Domestic Investment and Economy Growth in Nigeria: An Empirical Investigation

OYEDOKUN Godwin Emmanuel, PhD
Senior Lecturer
Accounting & Finance
School of Business &Economics
Saint Monica University
Cameroon

AJOSE Kehinde, PhD
Lecturer
Accounting and Finance Department
Mcpherson University
Nigeria

Abstract

Nigeria domestic investment has not been growing over time and it is with this that this study aimed at investigating the impact of domestic investment and economic growth in Nigeria. The model was subjected to a Co-integration test in order to determine the long run relationship between domestic investment, and economic growth in Nigeria for the period of 1980-2016. The Granger causality test was also used to determine the causality between domestic investment, and economic growth in Nigeria for the period of 1980-2016.The results also showed long run significant relationship exists between the variable examined and domestic investment. Granger cause economic growth in Nigeria within the period under study. The study also found that domestic investment positively influences real gross domestic product. The study recommends that government should create enabling an environment for domestic investment to rise through the adoption of macroeconomic policies that will boost investment opportunities in Nigeria.

Keywords: Capital Formation, Foreign Direct Investment, Domestic Investment, Economic Growth.

Word Count: 259

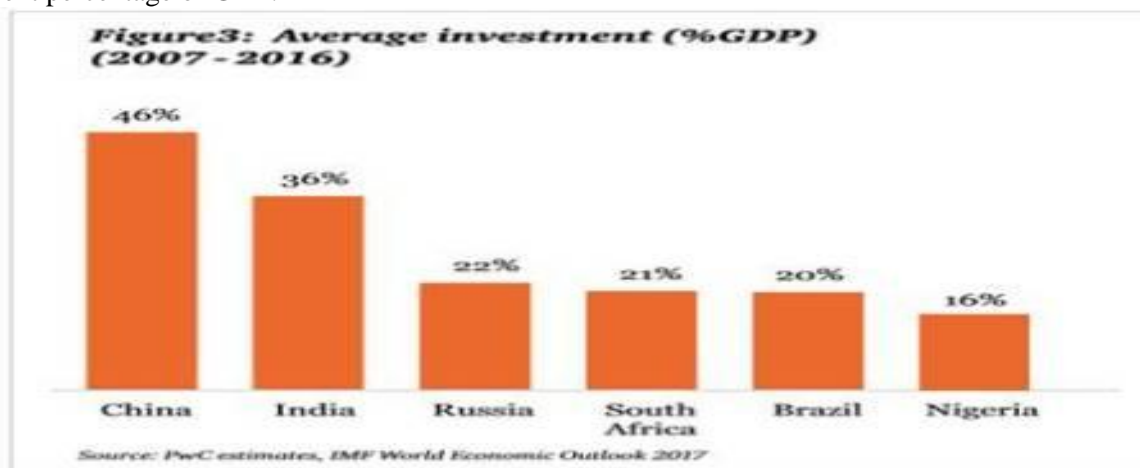## *1.0 Introduction*

1.1Background to the Study

The nature and stability of domestic investment have attracted enormous debate in the economics literature, particularly in the advanced market economies. The preponderance of studies on this subject includes Uremadu (2006), Adegbite and Owulabi (2007) where they argued that although foreign direct investment (FDI) is beneficial to host countries by speeding up the process of economic growth and development, its multiplier effect is greater. In other words, developing countries should depend greatly on domestic investment rather than foreign direct investment (FDI). This is because, borrowing from outside is not a proper strategy for growth and development since it does not only have adverse effect on the balance of payment as these loans will be serviced in the future with the use of their domestic resources, but it equally carries a foreign exchange risk such as devaluation of their currency which is one of the specific conditionality's for borrowing from International Monetary Fund (IMF). Hence, domestic investment through the capital formation is not just paramount but serves as a prerequisite for the geometric acceleration of growth and development of every economy as it provides domestic resources that can be used to fund the investment effort of the economy. The essence of this economic growth is for the creation of economic and social overhead capitals (or costs), which leads to increase in national output and income through the creation of employment opportunities and reduction of thevicious circle of poverty both from the demand side and supply side. Nigerian economy has undergone at least three distinct phases since independence from colonial rule in 1960 (Adeleke, 2014; Akanbi, 2010). The first is the vibrant era that was inherited from the colonial masters which lasted till around 1980.

