

## THE IMPACT OF TERRORISM ON EQUITY RETURNS: EVIDENCE FROM THE NIGERIAN STOCK MARKET

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**Abstract:** *This paper empirically examines the impact of terrorism on stock market returns in Nigeria. This is examined over the period, 1997-2015. Employing a dynamic system-GMM estimation technique, the findings show that terrorism has a significant negative effect on equity returns in Nigeria. In particular, the results, using Nigerian data, show that terrorism has a destabilizing effect on stock market performance, and hence, equity returns. The other variables- openness of the economy to financial flows has a positive and significant effect on stock market returns. Government effectiveness combined with other institutional variables to measure institutional quality and the infrastructure variables have positive but weak impacts on stock market performance in Nigeria perceivably due to the weak institutional capacity and infrastructure development in Nigeria. Inflation rate (a measure of macroeconomic policy environment) on the other hand is found to have a destabilizing effect on equity returns in Nigeria. We recommend amongst others, sound institutional framework with the capacity to restrain terrorism and other forms of insurgencies and violent conflicts, open investment policies, and coherent macroeconomic policies in order to enhance stock market performance in Nigeria.*

**Keywords:** *Terrorism, Equity returns, Institutional structures, System-GMM, Nigeria*

### 1. Introduction

It is well established in the development literature that investment and stock market can only thrive in an environment devoid of armed and violent conflicts, particularly terrorism.

A budding number of literatures posit that enhanced investment and equity returns can only be guaranteed in a stable environment supported with strong institutional framework to combat or restrain violence and conflicts (Acemoglu, Johnson & Robinson, 2002). Development economists Jensen (2003); Glaeser, et al, 2004 have found that sustained growth cannot take place under political and economic uncertainty but only in an atmosphere of certainty, stability and right institutional framework. In particular, recent evidence (see Bilson, Brailsford, Hallet & Shi, 2014) have shown that equity market perform better in a stable social, political and economic environment. Unfortunately, in the case of Nigeria, persistent wave of terrorism, particularly the onslaughts of the dissident Boko Haram militants have largely undermine investment, stock market performance and growth. The increasing wave of terrorism in Nigeria over the last decade and the intensity of the occurrence has thus become a subject of concern. The terrifying wave of terrorism in Nigeria in the past few years have had destabilizing effects on equity market, particularly assets return. The catastrophic effect of the activities of Boko Haram particularly in the Northern region of Nigeria has grounded investment and economic activities

in the region to a halt, with the effect of reducing stock market performance. A World Development Report (WIR) of the United Nations Conference on Trade and Development (UNCTAD, 2014) estimated that Nigeria has lost a about \$1billion foreign investment, owing to the devastation brought about by terrorist activities of the dissident Boko Haram.

Since investors are generally risk-averse, they invest only in environment economic stability and certainty. For instance, the fall in equity returns in the Nigerian Stock Market in recent time has been attributed to a number factors among which are poor macroeconomic policy environment, political instability, armed conflicts and insurgencies, which combines to create an environment of uncertainty, decrepit infrastructure, weak institutional capacity and a pervasive rent-seeking behaviour (Ozekhome, 2017).

There is overwhelming lack of empirical evidence on the impact of terrorism on equity returns in Nigeria, as no study has explored the negative consequences of terrorism and insurgency on stock market activities in Nigeria. Previous works on the issues addressed in this paper have been theoretical and just a handful had focused on the impact of terrorism on national development in Nigeria. None have been empirical. The only related study by Ezeoha and Ugwu (2015) focused on the impact of armed conflict on foreign direct investment in Africa. The study by Bamidele (2012) and a few others, which focused on the relationship between terrorism and national development not base on empirical evidence-findings. This work therefore represents the first critical attempt at an empirical/experimental research into the effect of terrorism on equity returns (stock market performance) in Nigeria. With this in view, the objective of this study is thus to fill the gap in literature by investigating the impact of terrorism on stock market returns in Nigeria. In addition, given the fact that no country is able to mobilize sufficient investment resources in an environment of conflict, violence and hostilities, and the recognition that the stock market is critical to the rapid economic growth of any Nigeria, it becomes important to empirically examine the nexus between terrorism and stock market returns in Nigeria. This is the motivation of this study.

