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Foreign Direct Investment and Economic Growth in Nigeria: A Sectoral Analysis

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Abstract

This study was carried out to analyse the effect of sectoral FDI inflows on economic growth in Nigeria between the period of 1980 and 2012. VECM and co-integration techniques were employed. The findings show that there is a positive relationship between FDI flow to manufacturing sector and economic growth, a positive relationship between FDI inflows to the oil sector and economic growth, and a positive influence between FDI inflows to service sector economic growth in the long run. However, there is a negative long run relationship between FDI inflows into the agriculture sector and the telecommunication sectors and economic growth. The paper therefore concludes that there is a need for policy makers to formulate policy that will help the economy maximize the growth potentials of the telecommunication sector.

Key Words: FDI, Economic Growth, VECM, Co-integration, Sectorial

1.0 Background of the Study

Achieving a sustained economic growth is one of the most important macroeconomic objectives of developing nations (Ezigbo, 2012). This is because of its role in increasing the levels of income, generating employment, and reducing poverty. Hence, understanding the process of achieving high and sustained growth is the key to reducing poverty, and improving welfare in developing countries. In the light of this fact, many developing nations have been embarking on many growth-enhancing policies aimed at achieving the required sustained growth. These include policies at encouraging investment. Investment is one of the determinants of the growth of an economy. Generally, economic theories assert that there is a positive relationship between the growth of output and investment in an economy. This was corroborated by World Bank (1989) when they concluded that the economic growth, measured by growth in GDP, is higher for countries with higher investment. This means that no country can grow higher than its level of investments. According to Anderson (1990), investment plays a vital role in the growth of an economy, if it is channeled efficiently to increase output. In recent time however, there is a growing doubt in the literatures over the role of public investment in economic growth process. This is because of the general view that government cannot continue to be a dominant player in economic activities, but should rather provide enabling environment for the private sector to thrive Khan (1996). However in developing countries, private investment has been generally low (Monjazeb et al, 2014). There are many reasons that account for the low investment in the developing countries. One of this is low saving. According to Monjazeb et al (2014), private savings is very low because the real per capita income is very low while desire for consumption is very high. This has led to the increasing calls for external inflow to bridge the gap between saving and investment in developing countries. According to Lucas (1990), this is premised on the fact that investment return in developed countries, where there is high level of saving, is low because per capita income is high. However, the per capita income in developing countries is low as saving is low, necessitating high return on investment. Hence, the free flow of capital across countries will mean that part of the saving in developed countries would be invested in developing countries. This will therefore help developing nations to achieve faster economic growth. One of such inflows is foreign direct investment (FDI). Against this backdrop, developing countries have been making various policies aimed at attracting FDI (Funke and Nsouli, 2003, Narula, 1996). The reason for this is because FDI is seen by developing countries as an important element in strategizing for the achievement of sustained economic growth (Ayanwale, 2007).

According to International Monetary Fund (IMF) (1995), FDI refers to an investment made to acquire lasting or long-term interest in enterprises operating outside of the economy of the investor. More specifically, it refers to an investment made to acquire a lasting management interest of about 10% or more voting stock in a firm or an enterprise operating in a country other than that of the investor's country of origin. FDI plays an important role in the economic growth of a nation. It helps to increase domestic investment, and promote the transfer of technology to the host countries (Falki, 2009). Also, Aitken and Harrison, (1999) asserted that FDI can help in the transfer of technology across countries, and improve technical expertise linkages between the local firms and their foreign counterparts. According to Khan (2007), FDI is the most important and significant

source of foreign inflows of resources to developing countries over the years. Portelli and Narula (2004) also asserted that the increased role of multinational enterprises in developing countries is a result of aggressive liberalization of FDI regimes and privatization programs, and that the less developed a country is, the greater is the need for FDI, as a means to alleviate resource and skill constraints normally associated with underdevelopment. According to United Nations Conference on Trade and Development (UNCTAD, 1999), FDI leads to increased efficiency of domestic firms through increased competition in the domestic market. However, there have been arguments in the literatures doubting the real effect of FDI on developing countries. This is based on some arguments that FDI can lead to a crowding out of domestic investment through reduction in capital accumulation. This could happen when foreign investors take over the limited resources such as skilled manpower and credit facility in the host countries (Herzer, 2012). Also, the knowledge transfers are often not real because domestic firms depend on crude and outdated technology and unskilled labors, thereby making them unable to learn from the multinationals (Herzer, 2012). Apart from this, Carkovic and Levine (2002) claimed that FDI does not have a significant independent influence on growth in developing countries. Also, UNCTAD (1999) concluded that the effect may be positive or negative depending on the variables of focus.