This phase was characterized by a buoyant agricultural sector in terms of production diversification (staple foods and cash crops), contribution to the gross domestic product (GDP) which averaged about 70 percent employment and export. The first phase witnessed the first large inflow of petro-dollar funds due to the Arab– Israeli conflict of the early 1970s. Growth performance could be described as impressive over this period. The recession in advanced western economies which started in the late 1970s due to rising interest rates and high production costs led to sharp decline in Nigerian export. The international price of crude also collapsed. The agricultural sector witnessed neglect due to the ease of flow of foreign exchange (forex) in the early 1970s. Growth performance in Nigeria declined significantly and by mid-1986 the country had to agree to adopt and implement some far-reaching economic reform measures in other to qualify for international assistance from multilateral lending institutions (Kalu and Mgbemena, 2015).

1.2 Statement of the Problem

Domestic investment has generated hit debates among scholars as to its importance in nation building (Kanu, Ozurumba & Anyanwu, 2014; Kanu, 2008; Lean & Song, 2008; Qin, Cagas, Quising, &. He, 2006; Odedokun, 1997). After the Nigerian civil war, the government sought an approach to build the national economy and place the economy on the part of development. As such, the government in an effort to build the economy embark on massive reconstruction and public-sector investments to achieve sustainable economic growth and development. However, records of the past four decades have generated some concern over the slow pace of industrial and infrastructural development. Questions have been raised as to what should constitute the optimal size of government's capital outlays that can turn around the economy. Overtime, the Nigerian nation has witnessed a tremendous increase in her revenue profile through oil exports. She has equally enjoyed cycles of an oil boom with successive governments harnessing the resources of the nation to execute its budget. Ironically, there has been an increase too in her expenditure pattern overtime. Paradoxically, it does not appear as if the increase in capital expenditures has translated into the increased capital formation and consequently economic growth and development.

The problem becomes that Nigeria domestic investment as well as capital accumulation has not been growing and has declined by 24% between 1998-2013 (World Bank, 2014). This is a real problem. Although, foreign direct investment has been growing steadily except with the recent economic recession in the country that sawa substantial reduction in FDI by about 28% within 2014-2016 (CBN, 2016). Nigeria macroeconomic indicators show the pitiable performance of a Domestic investment in Nigeria for the period 1986 till date (CBN, 2016). For example, domestic investment declined from 12.3% of GDP in 1991 to 8.3% of GDP in 1992, this may be partly due to the reduced public investment, which fell during the same period. Domestic investment then increased to 12.5% in 1993 and to 16% in 1994. Later, it fell continuously to 8.9% in 1996. Between 2001 and 2010, the ratio averaged 13%; it peaked at 16.2% in 2002 but fell again to 152% in 2010 (CBN, 2015). A mere look at the figure below will reveal domestic investment percentage of GDP in Nigeria is the lowest among the countries examined. From the graph, we could see why China remains the second largest economy in the world with 46% domestic investment percentage of GDP.

Figure3: Average investment (%GDP) (2007 - 2016)

Source: PwC estimates, IMF World Economic Outlook 2017

In view of the inconsistency in the findings of the various research reviewed, the q1declining nature of domestic investment in the country despite its tremendous contribution to national growth and development. As well as the fact that literature on investment in Nigeria is dominated by foreign direct investment which contributes more to the home companies' country more than the host company country. It is, therefore, necessary to investigate holistically domestic investment, and economic growth in Nigeria between the periods of 1980-2016.

1.3 Objectives of the Study

To examine the impact of domestic investment on economic growth in Nigeria.