Following this introduction, the paper is organized as follows. Section two consists of literature review which considers key theoretical and empirical issues associated with armed conflict and violence. Section three contains methodology, model specification and data, while section four contains the empirical results and analysis. Section five contains the conclusion and policy recommendations.

## **2. Literature review**

Two theoretical bases for the occurrence of armed and violent conflict, in particular terrorism, are provided in this section.

### **Social Conflict Theory (SCT)**

The tenet of this theory is that competition and struggle among social classes and state actors in their attempt to protect their selfish interest is the cause of hostility. The theory posits that class struggle leads to acquisition of weapons and ammunitions for self-preservation necessitating armed and violent struggle Max and Engel (1848). Another version of the social conflict theory states that social structures (such as political institutions, economic organs, legal Institutions etc.) are created in every society through conflict between groups with conflicting ideological interest and diverse means of control over state resources. Individual and resources in turn are influenced by these structures and by the unequal distribution of power and resources in the society (Knapp, 1994). Both versions of the social conflict theory explain armed conflict as motivated by struggle among rival social classes or extreme ideological or religious beliefs. If these dysfunctional relations are not redressed it results in arm struggle and full scale terrorism.

### **Frustration Aggression Theory**

The Frustration Aggression Theory posits that the occurrence of aggressive behavior always presupposes the existence of frustration. In another way, frustration is an antecedent to aggression. The existence of frustration often leads to some form of aggression which induces violence. Frustration produces a number of different types of response, one of which is instigation of some form of aggression and violent hostility, which magnifies into terrorism. In the context of this study, the destructive militant activities of the Boko Haram fundamentalist Religious sect in Northern Nigeria could be attributed to either frustration or as a result of extreme religious fundamentalism or ideological belief. In the same vein, the prolonged marginalization and economic deprivation of many Nigerians in the face of plenty by a mindless, corrupt, greedy and powerful political and rent-seeking class that has subject the majority to dehumanizing conditions is a case in this point. Nigeria is today plagued with social disorder, insecurity, weak infrastructural base, poverty, illiteracy, chronic balance of payment deficits, poor health statistics, ethnic and religious conflicts, corruption, crime and criminality and political crises and all these implies that we are unsecured in terms of human beings (UNDP, 2012) If these issues are not addressed, it could magnify and develop into full domestic terrorism.

### **Review of Empirical Studies**

A number of empirical studies have examined the impact of insurgency on business and investment in developing countries. A more conventional emphasis in this direction has been on the broad impact of terrorism on the domestic economies of these economies (Nitsch and Schumacher, 2004; Gailbulloev and Sander, 2011; Zimmermann, 2011; Bilson et al. 2012, Zimmermann, 2011, among others). We examine some of these studies.

Li and Vashchilko (2010) examine the relationship between armed conflict and foreign direct investment. Their results show that that military conflict due to terrorist insurgency has the propensity of discouraging bilateral investments. The sectoral impact of terrorism has also received empirical attention. Some examples include the study on the impact of terrorism on the tourism industry (Drakos & Kutan, 2003; Bilson et al, 2012), the agricultural sector (Singh, 2012), discriminate impact on mineral and non-mineral resources (Ashby and Ramos, 2013), bilateral trade (Oetzel, Getz & Ledk, 2007; Nich & Schumacher, 2004), as well as the relationship between terrorism and FDI (Bandyopadhyay, Sandler, & Yuonas, 2014; Ezeoha & Ugwu, 2015).

In particular, Drakos and Kutan, (2003) using evidence from Mediterranean countries-Greece, Israel and Turkey show how the intensity of terrorist attacks could have directly and indirectly undermine FDI indirectly by incremental transaction costs such as advertising expenses new or more tourists, reconstruction cost for damaged tourist facilities and security enforcement and military coordinated strategies to lessen terrorist attacks.