In Nigeria, as a result of saving-investment gap in the country, there have been calls and efforts to attract FDI to complement domestic investments (Danladi and Akomolafe, 2013). This includes the Nigerian Investment Promotion Commission Act of 1995, which was intended to open all sectors of the economy to foreign participation except sectors that deal in drugs and arms, and allowed for 100 per cent foreign ownership in all sectors, with the exception of the petroleum sector (Babatunde et al, 2013). With FDI inflows of about $7.03billion in 2013, Nigeria was the number one destination for FDI in Africa (UNCTAD (2013). However, various studies that have examined the effect of FDI on Nigeria have yielded mixed results. While some conclude that FDI has positively affected the country's growth, others have found no significant impact of FDI on growth in the country. For instance, Ayanwale and Bamire (2001) found a positive spillover of foreign firms FDI on domestic firm's productivity in Nigeria, and conclude that FDI leads to increase in productivity of domestic firms in the country. Also, Oyatoye et al (2011) found a positive relationship between FDI and gross domestic product (GDP) in Nigeria. However, Akinlo (2004) found that the impact of FDI on Nigeria's economic growth was small but insignificant. Also, Danladi and Akomolafe (2013) found out that there is no causality between the growth rate of GDP and FDI in Nigeria. As pointed out by Babatunde et al (2013), FDI inflow into Nigeria has been concentrated in the primary sector due to the availability of natural resources mainly crude oil, while FDI inflow to the manufacturing sector has not been insignificant. A sectoral analysis of the impact of FDI where the various sectors of the economy are considered independently has largely been left unaccounted for in Nigeria. This could be the reason for the mix results generated from the use of aggregate data of FDI in Nigeria. There is a need to take a sectoral look at the impact of FDI on economic growth in the country.

Therefore, the main objective of this study is to examine the impact of FDI on the economic growth of Nigeria using a sectoral analysis approach in order to consider the contribution of each of the dominant sectors' contribution to overall economic growth of the country. The remainder of this paper is divided into sections. Following this introductory section, section 2 provides some stylized facts about the performance of FDI in Nigeria over the years as well as a summary of the review of some relevant literature. While section highlights the methodology, section 5 provides the analysis of data on the subject matter and section 6 summarizes and concludes the study with some recommendations for policy makers.

2.0 Sectoral Flow of FDI in Nigeria

The FDI flow to the agricultural sector increased steadily from N65.8million in 1980 to N1969.6million in 1990.This fell sharply in the following years to N233.3million and N294.3million in 1991 and 1992 respectively. This however increased in 2000 and the value stood at N4182.4million. In 2001, there was a sharp decline in the FDI flow to the sector to about N1209million. Since then, the flow of FDI to the sector has been on the increase but the growth rate has not been too encouraging as it stood at N1778.5million in 2014. The flow of FDI into oil and gas sector rose from N1239.3million in 1980 to N37102.5million in 1990, but fell in the following year to N4395.3million. It has however ben on the increase since then. In 2000,FDI inflow to the sector stood at N78784.5million, and increase to N140497 in 2010, and stood at N201008.2million in 2014.

FDI inflow into telecommunication sector increased from N36.7million in 1980 to N1099.3million in 1990. It further increased toN2334.4million in 2000. By 2014, the FDI flow into the sector stood at N214244.5million. Also, FDI inflow into manufacturing sector increased from N586.0million in 1980 to N17543.5million in 1990. This further increased to N37252,4 million in 2000, and stood at N326, 450million in 2014. FDI inflow into the service sector also increased from N1298.9million in 1980 to N38889.0million in 1990. This further increased to N82, 578 in 2000 u fell sharply in the following years to about N12, 016million in 2001 but increased a little afterwards. By 2014, it stood at N58220.9million in 2014(CBN, 2014)

3.0 Literature Review

This section presents a brief review of literature on the relationship between FDI and economic growth.