1.4 Research Hypothesis

H_{o1}: There is no significant impact of domestic investment on economic growth in Nigeria

2.0 Literature Review and Theoretical Framework

2.1 Concept of Domestic Investment

Real domestic investment is an expenditure made to increase the total capital stock in the economy. This is done by acquiring further capital-producing assets and assets that can generate income within the domestic economy. Physical assets particularly add to the total capital stock. Boosting economic development requires higher rates of economic growth than savings can provide. Part of the finance for investment is provided by the corporate sector, bank loans and households' savings make up the other part. With this, savings is no longer a constraint to investment demand. With lower rates of interest, asset values tend to be on the upward swing which invariably represents the discounted value of such assets thereby increasing the rate of acquisition and investment in such assets increases aggregate demand. Investment, therefore, is not constrained by aggregate savings but more by domestic interest rates. Therefore, the new equation of investment is Investment = (Savings) + (newly created money available to Deposit Money Banks). Attempts at reducing expenditure have affected investment and had led to poor and sluggish growth and eventually affecting savings performance (Tang, Selvanathan, & Selvanathan, 2008).

The components of the Nigerian capital formation as analyzed by the National Bureau of Statistics (NBS, 2011)) comprises of both tangible and intangible stocks. The intangibles are the soft assets and increases or improvements on them. They are also known as the non-productive capability of the country. The statistics further states that the increase in capital formation in the country over the past year – 2010, was merely 1 billion (about $6.3 million) has been propelled by capital equipment's imports by firms involved in crude oil exploration and exploitation. This is worrisome, though nobody seems to care about the general welfare of the population.

2.2 Theoretical Framework

2.2.1 Neo-classical Theory of investment

Neoclassical financial theorists have made acrobatic theoretical efforts to defang the principal-agent problem so that the Pareto efficiency properties of markets could escape unscarred from its grasp. Unfortunately, the assumptions required to accomplish this task have no significant foundation in empirical or institutional reality. Stiglitz has accurately characterized the neoclassical principal-agent literature as "the triumph of ideology over theory and fact". Neoclassical investment theory, on the other hand, fails even to acknowledge the existence of the problem. Virtually all neoclassical models of the enterprise investment decision begin with the unsupported assertion that the firm's objective is the pursuit of the owners' objectives: the firm maximizes market value. Three points about the value maximization assumption are worthy of note. First, there is a great deal of empirical and institutional evidence that this assumption is false and virtually no direct empirical evidence that it is true.3 Second, if this highly questionable assumption is rejected, it is not at all clear that a distinct neoclassical approach to the theory of the firm can be identified. In its absence, neoclassical theorists have no generally agreed upon method for choosing an enterprise objective function, for specifying the constraint set, or even for identifying the cost of financial capital.

2.2.2 Keynesian Theory of investment

Gordon presents a formal model of what he calls the Keynesian theory of investment. We are less ambitious here, attempting only to sketch out the general characteristics of an investment theory based on the substitute core assumptions discussed in the previous sections. A realistic theory of investment should incorporate the assumption that the firm is a semi-autonomous agent with a preference function of its own.

We would expect the firm to pursue growth in size or market share and in profits -its growth objective - and avoid threats to its decision-making autonomy or its financial security - its safety objective. The existence of this safety objective makes the firm itself risk-averse. Growth is attainable only through capital accumulation, but capital accumulation must be financed. Debt finance creates explicit, legally binding cash flow commitments to creditors. But even internal funding and stock flotation create implicit cash flow commitments to shareholders. If commitments to stockholders cannot be met out of the future operating profits generated by invested capital, management may experience a threat to its decision-making autonomy; if commitments to creditors are not met, the firm might go bankrupt.

