Foreign Direct Investment and Economic Growth in Nigeria

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Abstract
This work empirically investigates the effect of foreign direct investment on Nigeria’s economic growth over the period 1990 to 2012. The study made use of ordinary least squares (OLS) estimation techniques in analyzing the secondary data. The secondary data were mainly sourced from Central Bank of Nigeria statistical bulletin (CBN), Annual report and Statement of accounts. The result shows that Export assumes a positive sign which implies that there is a positive relationship between Economic growth and Export; in conclusion FDI has led to increase in Export in Nigeria.

Keywords: Foreign direct investment, Economic growth, Gross domestic product

1.1 INTRODUCTION
Foreign direct investment (FDI) is seen as a way of filling the gap between domestic available supplies of saving, government revenue, human capital skills and the desired level of resources needed to achieve growth and development targets. FDI is described as investment made to acquire a lasting management interest (usually at least 10% of voting stock) and acquiring at least 10% of equity share in an enterprise operating in a country other than the home country of the investor (Mwilima, 2003). FDI is believed to have filled the gaps in management and technology through spillovers and other externalities. FDI occurs or takes place when a firm invests directly in facilities to produce or market a product in a foreign country (Hill, 2005), and is usually embarked upon by Multinational enterprises (MNEs) or Multinational corporations (MNCs). MNEs or MNCs are firms that have business facilities or interest spread over several countries, but controlled by a central headquarter (Stonner, Freeman, & Gilbert, 2007). MNEs or MNCs are believed to improve the foreign exchange position of a host country; its long-run impact may reduce foreign exchange earnings in both the current and capital accounts of the balance of payment (BOP).

Every country at one point or another seeks ways to improve its economy either through internal business strategies and re-strategizing or external adventures. So when a country seeks outside its border for business enhancement, economic emancipation and general improvement in its finances and economy, it is referred to as foreign investment. FDI has been further described as the long term investment reflecting a lasting interest and control, by a foreign direct investor or parent enterprise, of an enterprise entity resident in an economy other than that of the foreign investor (IMF, 1999). Many African countries including Nigeria have reformed their economic policy, investment laws and financial system, in order to provide a conducive environment for private investment (African Economic Outlook, 2006). Sub Saharan Africa as a region has to depend heavily on FDI for many reasons, some of which are exchange of scientific research and technological collaboration (Asiedu, 2001). Foreign direct investment (FDI) has increased dramatically in the past twenty years and with an alarming increase to become the most attractive and generally accepted type of flow of capital across borders in both developed, developing and under developed economies.

Nigeria is in the forefront of African nations who depend fully on foreign goods and services. According to information gathered from corporate Nigeria, the business, trade and investment guide 2010/2011 reveal that FDI in Nigeria has been growing over the years from USD1.14billion in 2011 and USD2.1billion in 2004 to USD11 billion in 2009 making Nigeria the nineteenth greatest recipient of FDI in the world. The Central Bank of Nigeria (2001) showed that FDI in Nigeria averaged US$1184.0 Million per year in the period 1997-2001. Zenith Economic Quarterly Magazine (2007) recorded Nigeria to have US$2040 Million inflow and US$172 Million outflow as at 2002. In 2005, FDI inflow increased to US$3403 Million and outflow US$200Million. Most of these FDI came from United States of America, chevron, Texaco, Exxon Mobil and United Kingdom, other major stakeholders includes china, Brazil, Italy, France and South Africa. The Nigerian government adopts several policies to attract FDI in this globalization era. Especially, the government implemented IMF monitored liberation of its economy, invites foreign investors in the manufacturing sector. The nation’s economic policies that helped in attracting the foreign investment and foreign entrepreneurs to invest...
their resources in Nigeria includes tariff concession on the imported goods, especially on imported raw and input material for industrial use, policies on reduction of corporate tax, tax relief for research and development and policies on joint venture business.

Though the market size of African countries keep growing in terms of purchasing power in the region with its vast population, political instability, internal conflict, poor governance, insecurity of life and property and corrupt practices still pose significant problems to many countries in Africa. Nigeria’s inability to attract the desired level of FDI is as a result of political, economic and social instability evidenced in pre and post election crises as well as social unrest in different parts of the country. The poor performance of the manufacturing sector in Nigeria in attracting commensurate FDI could be attributed to corruption which affect the cost of doing business in Nigeria and also hinder investors from investing in the country. Ali and Isse (2003) observed that in a country with poor economic condition, there is a tendency for such country to experience high level of corrupt practices which further worsens the rate of development. Odiaka (2006) observed that the power distribution to the industrial sector in Nigeria remain abysmally irregular. Okafor (2008) observed that the country consistently suffers from energy shortage, a major impediment to industrial, technological and economic growth. In Nigeria it is one of the many unresolved problems (Ayobolu, 2006), that have critically hobbled and skewed development.