Antwi and Zhao (2013) examined the relationship between FDI and economic growth in Ghana for the period 1980-2010 using Johansen's multivariate co-integration and Granger Causality test, the result confirmed a long-run negative relationship between GDP and FDI and also between GNI and FDI. Also, the Granger Causality test shows a uni-directional relationship between GDP and FDI, running from GDP to FDI.

In a study on the relationship between FDI and economic growth in Jordan from 1990 to 2009, Louzi&Abadi (2012) used co-integration and error correction mechanisms to show that FDI inflows do not exert an independent influence on economic growth. They conclude that there is a need for an appropriate policy mix to attract FDI to achieve developmental objectives. In the same vein, Chowdhury and Mavrotas (2003) examined the direction of causality between economic growth and FDI in three developing countries, Chile, Malaysia and Thailand. The results show a bi-directional causality between the two variables in Malaysia and Thailand, while uni-directional causality exists between the two variables, running from GDP to FDI in Chile. In Nigeria, Olusanya (2013) analyzed the causal relationship between FDI and economic growth from 1970 to 2010. The periods were further divided into pre-deregulated era (1970 to 1986), and post-deregulated era (1986-2010). The result shows a uni-directional causality from GDP to FDI in the pre-deregulation period. In the post-deregulation era, no causal relationship exists between the variables. However, between 1970 and 2010, the result shows a bi-directional causality between the variables. Also, using Ordinary Least Square (OLS), Adeleke, Olowe, Fasesin, (2014), examined the role of FDI on the economic growth in Nigeria between 1999 and 2013. The findings show that FDI is an engine of economic growth. Also, Olokoyo (2012) employed the use of Ordinary Least Square (OLS) regression technique to analyse the impact of Foreign Direct Investment on Economic Growth in Nigeria between the period of 1970 and 2007. The result shows no evidence of a strong link between FDI and economic growth in the country.

4.0 Research Methodology

4.1 Introduction

This section discusses the methods that will be used to achieve the objectives of this work. It begins with a discussion on the type and sources of data. This is followed by the model specification and formulation of a priori expectation. Techniques for data analysis conclude it.

4.2. Types and Sources of Data

The type of data that will be used for this research work is secondary data. The data spans the periods between 1981 and 2012. The data was sourced from the Central Bank of Nigeria statistical bulleting

3.3.1. Specification of the Model

The model used in this work borrows largely from the Cobb-Douglas type production function with labour and capital as the main independent variables with knowledge (total factor productivity) entering the model as labour augmenting or what is referred to as Harrod-neutral. This is as presented below:

$$Y = AK^{\alpha}L^{\beta} \quad \text{.....} \quad (4.1)$$

Where Y = Total production i.e. the monetary value of all goods produced in a year,

L = Labour input

K=Capital input,

A= Total factor productivity.

α and β are output elasticity for capital and labour, respectively.

Following Akinlo (2004), this model can be modified to accommodate the sectorial effect of FDI on economic growth. The modified version can be written as:

$$GDP_t = f(FDIM_t, FDIA_t, FDIT_t, FDIO_t, FDIS_t MS_t,) \quad \text{.....} \quad (4.2)$$

This is presented in linear form below:

$$GDP_t = \mu_0 + \mu_1 FDIM_t + \mu_2 FDIA_t + \mu_3 FDIT_t + \mu_4 FDIO_t + \mu_5 FDIS_t + \mu_6 MS_t + \varepsilon_t \quad \text{.....} \quad (4.3)$$

Where

GDP = Real Gross Domestic Product

FDIM = FDI inflow in Manufacturing sector

FDIA= FDI inflow in Agricultural Sector
FDIT= FDI inflow in Telecommunication Sector
FDIO= FDI inflow in Oil Sector
FDIS= FDI inflow in Service Sector
MS= Money Supply
Where $\mu_1, \mu_2, \mu_3, \mu_4, \mu_5$ and $\mu_6$are the coefficients to be estimated. εt is the error term. The error term represents the influence of other omitted variables in the model. All the variables are in log form.

