



## NIGERIA THE LARGEST ECONOMY IN AFRICA: A PARADOX OF ECONOMIC GROWTH HYPOTHESIS

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### ABSTRACT

*Despite Nigeria's impressive aggregate economic growth in the past 20 years, it seems the poor are getting poorer as inequality looms. The rapid gains in the overall per capita gross national product (GNP) growth has not been seen to 'trickle down' to the masses in terms of job creation and other economic opportunities or create necessary condition for income distribution. Majority of the people are yet to understand the characteristics of Nigeria's growth pattern, a distributional pattern that has left the poorest groups largely outside the sphere of economic expansion and material improvements. This study therefore examines the relationship between poverty and growth in Nigeria using a quantitative framework and also a co integration and error-correction modeling framework during the period 1980-2012. Although the interactions among policy instruments used in this study are not modelled in detail, the results serve to clarify the nature of the problem. The poverty variable coefficient is positive though statistically insignificant to growth. The hypothesis that real GDP does not Granger Cause poverty cannot be rejected, but the hypothesis that poverty does not Granger cause real GDP can be rejected. Therefore, it appears that Granger causality runs one way, from poverty to growth.*

## **1. INTRODUCTION**

For decades, development economists have taken pains to dissuade Less developing countries (LDCs) from relying on gross national product (GNP) or gross domestic product (GDP) as measure of development (Todaro, 1977; Ahluwalia et al 1979; Szekely 1999). In the 60s and early 70s development was conceived of, and accepted as an economy that can generate and sustain the attainment of a 6 percent annual target rate of GNP. Development was nearly always seen then as an economic phenomenon in which the rapid gains in the overall per capita GNP growth will 'trickle down' to the masses in terms of jobs and other economic opportunities or create necessary condition for income distribution.

Incidentally, by late 1960s many third world countries has attained the UN economic growth targets but the living conditions of the masses remained for the most part unchanged. A clamour was raised by an increasing number of economists and policy makers for the 'dethronement of GNP' and direct attack on widespread absolute poverty and massive unemployment. Latin American and Asian countries, which spearheaded the clamour, jilted the reliance on GNP and embraced the new growth theory (though lately for the Latin American countries). Mahbub ul Haq (1971) said, 'we are taught to take care of our GNP as this will take care of poverty, but let us reverse this and take care of poverty as this will take care of the GNP'. Most African economies were reluctant to jettison some of these 'eurocentric' theories from the Western world. Ake, (1983) said, one of the main weaknesses of mainstream Western social science is its discouragement of dialectical thinking, a weakness that has also spilled over into African studies. This discouragement of dialectical thinking is related to the West in justifying and

preserving existing social order. It is to this existing order that Nigeria has fallen prey to, in the rebasing of its GDP.

This paper focuses on the relationship between economic growth, inequality and the incidence of poverty in Nigeria. We argue on the premise that due to the skewed distribution pattern of growth experienced in Nigeria, its growth would not necessarily leads to a reduction in poverty incidence or does it enhance quality of life nor does it reduce inequality in low-income societies like Nigeria from a social science perspective, in the short run. The rest of the paper is divided into four sections. Section two is on conceptual framework and literature review while section three is on research methodology and model specification. Section four is on findings and discussion. Section five, concludes and recommends.

## **2. CONCEPTUAL FRAMEWORK AND LITERATURE REVIEW**

It will be easier to understand the phenomenon when we grasp the meaning of the basic concepts, in that way we shall begin by defining the basic concepts.

### **Economic growth:-**

It is the steady process by which the productive capacity of the economy is increased over time to bring about rising levels of national income (Todaro, 2011). Economic growth means more output, while economic development implies both more output and changes in the technical and institutional arrangements by which it is produced and distributed (Jhingan, 2012). Whereas economic growth may not necessarily account for development, yet the reality is that the material conditions of a people may not change for the better in the absence of economic growth. Therefore, ordinary common sense dictates that

government's efforts must first and foremost be directed at economic growth because the attainment of it, is a pre-requisite or rather a necessary condition for the citizens' economic empowerment and social wellbeing (Anochiwa, 2013).

### **Economic Development:-**

Development is not entirely an economic phenomenon. It is a multidimensional process involving the reorganization and reorientation of the entire economic and social systems. In addition to improvement in incomes and output, it typically involves radical changes in institutional, social and administrative structures as well as in popular attitudes and even customs and beliefs (Todaro 2012). But suffice it to say, that achieving "modern development is both possible and extremely difficult".

