FOREIGN DIRECT INVESTMENT - ECONOMIC GROWTH NEXUS:
EVIDENCE FROM NIGERIA (1990 – 2018)

Ogbonna Ben and Osodiuru, Peter Ekelem Chukwu

Yunnan Key Laboratory for Dai and Yi Medicines, Yunnan University of Chinese Medicine, Kunming 650500, Yunnan, People's Republic of China

ARTICLE INFO

Received 13th August, 2019
Received in revised form 11th September, 2019
Accepted 8th October, 2019
Published online 28th November, 2019

ABSTRACT

This study sought to empirically analyze the nexus between foreign direct investment (FDI) and economic growth in Nigeria. The work covered a period of 1990 - 2018 using data from Central Bank of Nigeria statistical bulletin. A growth model via the Ordinary Least Square method was used to ascertain the relationship between FDI and economic growth in Nigeria. The result of the OLS regression indicated that FDI has a positive and significant relationship with the growth of Nigerian economy for the period under study. The study therefore recommended that the Central Bank of Nigeria should come-up with policies that will help to stabilize the Naira exchange rate vis-à-vis the major currencies of the world, like the United States Dollar. This will boost the investors’ confidence in the economy. Government should strive to put under check corrupt and fraudulent practices, encourage self-employment, provide access to loan such as micro financing and above all eradicate terrorism that has chased many foreign investors away from Nigeria.

Keywords:
Foreign Direct Investment, Economic Growth, Gross Domestic Product, Nexus.

INTRODUCTION

Attracting Foreign Direct Investment has become very crucial for most countries because of its perceived positive impact on economic growth and development. Many countries have undertaken structural and regulatory reforms such as privatization of state enterprises, liberalisation of their foreign exchange markets and establishment of fiscal incentives like tax holidays in order to attract more Foreign Direct Investments. The quest by developing countries for increased Foreign Direct Investment stems from the assumption that Foreign Direct Investment leads to economic benefits within the host country. According to World Bank (2010), developing countries should endeavour to attract more Foreign Direct Investment because it encourages production improvements, contributes to the advancement in technology, boosts employment opportunities, bolsters business sector competition and creates exports. Fortanier & Maher (2001) indicated that Foreign Direct Investment through multinational enterprises is an influential and effective means to propagate technology from developed to developing countries. Fortanier and Maher further indicate that Foreign Direct Investment is habitually the only source of innovative and new technologies.

According to Mansfield & Romeo (1980), technology that comes with Foreign Direct Investment is newer compared to that sold through licensing. Also, Romer (1993) noted that Foreign Direct Investment is beneficial because it narrows the “idea or knowledge gap” between the developed and host countries and provides more growth opportunities. In addition, Foreign Direct Investment inflows bring other tangible and intangible benefits which substantially impact on economic growth and development. For example, Foreign Direct Investment inflows through mergers and acquisitions can bring better managerial and organisational skills. Fortanier and Maher (2001) disclosed that corporate governance is increasingly becoming a critical feature for cross border investment decisions and that good corporate governance enhances the confidence of investors. Foreign Direct Investment has been pivotal to economic growth in many countries across the globe. Most countries strive to attract Foreign Direct Investment (FDI) because of its acknowledged advantages as a tool of economic development. World Bank (1996) uncovered that many countries in Africa, especially Nigeria, have joined the rest of the world in seeking FDI as evidenced by the formation of the New Partnership for Africa’s Development (NEPAD), which has the attraction of foreign investment to Africa as a major component. FDI can also be seen as an investment made to
acquire a lasting management interest (normally 10% of voting stock) in a business enterprise operating in a country other than that of the investor defined according to residency. Such investments may take the form of either “greenfield” investment (also called “mortar and brick” investment) or merger and acquisition (M&A), which entails the acquisition of existing interest rather than new investment. In corporate governance, ownership of at least 10% of the ordinary shares or voting stock is the criterion for the existence of a direct investment relationship. Ownership of less than 10% is recorded as portfolio investment. 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. Countries could be both host to FDI projects in their own country and a participant in investment projects in other countries. A country’s inward FDI position is made up of the hosted FDI projects, while outward FDI comprises those investment projects owned abroad.