5.0 Presentation and Discussion of Results

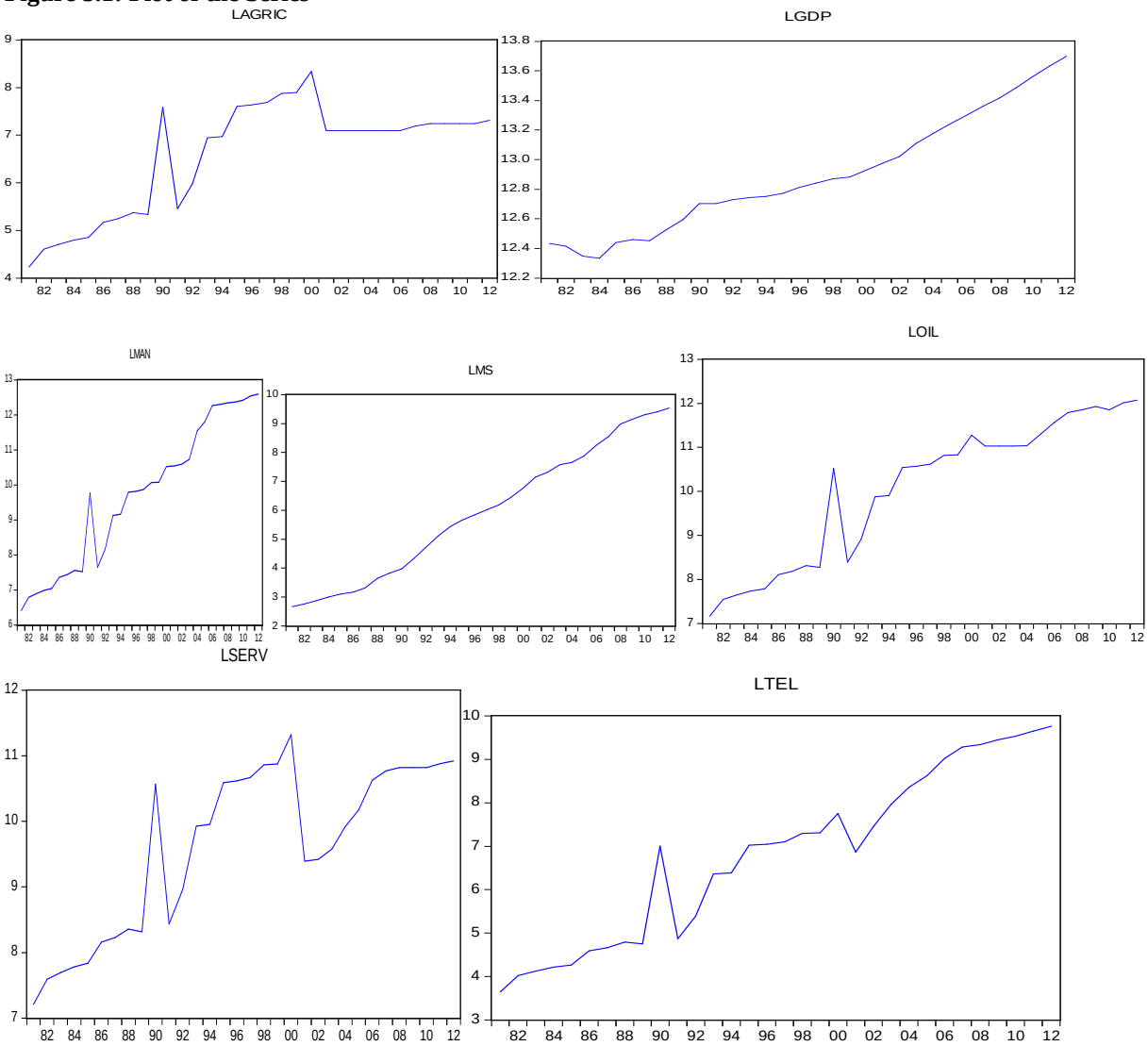
5.1 Introduction

In this section, we present and discuss the results of the analysis. We begin with the results of the unit root test. This will be followed with the co-integration results and those of the VECM consecutively.