Gailbulloev and Sander (2011) use a sample of 51 African countries for the period 1970-2007, and a fixed- effect panel estimation technique to examine the negative effects of domestic and transnational terrorism on growth. The empirical results show that whereas transnational terrorism had a significant negative effect on growth, domestic terrorism did not. The study by Zimmermann (2011) also confirmed the negative impact of terrorism on capital market performance and globalization.

Bilson et al. (2012) examine the impact of terrorism on global equity market integration. The findings show that terrorism has a reducing effect on capital market integration and internationalization. Bandyopahyay et al. (2013) using evidence from 78 developing countries for the period 1984-2008, find that both domestic terrorism and transnational terrorism have adverse impact on investment and equity markets.

Bamidele, (2012) investigate the link between national peace, security and sustainable development in Nigeria. In particular, the author examined the catastrophic effect of Boko haram terrorist activities on national development using both explanatory and descriptive approach.. He found that the activities of the insurgent boko haram have contributed in no small measure in slowing the development process in Nigeria. Against this backdrop, the authors therefore recommend effective and preventive strategies capable of diminishing the probabilities of their emergence and crystallization of the terrorist group in Nigeria.

Osarumwense (2014) examines the impact of terrorism on national development in Nigeria. Employing descriptive statistics through questionnaire survey, the results reveal that the terrorism, particularly the Boko Haram insurgency has had a destabilizing effect on business, and stock market activities in Nigeria.

Ezeoha and Ugwu (2015) working on a sample of 41 African countries over the period 1997-2012, examine the interactive impact of armed conflicts on investment in Africa. Employing the recent dynamic system GMM technique, the empirical results show that conflict has a significant destabilizing effect on FDI. The findings of the study also show that the impact of the conflict is higher in resource-rich countries and that the impact is both regional and seasonally-sensitive.

### **Boko Haram Phenomenon in Nigeria**

Of all the various forms of armed conflicts and insurgency in Nigeria, the most dreaded, catastrophic, dehumanizing, dastardly and devastating so far is the Boko Haram, otherwise known as (Jam'atu Alissunah Lidda'awati wal-Jihad). The group which sees western education as a sin has the objective to Islamize the Northern part of the country. The major cause of the Boko haram insurgency can be attributed to the youth bulge in the region resulting from mass birth without corresponding care, training and human capital development. This has given rise to Al-Magiri syndrome. It can therefore be said that youth bulges and unemployment have contributed in no small measure to the insecurity problem in Nigeria (Orji, 2012).

Some have described the activities of the militant group as class warfare but its operation does not suggest that, considering its high level of terrorism, informed by a type of Islamist orientation and ideology. What initially began as a local initiative by a rag-tag religious militia has now developed into an actual declaration of war on the State, and Christians alike. Beginning from 2009 when the leader of the sect, Mohammed Yusuf Abubakar was killed by the Nigerian police, the group has declared a full scale war on those that are opposed to its ideology. A United Nations Organization report in 2015 has it that the sect has killed about 600,000 people and rendered over 1.5 million homeless. The dissident group has not only killed and rendered millions homeless, but has also wantonly destroyed critical infrastructure, investments opportunities and foreign direct investment inflow in Nigeria. Security details reveal that tactical sophistication with which Boko haram has been carrying out their task can only be explained by sophisticated technology and communication gadget linked to Al-Qaeda in the Islamic Maghreb (Aqim) terrorist group. Boko haram use of large bombs is an indication that the dissident group is linked to or receiving training from Aqim . The activities of the terrorists group can be best be explained my multiplicity of factors and complex interwoven issues (Ozekhome, 2017).

### **3. Methodology**

#### **Model Specification**

The model used in this study is a modification of the model used previously by (Ezeoha and Ugwu, 2015), because of the need to model the terrorism –equity return nexus in the context of Nigeria, alongside other potential determinants of stock market returns (equity returns) in line with the literature. In empirical specification, the systematic relationship between terrorism and stock market return

(proxied by the Nigerian All Share Index-ASI) is captured in the stylized terrorism- All Share index function.

$$ASI_t = \alpha_0 + \alpha_1 ASI_{t-1} + TERR_t + \beta X_t + \varepsilon_t \dots \dots \dots (1)$$

Where ASI =All Share index (a measure of overall equity returns/performance),  $ASI_{t-1}$  is one year-lagged ASI, which relates current equity returns in the Nigerian Stock Market to past equity returns. It thus control for initial conditions that may stimulate further improvement in equity returns.

