectional relationship between trade openness and economic growth in Nigeria. The study recommended that government need to initiate a sound macroeconomic policy that can improve national and international trade in the nation.

Godslove and Adaku (2018) investigated the relationship between trade openness and economic growth in Nigeria between the periods of 1990 to 2015. The cointegration and ARDL model were used. The result showed that there was a long run relationship between trade openness and economic growth in Nigeria. The trade openness had positive impact on economic growth in Nigeria. The study recommended that there is need for government to regulate the trade openness.

According to Jadoon, Rashid and Azeem (2015) investigated the impact of trade liberalization on the human capital and economic growth for some selected Asian countries for the period of 1981 to 2012. The panel data analysis were used and the selected countries (India, Indonesia, Pakistan and Sri Lanka) were grouped as lower income nations and the selected nations of higher income nation (Japan, Malaysia, Singapore and South Korea) were also grouped for comparative analysis. The results showed that both the developed and developing nations enjoy the trade led growth within the period under reviewed and the impact of trade openness on human capital has shown positive for both group but only developed nations was statistically significant because of well-trained human capital. The effect of trade openness in form of increase in productivity of human capital has not been achieved in the developing nations because of poor trained attitude and inadequate skilled workers.

Nduka (2013) examined the impact of openness and economic growth in Nigeria from 1970-2008. The method used was OLS and cointegration, result shows that openness has positive impact on economic growth and there was long run relationship between trade openness and economic growth.

### 3.0 METHODOLOGY

#### 3.1 Data and Sources

The time series data used for this study are sourced from various publications of World Bank Development Indicator, United Development Indicator and CBN Statistical Bulletin, for the period of 1981 to 2018. The ARDL model is to be used in this study.

#### 3.2. Model specification

In order to achieve the objectives of this study, the study adopted the work of Moyo, Kolisi, and Khobaia (2017). Based on the model, the model specification for this study was built and modified. The modification is in line with some of the studies reviewed. However, the model specification for this study is as follow: -

$$GDPG_t = f(TRO_t, NEXR_t, INF_t, INTR_t, GCFU_t) \dots\dots\dots (1)$$

$$GDP_t = \beta_0 + \beta_1 TOP_t + \beta_2 NEXR_t + \beta_3 INF_t + \beta_4 INTR_t + \beta_5 GCFU_t + U_{t-1} \dots\dots\dots (2)$$

Theoretically, the coefficients of equation (3) are expected to take the following signs:  
 $\beta_1, \beta_5 > 0, \beta_2, \beta_3, \beta_4 < 0$

Where  $GDPG_t$  = Gross Domestic Products Growth which is a proxy for economic growth.  $TRO$  = Openness to trade, expressed as ratio of trade to GDP.  $NEXR$  = Nominal Exchange Rate, expressed as local currency relative to US dollar,  $INF$  = Inflation rate proxied by consumer price index.  $INTR$  = Interest rate,  $GCFU_t$  = Gross Capital Formation  $\beta_0$  = Constant,  $\beta_1 - \beta_5$  = Coefficient of explanatory variables  $u$  = Error term.

### 4.0 RESULTS AND DISCUSSION

#### 4.1 Unit Root Test

The findings of Augmented Dickey-Fuller (ADF) are presented in table 4.1 below:

**Table 4.1 Unit Root Result of Stationary Test**

VARIABLE	At Level		At First Difference		REMARKS
	T-STATISTICS	CRITICAL VALUE 5%	T-STATISTICS	CRITICAL VALUE 5%	
GDPGt	-3.462	-1.951	-	-	1(0)
TRO	-0.438	-3.581	-4.464	-3.581	1(1)
INFL	-3.939	-3.540	-	-	1(0)
NEXCH	-1.773	-3.537	-4.538	-3.540	1(1)
INTR	-2.622	-3.540	-6.152	-3.544	1(1)
GCFU	-4.062	-3.537	-	-	1(0)

**Sources:** Author's computation based on E-View Version 9

Table 4.1 is the summary of unit root test. It shows that three variables (GDPGt, INF and GCFU) are stationary at level at 5% level of significance while TRO, INTR and NEXCH are stationary at first difference at 5% level of significance. The levels of significance of the variables were determined at order where the absolute value of the t-statistics is greater than the critical values.

#### 4.2 Cointegration test

The result of the bound test is presented in Table 4.2

**Table 4.2: Cointegration Bound Test Result for trade openness and Economic growth**

ARDL Bound Test	F-Statistic	Critical Value Bounds 1%		Critical Value Bounds 5%		Critical Value Bounds 10%	
		Lower Bound (10)	Upper Bound (11)	Lower Bound (10)	Upper Bound (11)	Lower Bound (10)	Upper Bound (11)
	10.311	3.06	4.15	2.39	3.38	2.08	3.00

**Sources:** Author's computation based on E-View Version 9

The cointegration Bound test for long run relationship, in table 4.2, shows that F-statistics (10.311) is greater than upper bound critical value of 4.15, 3.38 and 3.00 at 1%, 5% and 10% level of significance respectively. The study therefore rejects the null hypothesis, and concludes that there is long run relationship between Trade Openness and economic growth in Nigeria.