5.2 Unit Root Test

As said earlier, the first step in a time-series analysis is to ensure the series are stationary. This is done in this study through ADF unit root test. The result is presented first in a graphical presentation. This is presented in figure 5.1 below. This will then be followed with the ADF unit root test.

Figure 5.1: Plot of the Series



Source: Authors' computation from

From the plot of the series above, it can be seen that they move with time, i.e they are trended, and deviate from the true mean. Hence we say the variables are not stationary at level. This is further confirmed by the ADF unit root test. The result is presented below in table 5.1

Table 5.1: ADF Unit Root Test

Variables	At level				At First Difference				Order of Integration
	Intercept		Intercept and Trend		Intercept		Intercept and Trend		
	T-Stat	Prob.	T-Stat	Prob.	T-Stat	Prob.	T-Stat	Prob.	
LRGDP	1.938680	0.9997	0.593415	0.9990	-3.782354**	0.0076	-4.374505**	0.0083	I(1)
LFDIM	-0.547122	0.8675	1.420694	0.9996	-6.913683**	0.0000	-6.793648**	0.0000	I(1)
LFDIO	-1.327158	0.6032	2.919623	0.9985	-7.124651**	0.0000	-4.109081*	0.0167	I(1)
LFDIT	-0.404405	0.8957	1.218919	0.9993	-6.931213**	0.0000	-6.797435**	0.0000	I(1)
LFDIS	-0.404405	0.2499	-3.120526	0.1193	-8.176100**	0.0000	-8.115183**	0.0000	I(1)
LFDIA	-1.910110	0.3234	-1.502926	0.8060	8.874331**	0.0000	-6.272459**	0.0001	I(1)
LMS	0.811754	0.9926	1.864155	0.9827	-3.284440*	0.0247	-3.855213*	0.0315	I(1)

*indicates significance at 5% level, ** indicates significance at 1%

From the result of the ADF statistics, it is clear that all the variables are not stationary at level. They are however stationary at first difference. This shows that they are integrated of other one, I(1). Since all the variables are integrated of the same order, we can use co-integration to analyze if they have long run relationship together. Hence we perform Johansen co-integration test . This result is presented below.

5.2 Johansen Co-integration Test

Since the series are integrated of the same order, I(1), co-integration test can be performed to determine their long run relationship. This is done using Johansen co-integration test. The Johansen co-integration was used because it performs better in multivariate model. The co-integration test helps to determine the presence or otherwise of long run equilibrium relationship between the dependent and independent variables in the model. The result is presented in table 5.2 below:

Table 5.2 Johansen Co-integration test

Hypothesized No. of CE(s)	Trace Statistics	Max Eigen Statistics	Critical Values (5%)		Critical Values (5%)	
			Trace	P-value	Max-Eigen	P-Value
r = 0	353.1250*	151.9652*	125.6154	0.0000	125.6154	0.0000
r ≤ 1	201.1598*	97.36296*	95.75366	0.0000	95.75366	0.0000
r ≤ 2	103.7969*	46.05553*	69.81889	0.0000	69.81889	0.0000
r ≤ 3	57.74133*	31.20523*	47.85613	0.0045	47.85613	0.0045
r ≤ 4	26.53611	21.61353*	29.79707	0.1135	29.79707	0.1135
r ≤ 5	4.922581	4.907894	15.49471	0.8170	15.49471	0.8170
r ≤ 6	0.014686	0.014686	3.841466	0.9034	3.841466	0.9034

Note: * denotes significant at 1% significance levels

From the result of Johansen co-integration test above, both Trace test and Max Eigen reveal that there is co-integrating equation. The Trace test indicates at least four co-integrating equations in the model, while Max Eigen reveals at least five co-integrating equations. Co-integration highlights the existence of long run equilibrium which converges over time. The implication is that we can now perform the VECM test.