The rapid growth of interest in foreign direct investment (FDI) stand from the perceived opportunities derivable from utilizing this form of foreign capital injection into the economy, to augment domestic savings and further promote economic development in most developing economies (Aremu, 2005). Alfaro (2006) stated that policymakers believe that FDI produces positive effects on host economies. Some of these benefits are in the form of externalities and the adoption of foreign technology. Olokoyo, (2012) stated that Foreign investment inflow, particularly foreign direct investment (FDI) is perceived to have a positive impact on economic growth of a host country through various direct and indirect channels. It augments domestic investment, which is crucial to the attainment of sustained growth and development. Governments have been trying to lift the country out of the economic crisis without achieving success as desired. Each of these governments has not focused much attention on investment especially foreign direct investment which will not only guarantee employment but will also impact positively on economic growth and development. FDI is needed to reduce the difference between the desired gross domestic investment and domestic savings (Erawoke & Eshanake, 2012).

Jenkin and Thomas (2002) opined that FDI is expected to contribute to economic growth including the provision of foreign capital as well as crowding in additional domestic investment. By promoting both forward and backward linkages with the domestic economy, additional employment is indirectly created and further economic activity stimulated. Adegbite and Ayadi (2010) stated that FDI helps fill the domestic revenue-generation gap in a developing economy, given that most developing countries’ governments do not seem to be able to generate sufficient revenue to meet their expenditure needs. Other benefits are in the form of externalities and the adoption of foreign technology. Foreign direct investment includes external resources; technology, managerial and marketing expertise and capital. All these generate a considerable impact on host nation’s productive capabilities and the success of government policies of stimulating the productive base of the economy depend largely on her ability to control adequate amount of FDI comprising managerial, capital and technological resources to boost the existing production capacity. Kumar (2007) described Foreign Direct Investment (FDI) in several ways. First and most likely it may involve parent enterprise injecting equity capital by purchasing shares in foreign affiliates. Second, it may take the form of reinvesting the affiliate’s earning. Third, it may entail short-or foreign investment as a share of Gross Domestic Product has grown rapidly, becoming the largest source of capital moving from developed nations to developing nations.

Nigeria has the potential to become Africa’s largest economy and a major player in the global economy because of its rich human and material resources. With its large reserves of human and natural resources, Nigeria has the potential to build a prosperous economy, reduce poverty significantly, and provide the health, education, and infrastructure services its population needs. However, this has not been achieved because all major productive sectors are inefficient because of over dependence on oil. Nigeria as a country, given her natural resource base and large market size, qualifies to be a major recipient of FDI in Africa and indeed is one of the top three leading African countries that consistently received FDI in the past decade. However, Asiedu (2003) asserted that the level of FDI attracted by Nigeria is not enough compared with the resource base and potential need. Further, the empirical relationship between FDI and economic growth in Nigeria is yet unclear, despite numerous studies that have examined the influence of FDI on Nigeria’s economic growth with varying outcomes. However, recent evidence affirms that the relationship between FDI and economic growth may be country and period specific. In addition, Asiedu (2003) stated that the determinants of FDI in one region may not be the same for other regions. Also, the determinants of FDI in countries within a region may be different from one another and from one period to another. In some instances, it has been found that it is economic growth or its prospect that leads to an increase in Foreign Direct Investment and not vice versa. According to Gorg & Greenaway (2002), Foreign Direct Investment has negative rather than positive spillovers in transition economies. The absence of positive spillovers is attributed to the size of the economies. In his own contribution, Joze (2003) indicates that the assertion that Foreign Direct Investment bolsters business competition in host economies may either be true or false. He indicates that sometimes multinational enterprises “crowd out” or force out domestic firms thus reducing competition.

The correlation between FDI and economic growth has been the subject of controversy and considerable research for many decades. Interest in the area has been revived in recent years largely due to the globalisation of the world economy and to the recognition that multinational corporations play an increasingly important role in trade, capital accumulation and economic growth in developing countries. It is against this backdrop, that the researcher dimmed it fit to conduct an empirical analysis of the nexus between foreign direct investment and economic growth in Nigeria from 1990 to 2018.