#### 4.3 Long-Run Estimates of ARDL Model

**Table 4.3 Cointegration Regression of Long-run ARDL Model**

Variable	Coefficient	Std Error	t-Statistics	Prob.
TRO	0.438791	0.135035	3.249454	0.0100
LGCFU	-3.599397	2.121012	-1.697018	0.1239
NEXCH	0.145401	0.063531	2.288670	0.0479
INFL	0.206923	0.247112	0.837368	0.4241
INTR	-0.126938	0.634196	-0.200155	0.8458
C	79.30232	56.93745	1.392797	0.1971

**Sources:** Author's computation based on E-View Version 9



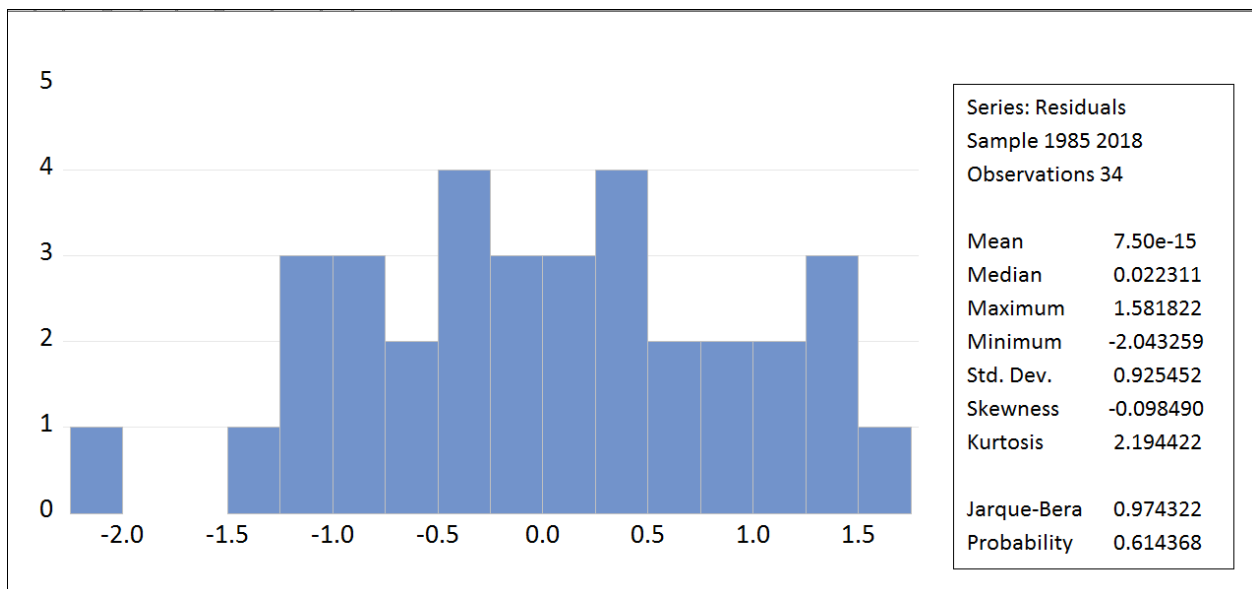
Table 4.3 shows the ARDL Model cointegration regression of the long run relationship between the variables. The table shows the sign, magnitude and the nature of statistical relationship between the dependent variable – GDPGr (Gross Domestic Product Per capita Growth) and explanatory variables which includes Openness to trade, Nominal exchange rate, Inflation rate, interest rate and capital formation. The coefficient of TRO is 0.438791, which indicates a positive relationship and statistically significant at 1%. This signified that an increased in the value of TRO will cause 0.43% increase in the value of GDPGr.

Also, the coefficient of GCFU is -3.599397 which means it has a negative influence on economic growth and is statistically insignificant. This indicates that a percentage increase in the GCFU will bring about 3.6% decreases in the economic growth. However, the coefficient of INFL. is 0.206923 which indicates a positive relationship and this signify that an increase in inflation rate will bring about 0.20% increase in economic growth. Nominal exchange rate has a statistical significance and positive impact on Nigerian economic. In the same vein, the coefficient of interest rate is -0.126938, which implies a negative relationship. An increase in interest rate can bring about a decrease in economic growth in the country. Finally, the constant coefficient of 79.30232 which means if all explanatory variables remained constant, there is tendency of GDPGr to increase by 79.30%.

**4.4 Post-estimation Diagnostic Tests**

**4.4.1 Test of normal distribution of the model using Histogram**

To establish the adequacy, reliability and error-free estimations, there is a need to carry out post-estimation tests of normality test, Serial Correlation test and Heteroskedacity test. The results are presented in the following order.



Sources: Author’s computation based on E- View Version 9

**Fig. 1 Test of normal distribution of the model using Histogram**

The figure 1 shows the normal distribution test, it is used to know whether the residuals of a model are normally distributed. The result shows that the probability value of 0.61 is greater than 0.05% level of significance. The study therefore accepts the null hypothesis, and established the fact that the residuals are normally distributed.