5.3 Vector Error Correction Model

Using the results from the co-integration, test the VECM was specified, and the result is presented in table 4.3 below:

Table 5.3a Normalized Long-run Co-integration Coefficients

Variable	Coefficient	Standard error	t-statistic
LRGDP	1.000000		
LFDIM	0.422577	0.07036	6.00561
LFDIO	4.624532	0.16087	28.7477
LFDIT	-3.769180	0.07577	-49.7426
LFDIS	1.144406	0.05160	22.1765
LFDIA	-2.598720	0.06538	-39.7491
LMS	0.041495	(0.01483	2.79737

The result shows that in the long-run, there is a positive relationship between FDI flow to manufacturing sector and economic growth. A 1% increase in FDI inflow to manufacturing sector will lead to 0.4% increase in economic growth. Also, A long-run positive relationship exists between FDI inflow to the oil sector and economic growth. A 1% increase in the FDI inflow to the oil sector will increase economic growth by 4.6%. Also, FDI inflows to service sector positively influence economic growth in the long run. A 1% increase in FDI inflow to service sector will increase economic growth by 1.14%. However, there is a negative long run relationship between FDI inflow into the agriculture sector and economic growth in the country. A 1% inflow of FDI into the agriculture sector will reduce economic growth by 2.5%. This is also the situation with the telecommunication sector. The reason for this may be because the telecommunication sector in Nigeria is dominated by foreigners and their equipment sought internationally. Another explanation for this may be the price of service provided by the telecommunication operators is too high for an economy that is still growing. All the variables are statistically significant.

Table 5.3b Short Run Result

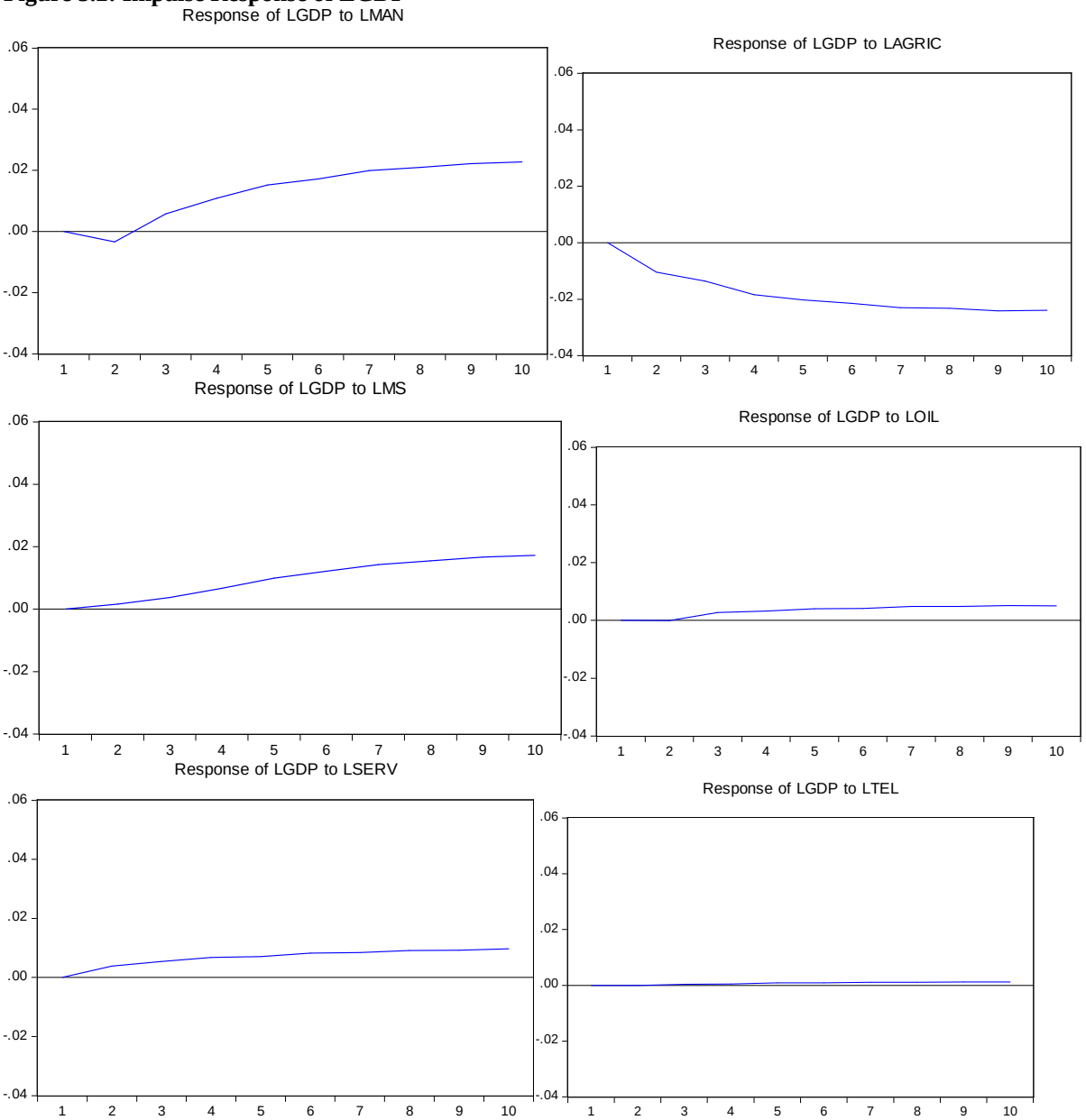
Variable	Coefficient	Standard error	t-statistic
DLRGDP	-0.354808	0.19900	1.98294
DLFDIM	-0.007590	0.05811	-0.13062
DLFDIO	0.043284	0.10930	-2.39601
DLFDIT	0.046464	0.07564	0.61426
DLFDIS	0.031484	0.10076	0.31247
DLFDIA	-0.044119	0.09165	-0.48138
DLMS	0.015511	0.07045	0.22015