TERR is intensity of terrorist attacks; and X is a vector of other variables, which according to the literature, influence stock market returns. The inclusion of these variables is to include, as much as possible other critical variables that impact on the assumed relationship, and thus avoid omitted variable bias. These variables include; inflation (INF)-measured as percentage change in consumer price index; The inclusion of inflation in particular is consistent with most equity returns equations by previous studies and is aimed at capturing the impact of macroeconomic environment and on equity returns, infrastructure (INFR) –as a proxy for this variable, we used the number of telephone mainlines and mobile subscribers per 1000. Physical infrastructure is regarded by foreign companies as important prerequisites for stock market performance and a critical intermediary variable in the conflict-equity return nexus. In particular, ICT infrastructure is a critical variable integrating local producers into international technological and communication network, thereby enhancing stock performance. Financial openness of the domestic economy (FOPN) is measured sum of foreign direct investment, portfolio equity and other inflows to GDP percent. Obadan and Ozekhome (2015) have shown that more financially open economies received more capital inflow, particularly portfolio capital inflows which is more akin to the stock market; INST represents institutional variable- which measures the quality of existing institutional structures proxied by government effectiveness. Institutional quality is measured by averaging the six indicators of institutional quality proposed by Kaufmann et al (2010) to include accountability, political stability; government effectiveness, regulatory quality, rule of law and control of corruption. Government effectiveness measures critical aspects of quality and availability of public service, the bureaucracy, the independence of the administration of political pressure and the credibility and transparency of the government's reform commitments and policies.

On the inclusion of these variables, the empirical specification of the model to be estimated is therefore:

$$ASI_t = \alpha_0 + \alpha_1 ASI_{t-1} + \alpha_2 TERR_t + \alpha_3 FOPN_t + \alpha_4 INFR_t + \dots (3)$$

The a priori expectations are  $(\alpha_1, \alpha_3, \alpha_4, \alpha_5) > 0$ ;  $(\alpha_2, \alpha_6) < 0$ .

$\alpha_0 - \alpha_7$  are parameters to be estimated and  $\varepsilon_t$  is the unobserved error term.

### Estimation Technique and Data Sources

To the extent that ASI and TERR are likely to be contemporaneously correlated and some of the explanatory variable are correlated with the error term,  $\varepsilon_t$ , and are endogenous to ASI, the least squares estimates of are likely to be biased and inconsistent. As a result, we use the generalized method of moments (GMM), which overcomes the problem of joint endogeneity in the estimation and, thus control for the potential biases resulting from simultaneous or reverse causation. The GMM technique allows us to address the triple-problem of endogeneity bias of the regressors, the measurement error and omitted variables by using the lagged values (in level and first difference as instrumental variables.

Data used in this empirical analysis are annual time series data covering the period 1997 to 2015. All the data (except terrorism (intensity of terrorist attack and institutional development variable, which measures the quality of institutional structures) are sourced from the CBN Statistical Bulletin. The conflict data is obtained from the Armed Conflict Location and Event Data Project Data base (ACLED) Code book 3 and the institutional variable is obtained from the World Governance Indicators of the World Bank, and all data in this study are in log form.

#### 4. Empirical Results and Analysis

In the empirical analysis, the initial characterization of the variables used in the regression analysis using descriptive statistics is first performed before the model estimation using GMM estimation approach. The summary statistics are presented in Table 1 below.