2.3 Empirical Framework on Domestic Investment and Economic Growth

Empirical work on domestic investment and economic growth has been enormous and somewhat consistent with its findings. For instance, Villa (2008) applies a multivariate time series analysis on output growth rate, investment and government consumption in Italy from 1950 to 2005 and finds that the causality is running from domestic investment to economic growth. But empirical findings from Qin, Cagas, Quising and He (2006) show a causal relationship between domestic investment and economic growth show that the causality is running from economic growth to domestic investment. Furthermore, Tang, Seventh and Selvanathan(2008) investigated the causal link between foreign direct investment, domestic investment and economic growth for the period 1988-2003 in China, by applying a multivariate VAR system with error correction model (ECM). Their findings show that domestic investment and economic growth are positively correlated, as such great economic growth spurs large domestic investment and vice versa. By implication, it means China's domestic investment has a greater impact on growth than FDI. They, therefore, recommend that the country's precedence should be based on encouraging and promoting domestic savings for domestic investment than attracting FDI. On the other hand, in the same study, Tang, Selvanathan and Selvanathan (2008) equally found that China's domestic investment and GDP do not have much impact on FDI inflows in the long run.

Export has been considered as one of the important variables in determining economic growth. Therefore, domestic investment and export may be fundamental in generating sustainable economic growth. Ghirmay, Grabowski and Sharma (2001) used co-integration test and Granger causality test to investigate the relationship between export-led and investment-led growth for 19 less developed countries. Findings from their study reveal that exports and investment are co-integrated with economic growth, particularly in Malaysia economy. However, these findings do not consistent with that of Sinha (1999) who uses the Johansen Co-integration test in some Asian countries and finds that domestic investment and exports are not co-integrated with economic growth in the case of Malaysia. Some studies, however, documented a close relationship between FDI and domestic investment in developing economies. In analysing the impact of FDI and domestic investment on economic growth in Sub-Saharan Africa for the period 1990-2003, Adams (2009) reveals that domestic investment is positively and significantly correlated with economic growth in both the Ordinary Least Squares (OLS) and fixed effects estimation.

3.0 Methodology

The research plan that is adopted for the study is descriptive research method and Ex Post Facto Research Design.The variables used for the analysis areall gross domestic product (RGDP) known as the dependent variable in the model and the independent variables: domestic investment (DIN), and government expenditure (GEX). The variable used in the analysis was subject to unit root test to determine whether the variables are stationary or not. The model was subjected to aco-integration test to determine the long run relationship between Domestic investment and economic growth in Nigeria for the period of 1980-2016. The Granger causality test was also used to determine the causality between Domestic investment, and economic growth in Nigeria for the period of 1980-2016.The research utilized secondary data annual time series for the variables identified above. The data was from the sources such as; Central Bank of Nigeria (CBN) statistical Bulletins, Nigeria Stock Exchange (NSE), and World Bank Data Base.

3.1 Model Specification

$RGDP_t = b_0 + b_1 DIN_t + b_2 GEX_t + u_t$
  Where; b_0 = Constant term,
 b_1 = Regression coefficient of DIN,
 b_2 = Regression coefficient of GEX

GEX=Government Expenditure
DIN= Domestic Investment
u_t = Error Term

4.0 Results and Discussion

4.1 Domestic Investment and Economic Growth

The impact of domestic investment and economic growth is examined in this section. The hypothesis used to test the impact is given below.

Hypothesis

H_{o1}: There is no significant impact of domestic investment on economic growth in Nigeria

4.2 Unit Root Test

The Augmented Dickey-Fuller (ADF) was employed to test for the existence of unit roots in the data using trend and intercept. The results are presented in table one below.