The short-run result shows a positive relationship between FDI inflow into the oil sector and economic growth. A 1% increase the FDI inflow in the short run will increase economic growth by 0.04%. Also, FDI inflow in the telecommunication in the short run has a positive relationship with economic growth. A 1% increase in FDI inflow to the telecommunication sector will increase economic growth by 0.04%. The same result also applies to the service sector where a 1% FDI flow to the service sector will lead to 0.03% increase in economic growth. However, the result shows that FDI flow into manufacturing sector negatively impair economic growth in the short run. The same result applies for agricultural sector. A 1% inflow of FDI into the sector has a negative effect of 0.04% on economic growth in the short-run. However, all the FDI flows to each sector were not significant in the short run, except FDI flow to the oil sector. The adjustment period to equilibrium is 35% annually.

5.4 Impulse Response Function

We explore the response-period of economic growth to innovation in FDI flow to each sector. Only the result of response GDP to the explanatory variables is presented in figure 5.2 below.

Figure 5.2: Impulse Response of LGDP



The result of the impulse response confirms that of the VECM. The response of economic growth to one period shock in FDI flow into manufacturing sector was initially negative until the second period. It then became profoundly positive. The response of economic growth to innovation in FDI flow to agricultural sector is negative throughout the periods. Also, the response of economic growth to shock in money supply is also positive. It was initially marginal but then increase with time. The response of economic growth to shock in the FDI flow to the oil sector is also positive. Though it was close to zero initially, but later became marginally profound. This also applies to the service sector. The response of economic growth to shocks in telecommunication sector FDI shows a mixed result. It is very close to zero.

5.5 Variance Decomposition

Variance decomposition determines the percentage of error variance in the system that is explained by the dependent variable and its determinants. Table 5.4 presents the variance decomposition results for Economic growth.