### **Poverty:-**

Though a multidimensional concept that borders on physical, moral and psychological aspects of human conditions, the poor is anyone who is living on less than \$1.50 a day or \$2 per day in Purchasing Power Parity (PPP) dollars. There are many methods of measuring absolute poverty- the "headcount" H, the total poverty gap (TPG), the normalized poverty gap (NPG), the Foster-Greer-Theobcke index (FGT) and the newly introduced multidimensional poverty index (MPI) (Todaro 2012).. Ordinarily, the higher the level of per capita income the lower will be the number of the absolutely poor, but overtime it is observed, especially from the experience of most developing countries, that higher levels of per capita income are no guarantee of reducing poverty. Poverty in Nigeria has been traced to many issues among which are corruptions, bad governance, debt overhang, unemployment and low productivity (Obadan, 2002). In this study we are not measuring poverty and inequality per se but our concern is why it must still exist where there is intimidating economic growth.

### **Inequality:-**

Inequality seems to be a straightforward concept: the disproportionate distribution of total national income among households. Obviously, as it suggests a departure from the simple idea of equality, the concept looks straight forward Cowell (1995). However, difficulties arise when the concept is framed into the social context and in connection with economic problems (Gallo, 2002). In this context, the concept is generally related to differences in income, consumption or wealth and associated with social welfare. In this common usage the term embodies so much on value judgment about fairness which will differ according to different ethical viewpoints.

### **Economic Growth, Poverty and Inequality Nexus:-**

Much of the debate on economic growth and poverty has its origin in the classical contributions of Kuznets (1955, 1963), who hypothesized that the process of development was likely be accompanied by a substantial increase in inequality, which would reverse itself only at a relatively advanced stage. As a country develops, it acquires more capital, which leads to the owners of this capital having more wealth and income and introducing inequality. Eventually, through various possible redistribution mechanisms such as social welfare programs(which hardly exists in most LDCs), more developed countries move back to lower levels of inequality- Kuznets U-curve. For more than 40 years the debate has been on, despite the little empirical support that this hypothesis has received. This is why Gary Fields (1988, p.462) called it "one of the greater ironies in the history of thought on economic development". Kuznets stated that there was "... a long swing in the inequality characterizing the secular income structure: Surprisingly, Kuznets recognizes that his paper "...is perhaps

5 per cent empirical information and 95 per cent speculation, some of it possibly tainted by wishful thinking” The question to ask is this: Does economic growth tend to improve, worsen or have no necessary effect on income distribution? Are high levels of income inequality a necessary condition for growth acceleration?

### **Literature Review:-**

Many authors have empirically examined the relationship between economic growth and income inequality in a large group of countries (Kohli, 2004; Etekpe and Inyang, 2008). Following the broader economic growth literature, the typical approach was to relate countries’ real GDP per capita growth over a long period of time (e.g., 1970 through 2010) to the income distribution at the start of the period, simultaneously taking into account other standard determinants such as the initial level of real GDP per capita. A typical conclusion was that more unequal countries tend to grow slower (Alesina and Rodrik, 1994; Deininger and Squire, 1998) though the evidence was contested by Barro, (2000). Fields (1991) findings show, that there is not a definite relationship between changes in inequality and the level or the rate of economic growth, but that those changes seem to be associated with the “pattern of growth”.

Further support to this view is given by Mátyás, Kónya and Macquarie (1998), who, using a two panel data set of 47 and 62 countries, find that it is not the GDP per capita which explains income inequalities but rather the specific characteristics of a country such as social structure, political system, and natural resources. Forbes (2000) found that an increase in inequality tends to raise growth during the subsequent period. This literature did not go too far as Banerjee and Duflo (2003) found a

complex relationship between inequality and growth, in which changes in inequality in either direction lowered growth subsequently. Morley (1995), Psacharopoulos et. al (1995), and Ravallion and Chen (1997) found that growth reduced “poverty”, although not inequality, while Ravallion and Datt (1996) show that aggregate growth is able to reduce “poverty”. Also, Jha’s (1996) estimates prove that the bottom 20% of the population benefits from economic growth in the long run, suggesting that trickle down seems to operate.

In recent years, the economic growth literature has recognized that growth in most countries does not follow a smooth path, but is characterized by sharp turning points – periods of sustained growth and stagnation. The interesting empirical questions, then, are about the determinants of the turning points (Pritchett, 2000).