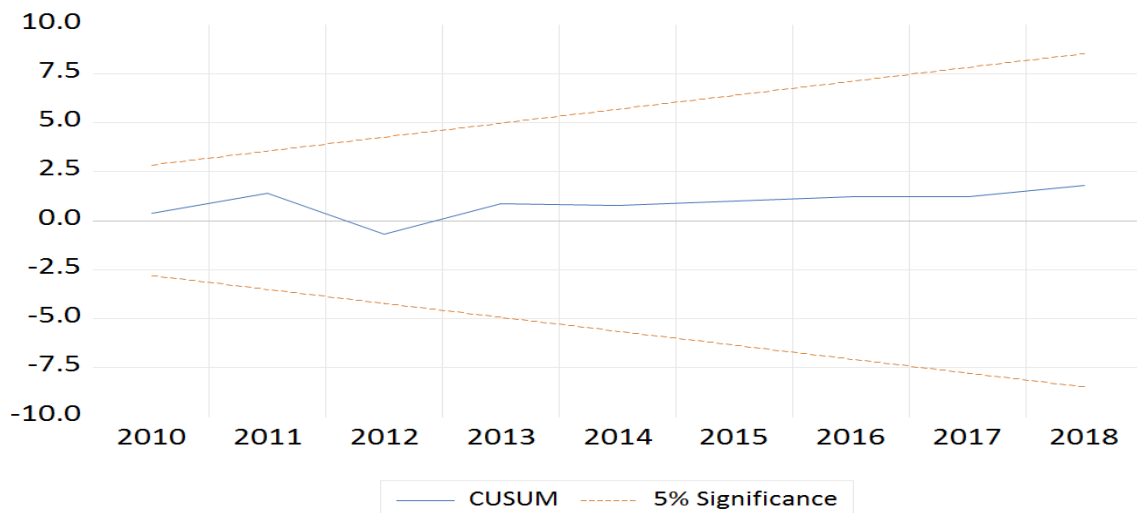
**Table 4.4 Post-estimation Tests**

Diagnostic Tests	Statistics	P-Value
Serial Correlation Test	Breucsh Godfrey (LM Test)	0.380
Heteroskedacity Tests	Breucsh-Pagan - Godfrey Test	0.295

**Sources:** Author's computation based on E-View Version 9

As shown in table 4.4, the post estimation tests revealed that the null hypotheses should be accepted since the probability values of 0.380 and 0.295 are greater than 0.05% level of significance. The test for Serial Correlation signified that the errors are not correlated with each other, no serial correlation and the test for Heteroskedacity indicated that there is equal variance among the errors of the model and variance of residual are the same. CUSUM Test was also carried out to know whether the model do not suffer from omission of some significant variables or addition of redundant variables.

The CUSUM diagram is presented in figure 2:



Source: Author's computation based on E-View Version 9

### Figure 2: CUSUM test

In the figure 2, the two red lines represent the upper and the lower bounds of a model, at 5% level of significant. The presence of blue line in-between the red lines confirm the adequacy and stability of the model.

## 5.0 SUMMARY CONCLUSION AND RECOMMENDATION.

This study examined the impact of long-run relationship of trade openness on the Nigeria's economic growth as from 1981 to 2018. The economic growth was proxied as Gross Domestic Product per Growth and trade openness was proxied as TRO. Variables such as exchange rate, inflation, capital formation and interest rate are controlled for in the model. For stationary test, three variables (GDPGt, INFL & GCFU) are stationary at level and other variables (TRO, NEXCH & INTR) are stationary at first difference, all in 5% level of significance. The cointegration bound test established long run relationship between trade openness and economic growth at 5% statistical level of significance. In addition, the ARDL model of long-run regression confirmed that an increase in trade openness associated with an

increase in GDP per growth in Nigeria. This signified that trade openness is statistically significant and can impact positively on Nigerian economic growth. This is in line with apriori expectation. But the level of impact is minor this may be due to poor economic policies and implementation toward trade. Other related problems affect Nigerian economy include monoculturalism, reliance on exportation of primary products, high level of government spending on recurrent expenditures and business unfriendly environment. The study therefore, concluded that trade openness is an important determinant of Nigerian economic growth.

Trade openness can be seen as economic stimulant, as it integrates the world economies and generation of new and broader markets for various countries within the global space. However, Nigeria is a monoculture economy with over dependence on oil sector. There is a need for diversification; the high dependence on primary commodity remains one of the most obvious features of trade pattern of countries in Africa with other part of the world. For a nation to have a satisfied gain from trade openness and to have a desirable level of economic growth there is a need for government to provide a sound trade policy that can guarantee trade openness for national and international economic integration and boost economic development. For Nigeria to continue opening up to trade, there is a need for line up import and export according to suitable policies that will reduce importation of consumer goods and technological improvement so as to increase the value of their export.

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