1.2 OBJECTIVE OF THE STUDY
The main objective of this study is to determine the effect of foreign direct investment on the growth of the Nigerian economy. Consequently, the specific objective is to determine the effect of foreign direct investment on the economic growth in Nigeria

2.1 REVIEW OF RELATED LITERATURE
Foreign direct investments consist of external resources, including technology, managerial and marketing expertise and capital. All these generate a considerable impact on host nation’s production capabilities. Kumar (2007), described FDI in several ways, first and most likely it may involve parent enterprise injecting equity capital by purchasing shares in foreign affiliates. According to World Trade Organization New (WTON, 2001) foreign direct investment occurs when an investor based in one country, home country, acquire an asset in another country the host country with the intent to manage the asset. Foreign direct investment is described as investment made to acquire a lasting interest (usually at voting stock) and acquiring at least 10% of equity share in an enterprise operating in a country other than the home country of investors (Mwilima 2003). According to (Ayanwale 2007), that ownership of at least 10% of the ordinary shares or voting stock is the criterion for the existence of a direct investment relationship. The United Nations defined FDI as investment in enterprise located in one country but effectively control by residents of another country. This definition not only considers foreign direct investment from an investment point of view, but also defines the status of corporate control.

Economic growth is the increase in the amount of goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase in real gross domestic product, or real GDP. Growth is usually calculated in real terms, that is, inflation adjusted terms, in order to net out the effect of inflation on the price of the goods and service produced. FDI comprises not only merger and acquisition and new investment, but also reinvested earnings and loans and similar capital transfer between parent companies and their affiliates. FDI flows have grown in importance relative to other firms of international capital flows, and the resulting production has increased as a share of world output, but it was still only about 8% at the end of the 20th century. The United States began its role as foreign direct investors in the late 19th century. It became the dominant supplier of direct investment to the rest of the world, accounting for about half of the world’s stock in 1966. Since then, other countries have become major direct investors.

The United States share is now less than a quarter of the world total and the United States has become a major recipient of FDI from other countries. Lipsey and Chrystal (2003) noted that FDI is always undertaken by domestic firms which have accumulated some benefits in the local market such benefits includes patents and know-how that bestowed on them when they enter into foreign markets. Foreign direct investment generates investments that may not be possible with the local resources only. Working with large firms linked to the global market, FDI promotes workers and management training; provide advanced technology that is not easily transferable outside the firms and already in use by foreign firms. Finally, it generates higher paying jobs and links the recipient economy into the world economy in a way that would be difficult to achieve by new firms of a local origin (Lipsey & Chrystal, 2003).

2.2 REVIEW OF EMPIRICAL STUDIES
Otepola (2002) found that FDI contributes significantly to growth especially through exports. The study also reported a low level of existing human capital, suggesting that human capital available in Nigeria is not FDI including. He further recommended a mixture of practical government policies to attract FDI to priority sectors of the economy.
Ayanwale (2001) examined the influence of FDI on firm level of productivity in the Agro/Agro Allied sector in Nigeria, and reported a positive spillover effect of foreign firms on domestic firm’s productivity. Akino (2004) investigated the impact of FDI on economic growth in Nigeria over the period 1970-2001. The result of his error correction model (ECM) shows that both foreign capital and foreign lagged capital have small and statistically insignificant impact on economic growth. He attributed this to capital flight. This study also found labour force and human capital to have significant positive effect on growth.

Jerome and Ogunkola (2004) assessed the magnitude, direction and prospects of FDI in Nigeria. They noted that, FDI regime in Nigeria was generally improving but some serious deficiencies or shortcomings still remain. These deficiencies are predominant in the area of the corporate environment (such as corporate law, labour law and bankruptcy) and institutional uncertainty, as well as the rule of law.

They further noted that the establishment and activities of the Economic and Financial Crimes Commission (EFCC), and the Nigeria Investment Promotion Commission (NIPC) are efforts to improve the corporate environment and uphold the rule of law (Jerome & Ogunkola, 2004).

Ayanwale (2007) investigated the relationship between Non-extractive FDI and economic growth in Nigeria over the period 1970-2002. The study found that FDI has a positive link with economic growth, but cautioned that the overall effect of FDI on economic growth may not be significant. Also that the manufacturing sector FDI negatively affects the economy, reflecting poor business environment in the country (Ayanwale, 2007).

Ayadi (2007) in his study on FDI and Economic growth in Nigeria over the period 1980-2007 found that FDI has not contributed significantly to the explanation of output growth in Nigeria. The failure of FDI to generate the desired growth rate is attributed to the limited infrastructural development in Nigeria. He also found that FDI has some level of influence on export of goods and services. Ayadi (2007) recommended that Nigeria should invest in human capital development in order to benefit from technological spillovers or other externalities associated with FDI. This recommendation was made because the study found human capital an essential factor in the FDI-growth debate in Nigeria.

Oyatoye, Arogundade, Adebisi, and Oluwakayode (2011) in a study of FDI, Export and Economic growth in Nigeria over the period of 1987-2006 found that there is a positive relationship between FDI and gross domestic product (GDP). The result further showed that one naira increase in the value of FDI will lead to N104,749 increase in GDP.

Other contributors to the FDI debate include:

Fry (1992) examined the role of FDI in promoting growth in a pooled panel data of developing countries from 1966-1988. His results did not support any significant effect of FDI on economic growth, but it had a significant effect on domestic investments. This suggests that FDI crowds-out domestic investment, through this later result differs among regions of countries.