### **Poverty in Nigeria: Underlying forces:-**

The reason why Nigeria increases its poverty level is multifarious- it is historical, economic and political. Historically, it is argued that Nigeria’s contact with the forces of Western imperialism distorted and disarticulated her economy. The country also became ‘peripherized’ by the international division of labour (IDL), and became dependent economically, socially and politically. The natural fall out is rule by repression and suppression that leaves the people impoverished and subjugated. Nigeria’s deplorable poverty index is also traceable to the people’s orientation of governance; an orientation of winner takes all. The institutions that could have checked some of the excesses of governance are cowed and moribund. Again, we see pervasiveness of corruption and inequality attributable to unequal access to income opportunities, basic infrastructure, poor education and health status and the

misappropriation of the proceeds from the natural resources (Oseni et al 2012; Sule 2012; Omonona 2010; Clinton 2012). It is estimated that Nigeria has sold no less than 4 billion barrels of crude oil at an average rate of 1.5 million barrels per day between 2004 and 2010. At a modest exchange rate of N120/\$ and \$70 per barrel, the total proceeds would have been at least N32 trillion (Oseni et al 2012). Nigeria may be suffering from 'mineral resource curse' because no nation that depends on mineral resource has ever developed.

### **GNP as a biased index of national development:-**

As we have asserted at the beginning, GNP may not satisfactorily account for national development. For example, suppose an economy consists of only 10 individual and 9 had no income and the tenth received 100 units of income. The GNP for this economy could therefore be 100 per capita  $GNP = 10$ . If the economy GNP is rebased so that GNP is 120 units the 20% per capita is now = 12. If the nine individuals still have no income before and now, (ie  $1.2 \times 0 = 0$ ) a rise in such per capita income does not call for rejoicing. In this case, GNP instead of measuring the welfare of the society at such a circumstance would merely be measuring the welfare of an individual (Todaro 1977; Ahluwalia et al, 1979). Therefore using the measure of GNP growth as an index of improvement, accords to each income group a welfare valuation that corresponds to their respective income shares. The question is what are the respective income shares of many people in Nigeria. This will go to explain (preemptively) why Nigeria overblown income per capita may be very, very narrow and may lack the trickle-down effect.

### **3. METHODOLOGY**

Following the lead of Dike (2007a) and Saaed (2007), the study employs two

econometric models to achieve the empirical results. The first econometric model examines the short-run and long-run relationship between real RGDP and POVERTY by applying the Johansen (1988) co-integration test and the associated Error Correction Model (ECM) and the second is the application of the Granger causality test to determine the direction of causality between the two variables. Thirdly descriptive statistics is used to analyze data sourced. The descriptive design enables us to use graph, charts and diagrams to describe the data. Getting data to analyze Nigeria phenomenon is often characterized by conjectures this is why it took almost two decades to rebase its GDP. When it comes to information gathering and data collection Nigeria is a difficult place to go. As we have chosen 1980 to 2012 it's still not without some breaks.

### **Data Description and Sources:-**

The data covers the period from 1980 to 2012. All the variables are taken on annual basis from various issues of the Central Bank of Nigeria (CBN) Statistical Bulletin. Estimation Technique: We took the unit root test, Augmented Dickey-Fuller (ADF) test; we employ the maximum-likelihood test procedure established by Johansen and Juselius (1990) and Johansen (1991) for Cointegration Test. After the testing of the Cointegration relationship, we test for causality between Growth and poverty in Nigeria. If the two variables are co-integrated, an Error Correction Model (ECM) is required to be included (Granger, 1988).

### **Model Specification:-**

The primary model showing the relationship between economic growth and poverty is specified thus:

$$RGDP = f(POV) \text{-----} (1)$$

$$RGDP_t = \alpha_0 + \alpha_1 POV_t + \text{-----} (2)$$

Where

RGDP is Real Gross Domestic product as a proxy for Economic Growth

POV is poverty a partial measure of trickle-down effect.  $\alpha_0$  is the constant term, 't' is the time trend, and '  $\epsilon$  ' is the random error term-

#### 4. EMPIRICAL FINDINGS AND ANALYSIS

In order to test for the stationarity of the variables, Augmented Dickey-Fuller (ADF) tests was used to investigate if the variables had a unit root or not.

**Unit Root Test:** The Augmented Dickey-Fuller (ADF) test for unit roots was conducted for all the time series employed for the study. The ADF results in Table 1.1 show that all the variables are non-stationary in their levels. However, with their first differences, growth rate of real GDP, poverty (POV) become stationary, that is, they are I (1) since the ADF value of each of these variables are greater than the 5% critical value in the fourth and fifth column. With these results, all variables are regressed at their stationary level.