Table 4.1: Augmented Dickey-Fuller Unit RootTest
Trend and Intercept @ Levels

Series	ADF Test Statistic	5% critical values	10% critical values	Order	Remarks
LRGDP	-1.433594	-3.552973	-3.209642	0	Not Stationary
LDI	-3.456777	-3.552973	-3.209642	0	Not Stationary
LGEX	-0.330000	-3.552973	-3.209642	0	Not Stationary

Sources: Researchers' compilation from E-view (version 9.0) (2018)

Table 4.2: Augmented Dickey-Fuller Unit RootTest
Trend and Intercept @ 1st Difference

Series	ADFTest Statistic	5% critical values	10% critical values	Order	Remarks
LRGDP	-6.228408	-3.548490	-3.207094	1	Stationary
LDI	-4.532332	-3.548490	-3.207094	1	Stationary
LGEX	-3.681068	-3.548490	-3.207094	1	Stationary

Sources: Researchers' compilation from E-view (version 9.0) (2018)

The above empirical test shows that RGDP, DIN,and GEX, are not stationary at levels. Considering the time series using Augmented-Dickey Fuller at Trend & Intercept and Intercept, all their calculated statistics are less than the critical values both at 10% and 5% level of significance integrated of order one. However, at 5% level of significance, all the variables became stationary at first difference since their t-test is greater than the Critical value at 5% level of significance. Since the result is significant, we, therefore, proceed to conduct a co-integration test to ascertain if there exists along-run relationship between the variables under consideration. It should be further noted that proper examination of the co-integration test, Error Correction Model (ECM) and Granger causality test cannot be conducted without first carrying a unit root test. According to Pesaran and Yongcheol (1999) and Pesaran, Yongcheol and Richard (2001), if variables are stationary at level normal OLS can be used to estimate the parameters, but if series are not stationary at level but are stationary at same order, I(1) and is co integrated we can go ahead and estimate their parameter estimate with an ECM result.

Table 4.3. Johansen co-integration test

Series: LOG(RGDP) LOG(DIN) LOG(GFCF) LOG(FDI) LOG(SAV) LOG(GEX)				
Lags interval (in first differences): 1 to 1				
Unrestricted Cointegration Rank Test (Trace)				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.596346	108.7602	95.75366	0.0047
At most 1 *	0.580214	77.00833	69.81889	0.0119
At most 2	0.447395	46.62800	47.85613	0.0649
At most 3	0.361792	25.86911	29.79707	0.1327
At most 4	0.247786	10.15094	15.49471	0.2693
At most 5	0.005278	0.185223	3.841466	0.6669
Trace test indicates 2 co-integrating eqn(s) at the 0.05 level				
* denotes rejection of the hypothesis at the 0.05 level				
**MacKinnon-Haug-Michelis (1999) p-values				

Sources: Researchers' compilation from E-view (version 9.0) (2018)

Under the Johansen Co-integration Test, there is one co-integrating equation. In Johansen's Method, the trace statistic determines whether co-integrated variables exist. As can be seen from the trace statistics, here only the absolute values of RGDP are greater than 5% critical values (i.e. GDP [108.7602 >95.75366], also its Eigen-value is greater than 5% level of significance, signifying the presence of long-run relationship among the variables employed in the analysis. In other words, the null hypothesis of no co-integration among the variables is rejected since at least two variables in the five equations at 5% were statistically significant. The test result shows the existence of a long-run equilibrium relationship among the variables.

4.3 Vector Error Correction Mechanism (VECM)

The presence of long-run equilibrium relationship among the variables as found from the Johansen co-integration led to the application of VECM. With this approach, both the long-run equilibrium and short-run dynamic relationships associated with variables under study is established.

Table 4.4: VECM

Included observations: 34 after adjustments			
Standard errors in ( )& t-statistics in [ ]			
Co-integrating Eq:	CointEq1		
LOG(GDP(-1))	1.000000		
LOG(DIN(-1))	1.762600		
	(0.35956)		
	[4.90214]		
LOG(GEX(-1))	1.191110		
	(0.45915)		
	[2.59414]		
C	-11.70186		
Error Correction:	D(LOG(GDP))	D(LOG(DIN))	D(LOG(GEX))
CointEq1	-0.44331	0.408863	-0.011533
	(0.01839)	(0.09093)	(0.03782)
	[-24.1060]	[4.49663]	[-0.30491]
D(LOG(GDP(-1)))	0.404644	-1.405117	0.898070
	(0.10946)	(1.03551)	(0.43075)
	[3.69673]	[-1.35694]	[2.08489]
D(LOG(GDP(-2)))	0.093574	1.508287	-0.492901
	(0.21094)	(1.04281)	(0.43379)
	[0.44361]	[1.44637]	[-1.13627]
D(LOG(DIN(-1)))	0.217483	0.589033	0.077088
	(0.02924)	(0.14457)	(0.06014)
	[7.43785]	[4.07448]	[1.28187]
D(LOG(DIN(-2)))	0.040378	0.100930	0.028299
	(0.03517)	(0.17387)	(0.07233)