Blomstrom, Kokko and Zejan (1994) examined a sample of both developed and developing countries and concluded in favour of significant positive effect for both regions. But when they split their sample into two groups based on their level of per-capita income, it was found that FDI exerts positive effect on economic growth but there seems to be a threshold level of income above which FDI has positive effects on economic growth and below which it does not. The explanation was that only the countries that have reached a certain income level can absorb new technologies and benefit from technology diffusion and also reap the extra advantages of FDI.

Balasubramaniam, Salis, and Sapsford (1996) examined the role of FDI on the growth process of developing countries with differing trade policy regimes for the period of 1970-1985. Their results found, band sometimes negative for countries with import substitution policies. This implies that the effect of FDI varies across countries and the trade policy of a country can affect the role of FDI in economic growth.

Borensztein, De Gregorio, and Lee (1998) in their study of 69 developing economies over the period 1970-1989, applying regression analysis, concludes that the interactions of FDI and human capital had important effect on economic growth. They suggest that the difference in technological absorptive ability may explain the variation in growth effect of FDI across countries that is to say that FDI is dependent on human capital stock. The author suggests that countries need a minimum threshold stock of human capital in other to experience positive effects of FDI.
Tang, Selvanathan, and Selvanathan (2008) explored the casual link between FDI, domestic investment and economic growth in China between 1988-2003, using a multivariate VAR and ECM (Error Correction Model). The result shows that there is a bi-directional causality between domestic investment and economic growth. They concluded that there is a higher level of complementarities between FDI and domestic resources.

3.1 METHODOLOGY
The estimation method adopted in this study is the ordinary least square (OLS). Time series data over the period 1990 to 2012 were used. The data used were secondary in nature sourced from CBN statistical bulletin, CBN annual report and Statement of accounts.

3.1.2 MODEL SPECIFICATION
GDP = F (FDI, IMP, EXP, INFL, EXCH, TECH, INTR) $e_{t}$---------------- (1)

This can be econometrically modeled thus:

$$LGDP = a_0 + a_1LFDI + a_2LIMP + a_3LEXP + a_4LINFL + a_5LEXCH + a_6LTECH + a_7LINT \quad e_{t}$$

Where:
- $e_{t}$ represents stochastic term
- $a_1$ – $a_7$ = Parameter Estimate
- LGDP = Log of Gross domestic product
- LFDI = Log of Foreign Direct Investment
- LIMP = Log of Import
- LEXP = Log of Export
- LINFL = Log of Inflation
- LEXCH = Log of Exchange
- LTECH = Log of Technology
- LINT = Log of Interest Rate

As stated in this study, economic growth i.e. GDP, has a functional relationship with foreign direct investment (FDI), import (IMP), export (EXP), inflation (INFL), exchange rate (EXCH), technology (TECH), and interest rate(INTR).

4.1 PRESENTATION OF DATA AND DISCUSSION OF FINDINGS
Method: Least Squares
Date: 07/03/12 Time: 22:58
Sample(adjusted): 1991 – 2012
Included observations: 22 after adjusting endpoints

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R-squared 0.655873
Adjusted R-squared 0.483809
S.E. of regression 0.359150
Sum squared resid 1.805847
Log likelihood -3.716507
Durbin-Watson stat 1.149481
Source: E-Views 7

From the result presented above the following facts emerged prominently. The equation has FDI, import, export, inflation, exchange rate, technology and interest rate as independent variables. The coefficient of the constant term is 13.07545 and assumes a positive sign. It is statistically significant at 0.0003 levels. FDI has a negative
sign and shows an inverse relationship between GDP and FDI. Import has a negative sign and shows an inverse relationship between GDP and import. It is statistically significant at 0.0540. Export assumes a positive sign. This implies that there is a direct positive relationship between economic growth and export and it agrees with appropriate expectation. Inflation assumes a negative sign and shows an inverse relationship between economic growth and inflation. Exchange rate assumes a positive sign. This implies that there is a direct positive relationship between economic growth and technology. Interest rate, however, assumes a negative sign which shows that an inverse relationship exists between GDP and interest rate. R-Square ($R^2$) in this model is 0.66 (2.dp) implying a good fit for the model. This implies that the independent variable can explain 66% of the variability of the dependent variable.

The F statistics tell us if the model will be accepted or not. Decision rule: For the model to be accepted the F statistics must be relatively high and positive. For this model the F statistic is 3.811805, therefore it is accepted.

5.1 POLICY RECOMMENDATION

The Nigerian government should establish favorable economic and political policies. Economic policies will thus encourage a continuous flow of foreign direct investment and exportation of goods and services in Nigeria. Political policies should address the political environment of the country. It is widely noted that political instability exposes an economy to varying forms of economic deprivation in the form of reduced investment by foreign Multinationals, a situation that would also adversely affect the level of FDI in the country.

References


African Economic Outlook, 2005/2006. Published by the OECD Development Centre and the African Development Bank, with financial support from the European Commission


### Appendix 1

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SOURCE: CBN STATISTICAL BULLETIN (VARIOUS ISSUES)
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