The model was estimated using the co-integration and error correction method (ECM). Most of the variables considered in the determination of economic growth in Nigeria have the expected signs. The coefficient of POV is positive in the current period and negative in the lag two. The value of the adjusted R-squared ( $R^2$ ) for the model, is low at 0.32. It implies that poverty variables explained about 32% systematic variation on Real Gross Domestic Product (RGDP) over the observed period (1980-2012) in Nigerian economy while the remaining 68% variation is explained by other determinants of growth not included in

this study. The value of Durbin Watson is 2.0 for the model. This falls within the acceptable region indicating positive first order serial autocorrelation among the variables. The lagged error correction term ECM (t-1) included in the model to capture the long run dynamics between the co-integrating series are correctly signed (negative) and statistically significant. The coefficient indicated adjustment of 100% for the model. These adjustments imply that errors are corrected within one year. The error correction model also reveals a long run relationship between explanatory and dependent variables in the model. Thus, the hypothesis of a significant linear relationship between economic growth, measured by the growth rate of real GDP, and poverty is validated. Based on the Probability values reported in the table 1.4, the hypothesis that RGDP does not Granger Cause POV cannot be rejected, but the hypothesis that POV does not Granger cause RGDP can be rejected. Therefore, it appears that Granger causality runs one way, from POV to RGDP, but not the other way. X “Granger causes” Y if past values of X can help explain Y. If Granger causality holds this does not guarantee that X causes Y. But, it suggests that X might be causing Y. In this sense, our causality test suggests that poverty might influence growth. This argument is relevant in the short run from the ECM result however in the long run we saw that 1 per cent increase in poverty will lead to 149 per cent decrease in growth.

**Table 1.1: Unit root test result at ordinary level and 1<sup>st</sup> difference**

| Variable | ADF statistics | 5% critical value | ADF statistics | 5% critical value |
|----------|----------------|-------------------|----------------|-------------------|
| LN(RGDP) | -3.814697      | -3.6576           | -6.721447      | -3.6661           |
| LN(POV)  | -2.102196      | -3.6576           | -7.070490      | -3.6752           |

**Table 1.2: Johanson Cointegration Result.**

| Series: D(LOG(RGDP),2) D(LOG(POV),2) |                  |                          |                          |                           |
|--------------------------------------|------------------|--------------------------|--------------------------|---------------------------|
| Lags interval: 1 to 1                |                  |                          |                          |                           |
| Eigenvalue                           | Likelihood Ratio | 5 Percent Critical Value | 1 Percent Critical Value | Hypothesized No. of CE(s) |
| <b>0.884185</b>                      | 132.0160         | 29.68                    | 35.65                    | None **                   |
| <b>0.747156</b>                      | 69.49888         | 15.41                    | 20.04                    | At most 1 **              |

*(\*\*) denotes rejection of the hypothesis at 5% (1%) significance level*

*L.R test indicates 2 cointegration equations at 5% significance level.*

**Table 1.3: Parsimonious Result**

| Dependent Variable: D(LOG(RGDP))                    |             |                       |             |          |
|---|-------------|-----------------------|-------------|----------|
| Method: Least Squares                               |             |                       |             |          |
| Date: 09/23/14 Time: 13:16                          |             |                       |             |          |
| Sample(adjusted): 1984 2012                         |             |                       |             |          |
| Included observations: 29 after adjusting endpoints |             |                       |             |          |
| Variable  | Coefficient | Std. Error            | t-Statistic | Prob.    |
| C   | 0.037900    | 0.116129              | 0.326362    | 0.7472   |
| D(LOG(RGDP(-1)))                                    | 0.255536    | 0.215997              | 1.183050    | 0.2494   |
| D(LOG(RGDP(-3)))                                    | -0.017295   | 0.163055              | -0.106066   | 0.9165   |
| D(LOG(POV))   | 0.423664    | 1.358311              | 0.311905    | 0.7580   |
| D(LOG(POV(-2)))                                     | -1.492590   | 1.311214              | -1.138327   | 0.2672   |
| D(LOG(POV(-3)))                                     | -1.476936   | 1.357411              | -1.088053   |          |
| ECM(-1)   | -1.000239   | 0.245750              | -4.070157   | 0.0005   |
| R-squared   | 0.473219    | Mean dependent var    |             | 0.037784 |
| Adjusted R-squared                                  | 0.329551    | S.D. dependent var    |             | 0.706333 |
| S.E. of regression                                  | 0.578352    | Akaike info criterion |             | 1.949237 |
| Sum squared resid                                   | 7.358798    | Schwarz criterion     |             | 2.279273 |
| Log likelihood                                      | -21.26393   | Durbin-Watson stat    |             | 2.007634 |