##### Descriptive Statistics.

Table 1 presents the descriptive statistics of the sample data on the variables used for the analysis. The descriptive statistics shows that the average growth rate of ASI over the period is 8.70 percent, with a median value of 7.82 percent. The maximum growth rate of 56.2 percent and a minimum value of -2.20 percent, gives clear indications that the growth rate of equity returns growth rate has moved rather apart during the period of the study. This wide dispersion is confirmed by the relatively high standard deviation value for the variable which is 4.65 percent. Apparently, stock market performance has generally been unstable in the country of the years, assuming an oscillatory pattern. This is not unconnected with the poor macroeconomic environment and weak institutional framework, characterizing an environment of insurgency and violent conflicts, particularly terrorism. The mean value of conflict intensity- a proxy for terrorism is 965, with a median value of 950. Its maximum and minimum values are 7430 and 0 respectively, while its standard deviation is 3835.2. Invariably, terrorism occurs with terrific frequency in Nigeria. Financial openness variable has a mean value of 22.3 percent and a median value of 22.8 percent. It shows that the domestic economy is open to capital inflows. Inflation has a mean value of 12.20 percent growth rate and a median value of 12.25, an indication it has been characterized by differential growth rate, with the rate of growth exceeding the observed average over the period of study. The maximum and minimum values are 18.9 percent and 6.6 percent respectively. Its standard deviation of 5.2 percent combine with a kurtosis value of -2.53 is a clear indication of inflation variability over the period of study. Infrastructure (proxied by information communication technology) has a men value of 54.21; median value of 49.98 percent, and a standard deviation value of 4.70 percent. Institutional quality has a mean value of -0.76, with a median value of -0.70. The maximum and minimum values are 0.86 percent and -0.17 percent, respectively. The value indicates that the growth rate of institutional development has been characterized by marked disparity and weak institutional structures in Nigeria. The Jarque Bera value of ASI is 15.05, and is significant at the 1 percent level, indicating that the hypothesis of normality in the distribution cannot be accepted. This implies that the data series may have endogeneity issues. This therefore necessitates adoption of a dynamic GMM estimator which is capable of controlling the joint endogeneity effect of most of the explanatory variables with ASI and, thus to control for the biases resulting from simultaneous or reverse causation.

**Table.1. Descriptive Statistics**

	<i>Mean</i>	<i>Median</i>	<i>Max.</i>	<i>Min.</i>	<i>Std. Dev.</i>	<i>Skew</i>	<i>Kurt.</i>	<i>J-B</i>
ASI	8.70	7.82	156.2	-2.20	4.65	3.22	4.22	15.05
TERR	965	950	7430	0	3531	3835	4.7	14.50
FOPN	22.3	22.8	25.14	-0.05	3.76	3.80	2.10	4.26
INFR	54.21	49.98	87.3	15.40	4.70	1.71	2.60	3.12
INST	-0.76	-0.70	0.86	-0.17	0.55	-1.28	-1.94	7.21
INF	12.20	12.25	18.87	6.62	5.20	-1.78	-1.85	9.50

*Source: Author's computation (2017)*

##### Analysis of Generalized Method of Moments (GMM) results

The result of the Generalized Method of Moment (GMM) is presented in table 2 below and subsequently analyzed

**Table 2. Arellano-Bover System-GMM Estimate**  
**Dependent Variable: ASI**

Variables	Estimated Coefficients	t-statistics
C	0.057	1.453
Lagged ASI	0.051	1.240***
TERR	-0.145	-3.112**
FOPN	0.203	2.202**
INFR	0.373	1.803**
INST	0.041	1.422*
INF	-0.241	-2.370**