	[1.14808]	[0.58049]	[0.39126]
D(LOG(GEX(-1)))	0.144712	-0.040827	-0.331537
	(0.06444)	(0.46688)	(0.19421)
	[2.24569]	[-0.08745]	[-1.70708]
D(LOG(GEX(-2)))	0.125437	1.329219	0.117031
	(0.09100)	(0.44986)	(0.18713)
	[1.37849]	[2.95476]	[0.62539]
C	0.057248	-0.168707	0.122880
	(0.03882)	(0.19192)	(0.07984)
	[1.47465]	[-0.87904]	[1.53916]
R-squared	0.599053	0.604542	0.379029

Sources: Researchers' compilation from E-view (version 9.0) (2018)

F-statistics = 22.466
DW = 2.0

The choice of lag length of one (2) was informed by the better results of the VECM which met the two conditions necessary for use of error correction model and was determined by AIC and Schwarz SC.

4.4 Granger Causality Test

With this test, the pair-wise relationships between the estimated variables are ascertained. Thus, the table is presented below:

Table 4.5: Granger Causality

Lags: 2			
Null Hypothesis:	Obs	F-Statistic	Prob.
LOG(DIN) does not Granger Cause LOG(RGDP)	36	6.75200	0. 0001
LOG(RGDP) does not Granger Cause LOG(DIN)		1.06625	0.3570

Sources: Researchers' compilation from E-view (version 9.0) (2018)

4.5 Test of Research Hypotheses

4.5.1 Hypothesis

H_0: There is no significant impact of domestic investment on economic growth in Nigeria
H_1: There isa significant impact of domestic investment on Nigeria economic growth in Nigeria.
F- Test: is employed in testing the hypothesis. This test will help to capture the joint influence of the explanatory variables on the dependent variable.

4.5.2 Decision Rule;

If F-cal. > F-tab reject the null hypothesis or if the P-value is less than 5% level of significance, otherwise accept the null hypothesis. Using 5% level of significance at 3 and 33 degrees of freedom, the tabulated F-value is 2.82. Since the calculated F-value (22.4) is greater than the tabulated F-value at 5% level of significance; we reject the null hypothesis and conclude that domestic investment has a significant impact on Economic Growth of Nigeria within the sample period.

4.6 Detail Discussions of the Findings

This section dealt with the discussion of the findings. Thus, discussions were made in the light of the data analysis, thereby linking the results of the analysis to the existing theory. The test on unit root test shows that LRGDP, LDIN, and LGEX, and are not stationary at levels. However, all the variables are stationary at first difference in ADF tests. Considering the time series using Augmented-Dickey Fuller at Trend & Intercept, all their calculated statistics are greater than the critical values at 5% level of significance. The results show that the time series are integrated of the same order; I (1), with the application of ADF test respectively. According to Pesaran and Yongcheol (1999) and Pesaran, Yongcheol and Richard (2001), if the data used in the econometric analysis is not stationary at level but is stationary after differencing the data, it means that information regarding the long run relationship between the variables has been lost during the process of differencing the data. As such they advocate for the test of long-run relationship to ascertain the long run status of the model.

The summary of the Johansen Co-integration Test is shown in above. The model with lag 1 was chosen with the linear deterministic test assumption. In order to find out if there is long-run equilibrium relationship that exists between the LRGDP and the explanatory variables; LDIN, and LGEX, using the Johansen Co-integration Test.