**Table 1.4: Pairwise Granger Causality Tests**

| Date: 09/23/14 Time: 13:20                |     |             |             |
|---|-----|-------------|-------------|
| Sample: 1980 2012                         |     |             |             |
| Lags: 2                                   |     |             |             |
| Null Hypothesis:                          | Obs | F-Statistic | Probability |
| LOG(RGDP) does not Granger Cause LOG(POV) | 31  | 0.09541     | 0.90931     |
| LOG(POV) does not Granger Cause LOG(RGDP) |     | 2.90935     | 0.07241     |

In examining the relationship between each of the independent variables and economic growth, it could be seen that poverty growth does not cause poverty, however poverty

can adversely influence growth in the long run. But this study goes to show that the growth of the economy could seriously be affected and slowed down because of poverty and inequality.

### **The Growth Paradox:-**

The number of Nigerians living below poverty line rose from 80.2m in 2006 to 112.5m in 2012 (63.7% rise in poverty incidence) during the period while the population rose from 139.2m to 158.6m (13.9% rise in population) over the same period. Again, the number of unemployed members of the labour force continued to grow from 12.3% in 2006 to 23.9% in 2012. Again, real GDP rose from 18.21 in 2006 to 20.79 in 2012. Thus, Nigeria's economy grew strongly at an average annual growth rate in excess of 6.6%, making the country the 5th fastest growing economy in the World in 2012 at 8.73% real growth rate. Again, in table 1.6, in 1980 gross national income (GNI) capita at 2005 PPP was \$1,571 and in 2012 it was \$2012. The rate of unemployment in 2005 was 12.3% and in 2011 has risen to 23.9%. In other words, as the real GDP is increasing, unemployment is increasing, poverty is increasing, inequality is increasing, income per capita is increasing and the general welfare is decreasing. The above represents the paradox of growth in the face of poverty and inequality. It contradicts and conflicts with rational economic and social theories as well as historical trends. It highlights and brings to fore vividly the structural defects and disequilibrium in the Nigerian economy.

### **Where do this disconnect stem from?**

The structural disconnect in the Nigeria system occurs at the investment resource use link in the transmission channel. The low and medium sector is not robust, taste for foreign goods among the rich, infrastructural decay and fiscal mismanagement has ensured that the resultant investment demand is "exported". (BGL reports, 2012). According to Todaro (1994), unlike the historical experience of the now developed countries, the rich in developing countries are characterized by spending in luxury consumption (usually imported) and

saving abroad. In Nigeria virtually all the people that have means whether in military or politics or business must own a house in a foreign land and its customary that they go abroad to do their shopping. For example the Director General of the Securities and Exchange Commission (SEC), asserted that Nigeria lost an astonishing \$140 billion (about #224 trillion) between 2002 and 2011. This huge sum goes out through illegal means. In fact it is said that Nigeria is ranked in the top ten brackets of countries in the world with illicit financial outflows (Daily Sun Mon. Sept 22, 2014).

### **5. CONCLUSION**

Growth is definitely important because it supplies the essential resources for the attainment of other economic, political and social ends. From our findings economic growth does not granger cause poverty, but that analysis is densed because there are other factors that should capture the distributional pattern for the analysis to be complete that is not taken in this study. However, economic growth by itself may not necessarily be sufficient to reduce the level of inequality or poverty until it is sustainable. When growth is unsustainable a country is enjoying current consumption at the expense of future generations. And a sustainable growth must be inclusive. It is the distributional pattern of growth that defines its inclusiveness and fragile economies like Nigeria where poverty and inequality is high must be interested in the sustainability of its growth. It is not surprising therefore that we experience what will seem as contradiction in Nigeria's economic growth pattern. Government policies could help to address some of the challenges associated with Nigeria's growth pattern.



- It is desirable to have policies pattern of growth which is broad-based in terms of its coverage of sectors, regions or population, including the agricultural Sector.
- Fast agricultural growth may also form a basis for transformative growth with the sectoral composition of growth shifting towards manufacturing and services later.
- Government should design policies that will be explicitly pro-poor, for example through broad-based expenditure on education and health. This provides an important opportunity for the benefits of growth to be more widely shared, and in a manner which is not likely to have major disincentive effects that would crowd out future growth.
- It is equally important to have policies that will enhance investment in market development, research infrastructure and value added processing activities may all be important.

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