\*\*\* Statistical significance at the 1% level

\*\* Statistical significance at the 5 % level

\* Statistical significance at the 10% level

*Source: Author's computation (2017).*

In the results, the coefficient of lagged ASI is positive but not significant at the 5 percent level. This implies that current equity returns are independent of the previous returns, and as such, the current or future rates of returns are independent of past rates of return. In the same vein, it implies that previous rates of equity returns do not necessarily explain current equity prices. This is a clear attestation of the existence of a random walk (weak form of efficiency)-which tenaciously holds that prices of traded securities already reflect all past publicly available information, thus, it is impossible for investors to earn any abnormal return by using past information on stock prices. Since all the data are in log form, the coefficients are elasticities. Accordingly, a 10 percent increase in previous equity returns will enhance current equity return by 0.05 percent. The coefficient of the variable of prime interest-the intensity of armed conflict (proxy for terrorism) is appropriately negative in line with theoretical expectation and significant at the 1 percent level. This implies that terrorism has an outright and highly destabilizing equity returns in the Nigerian stock market. In particular terrorism discourages foreign investment inflows, particularly portfolio equity into the stock market, reduces economic activities, weakens the capacity of existing infrastructure and consequently reduces equity returns. In the same vein, the uncertainty it creates in the investment environment contributes to reducing equity returns in the stock market. This finding is in line with the findings of Zimmermann, (2011), Bilson et al, (2012) and Bandyopadhyay et al (2014)). This result also provides explanation to the falling stock market activities in Nigeria since the Boko Haram catastrophe. The coefficient of inflation is negative in line with apriori expectation and significant at the 5 percent level. This implies that high inflation rate reduces the return on equity on account of economic instability and uncertainty syndrome. Through its eroding effect, high inflation rate reduces the expected return on financial assets and thus diminishes the incentive for further investment in stocks. The result corroborates the findings of Mijiyawa (2015). In line with the estimate, a 10 percent rise in inflation rate will reduce financial assets return by 2.4 percent. The coefficient of financial openness is consistent with theoretical expectation and significant at the 5 percent level. The result corroborates earlier empirical findings by Azienman and Noy (2006), and Ayanwu (2012 that an open economy is able to attract greater foreign investment inflow. In similar vein, it conforms to the position of Law and Habibullah (2009) that an open economy is able to provide insulation and control against the abuse of political class and extractive behaviours and promote competitive behavior. In line with the estimates, a 10 percent increase in financial openness will lead to a rise in equity returns by 2.2 percent. Infrastructure (proxied by communication infrastructure technology) ha the expected positive sign but is not statistically significant at the 5 percent level. This could be due to the low level of infrastructural development in Nigeria (Ozekhome, 2017). Infrastructure

is critical in integrating local producers and investors into international technological and communication networks, and in attracting vertical investment into the stock market (Addison and Heshmati, 2003). Since the t-value of its coefficient is greater than unity, we may infer that infrastructural development facilitates stock market transactions, and is necessary for stock market to operate successfully. This in turn, stimulates equity returns. The coefficient of institution is positive in line with apriori expectation and significant at the 10 percent level. This implies that institutional framework and capacity needs to be strengthened in Nigeria. Strong institutional framework, particularly, government effectiveness is important in enhancing stock market performance. Essentially, an effective government is able to provide and sustain quality of public service delivery, immunize the economy from political pressures, restrain socio-political violence and hostilities, and all forms of insurgencies, enhance the quality of policy formulation and implementation and enhance the credibility of the government's commitment to such policies (World Governance Indicators, 2014, cited in Ezeoha and Ugwu, 2015).

### 5. Conclusion

This paper has empirically examined the impact of terrorism on equity returns in Nigeria. The empirical results from the dynamic system-GMM estimation provides strong evidence that terrorism has an outright destabilizing effect on financial assets returns in Nigeria, as it creates an environment of uncertainty and diminishes the incentive to invest in the stock market. In addition, increase intensity of terrorism and insurgencies weakens the existing infrastructure and institutional capacity, which combines to reduce equity performance.

Considering the significance of the variable of interest, it is necessary for the government to create a stable economic and investment friendly environment through the restraint and curtailment of incidences of terrorism and other insurgencies and armed conflicts, particularly in the Northern part of Nigeria, where such has had enormous and unquantifiable adverse effects on businesses and investment. In addition, government should embark on the rebuilding of infrastructure that are critical to the operations of the stock market and the economy, which have been destroyed owing terrorists and other violent attacks. Very importantly, a strong institutional framework to resist and restrain acts and incidences of terrorism and other armed conflicts and insurgencies is critical. Supporting macroeconomic policies, particularly with respect to low inflation rate and policies regarding openness of the economy to foreign capital and investments resources that can augment resource-constraints also need to be put in place to steer the performance of the stock market in order to enhance equity returns in Nigeria.

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