Table 5.4 Variance Decomposition of LGDP

Period	S.E.	LGDP	LAGRIC	LMAN	LMS	LOIL	LSERV	LTEL
1	0.037198	100.0000	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000
2	0.061746	96.40338	2.843537	0.301957	0.065738	0.000158	0.385223	2.97E-06
3	0.083765	94.21944	4.170788	0.632392	0.235715	0.110028	0.629342	0.002294
4	0.103447	91.00918	0.899381	1.511402	0.569110	9.168300	0.839386	0.003239
5	0.121621	88.02515	0.048979	2.656716	1.083825	7.231560	0.946348	0.007418
6	0.137979	85.48693	0.902137	3.617451	1.621202	4.268713	1.094094	0.009475
7	0.153402	83.03776	0.649803	4.616246	2.176275	7.317780	1.189283	0.012849
8	0.167602	81.05788	0.164379	5.437624	2.680414	9.348654	1.296280	0.014769
9	0.181040	79.28751	0.626677	6.169052	3.146510	9.379761	1.373107	0.017384
10	0.193580	77.85775	0.949863	6.772464	3.545486	9.400634	1.454719	0.019081

The result depicts that the largest source of variations in LGDP forecast error is attributable to its own shocks. The innovations of agricultural sector FDI, manufacturing sector FDI, oil sector FDI, Telecommunication sector FDI, and service sector FDI are other important sources of the forecast error variance of GDP. In all, the oil sector FDI contributed the largest variation to GDP. This is followed by the manufacturing sector FDI. The telecommunication sector FDI contributed the least to the forecast error variance.

5.6 Granger Causality Test

The granger causality test was conducted to determine the linkages among the sectors. The result is presented in table 5.5 below.

Table 5.5: Results of the Pair-wise Granger Causality Tests.

VARIABLE	LGDP	LFDIM	LFDIO	LFDIT	LFDIS	LFDIA	LMS
LRGDP		1.45092 (0.2534)	1.34435 (0.2789)	2.14199 (0.1385)	0.98823 (0.3863)	1.15402 (0.3316)	1.02463 (0.3735)
LFDIM	1.01561 (0.3766)		0.46286 (0.6348)	1.03498 (0.3700)	0.32491 (0.7256)	0.13139 (0.8775)	6.73838 (0.0046)
LFDIO	0.68030 (0.5156)	0.17012 (0.8445)		0.20314 (0.8175)	0.16075 (0.8524)	0.06870 (0.9338)	2.65735 (0.0899)
LFDIT	0.82003 (0.4519)	0.03359 (0.9670)	0.81783 (0.4529)		1.07850 (0.3554)	1.43773 (0.2564)	6.82224 (0.0043)
LFDIS	0.86935 (0.4315)	1.46436 (0.2504)	0.16075 (0.8524)	1.44921 (0.2538)		1.73553 (0.1969)	0.91989 (0.4116)
LFDIA	0.07234 (0.9304)	0.43619 (0.6513)	0.50182 (0.6114)	0.12472 (0.8833)	0.28262 (0.7562)		0.21993 (0.8041)
LMS	0.45152 (0.6417)	4.23179 (0.0261)	1.97181 (0.1603)	3.07378 (0.0640)	1.95923 (0.1620)	1.54988 (0.2320)	

NB: The numbers in parenthesis show the P-values for the corresponding
F-square statistics

The result of the granger causality test shows a bi-directional causality between FDI flow to manufacturing sector and money supply. There is also a uni-directional causality from money supply to FDI flow to the oil

sector. There is also a bi-directional causality between FDI flow to telecommunication and money supply. However, there is no causality between economic growth and FDI flow to any of the sectors. The result shows that the level of money supplies in the country play a vital role in attraction of FDI into a given sector.

6.0 Summary, Policy Implication and Recommendation.

This study has been carried out to analyse the effect of sectorial FDI flow on economic growth in Nigeria. VECM and co-integration techniques were employed. The findings of this paper are important for policy makers. The negative relationship between FDI flow to telecommunication sector and economic growth is a call to the policy makers. This may be explained that the price of service provided by the telecommunication operators is too high for an economy that is still growing. The paper therefore concludes that there is need for policy makers to formulate policy that will help the economy maximize the growth potentials of the telecommunication sector.

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