The test revealed that there is one co-integrating equation among the co-integrating equation. As can be seen from the trace statistics above and Eigen-value. The trace statistics is greater than the critical value at 5% level of significance and was collaborated by the Eigen-value which is significantly different from zero.

In other words, the null hypothesis of no co-integration among the variables is rejected since at least one equation at 5% critical value is statistically significant. The test result shows the existence of a long-run equilibrium relationship among the variables. With the identification of co-integrating equations among the variables employed for estimation, vector error correction model VECM estimation presents the only option for predicting the dynamic behaviour of LRGDP in response to, LDIN and LGEX in the first model

The Error correction term in both models met the required conditions. Negative sign and statistical significance of the error correction coefficients are necessary conditions for any disequilibrium to be corrected. In light of this, the coefficient of ECM (-1) in the model is -0.44331. The coefficient indicated that the speed of adjustment between the short-run dynamics and the long run equilibrium in the first model is 44.3%. Thus, ECM will adequately act to correct any deviations of the short run dynamics to its long-run equilibrium annually in both the first model.

The t-test revealed that all the variables in the first model which sought to seek the impact of domestic investment on economic growth in Nigeria are all significant at 5% level of significance. This is revealed by the fact that both the P-value of Lagged RGDP, Lagged DIN by one year and Lagged government expenditure were all less than the 5% level of significance. As such, it is convenient to conclude that domestic investment particularly has appositive significant impact on Nigeria economic growth within the period under review.

4.7 Implication of the Results

From the discussion above, it was revealed that domestic investment has a significant positive impact on economic growth in Nigeria within the period under review. This finding means that the higher the domestic investment the higher the economic growth of Nigeria. The findings conform to the findings of Adekunle and Aderemi (2012) who examined the relationship between Domestic Investment, Capital Formation and Population Growth in Nigeria. They noted that there exists appositive relationship between economic growth and domestic investment in Nigeria. For instance, Ghura and Hadji 1996) conducted research on domestic investment and capital formation in selected Africa countries and argued that domestic investment has a significant impact on the economic growth among the countries investigated.

5.0 Conclusion and Recommendation

5.1 Conclusion

The general objective of this study is to evaluate the link existing among domestic investment, and economic growth while the specific objectives are to; ascertain if there is long run significant relationship that exists among domestic investment, and economic growth in Nigeria within 1980 and 2016 and to find out if there is significant causal relationship between domestic investment and economic growth within the period under study.

The study employed ex-post facto research design using Nigeria's data obtained from Central Bank of Nigeria (CBN) (1980-2016). The empirical results were on Augmented Dickey-Fuller test. In the second step, Johansen Co-integration Test was conducted. The presence of long-run equilibrium found led to the use of Vector Error Correction Mechanism (VECM). It was found that domestic investment cause growth of the economic growth in Nigeria within the period under study. It is therefore imperative to conclude from the findings that domestic investment, have significant impact on Nigeria economic growth The researcher noted that, if Nigeria economy will make a meaningful progress, there is need to increase investment in the domestic economy, encourage industrialization, promote agricultural output drastically and above all draft developmental document that addresses how the country will achieve sustainable high level of economic growth.

5.2. Policy Recommendations

Given the above findings, the research, therefore, made the following pertinent recommendations:

1. There is a need for government to create enabling an environment for domestic investment to rise through the adoption of macroeconomic policies which will boost investment opportunities in the economy thereby contributing to the growth of the economy.

2. It was found that domestic investment cause economic growth; there should be diversification of the economy. Policy formulators in Nigeria need to enact some investor-friendly policies that will encourage, promote domestic investment.

3. The government should pursue the policy of export promotion thereby encouraging domestic companies to go into more production. To achieve this, the government needs to reduce both the tax rate and interest rate by at least 10% to encourage domestic investment in the country.

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