Conceptual Framework

Foreign direct investment is an investment made by an individual or a company (investor) in a country which is not the country of origin of the investor, in the form of either establishing business or acquiring business assets in the country.
Foreign Direct Investment (FDI) is the process where people in one country obtain ownership of assets for the purpose of gaining control over the production, distribution and other activities of a firm in a foreign country (Moosa, 2002). 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, entrepreneurship 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 headquarters (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, 2003). 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.

Economic growth is the increase in the amount of goods and services produced by an economy over time. It is conventionally measured as the percentage rate of increase in real gross domestic product, or real GDP (Alfaro, 2006). 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 forms 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 (Kumar, 2007).

However, the relation between FDI and economic growth deserves special attention. If, on one hand, economic growth is a powerful stimulant to the inflow of FDI, on the other, an increase in foreign investment - since this would mean an increase in the existing capital stock - would also be one of the factors responsible for economic growth, meaning the existence of an endogenous problem (Moosa, 2002). There are, also, other studies that deal with proving the relation between FDI and the level of economic activity. Regarding the determinants of FDIs, it must be stated that there are substantial differences between the flows that only involve developing countries, whether between home and host countries, and those in which the host countries are developing countries. According to Dunning (2002), in the former case strategic asset-seeking investments take place, in which FDI is used in mergers and acquisitions, seeking horizontal efficiency. In the second case, investments are characterized by the search for markets, and resources, thus being of vertical efficiency.

Theoretical Framework

The theoretical framework adopted for the present study was standard neoclassical theory postulated by Gremon in 1972. The standard neoclassical theory stated that economic growth and development are based on the utilization of land, labour and capital in production. Since developing countries in general, have underutilized land and labour and exhibit low savings rate, the marginal productivity of capital is likely to be greater in these countries. Thus, the neo-liberal theories of development assume that interdependence between the developed and the developing countries can benefit the latter. This is because capital will flow from rich to poor areas where the returns on capital investments will be highest, helping to bring about a transformation of ‘backward’ economies. Furthermore, the standard neo-classical theory predicts that poorer countries grow faster on average than richer countries because of diminishing returns on capital. Poor countries were expected to converge with the rich over time because of their higher capacity for absorbing capital. The reality, however, is that over the years divergence has been the case, the gap between the rich and poor economies has continued to increase. The volume of capital flow to the poor economies relative to the rich has been low.

Empirical Review

Ilgun, Koch and Orhan (2010) investigated the relationship between growth and Foreign Direct Investment (FDI) in Turkey. The authors stated that there are mixed conclusions about the impact of FDI on growth and the literature included many studies where FDI has negative, positive and no significant effects on growth. They provide empirical support to bi-directional causality between FDI and growth. Nwoagu and Ryan (2015) investigated how foreign direct investment (FDI), foreign aid, and remittances impact the economic growth of 53 African and 34 Latin American and Caribbean countries and found that, for Latin America and the Caribbean, foreign aid and remittances affect growth when estimated separately, while remittances affect growth when they are estimated simultaneously. Their results also show that both regions’ results confirm that spatial interdependence is important.
Anyawale (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. Akinlo (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.

Anyawale (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 (Anyawale, 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. Blomstrom, Kokko and Zejan (1994) examined a sample of both developed and developing countries and concluded in favour of complementarities between FDI and domestic resources. Asia and its 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. 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.

RESEARCH METHODOLOGY

This study used secondary data collected from Central Bank of Nigeria statistical bulletin and publications of the National Bureau of Statistics from 1990 – 2018.

Model Specification

\[
\text{GDP} = f (\text{FDI}, \text{EXR})
\]

\[
\text{GDP} = \alpha_0 + \alpha_1 \text{FDI} + \alpha_2 \text{EXR} + e
\]

Where:

- GDP = Gross Domestic Product
- FDI = Foreign Direct Investment
- EXR = Exchange Rate
- e = Error Term
- \(\alpha_0\) = Intercept
- \(\alpha_1 - \alpha_2\) = Regression Coefficients

Gross Domestic Product is the dependent variable and proxy for economic growth; Foreign Direct Investment is the independent variable; Exchange Rate is the moderating variable.

The study adopted an ordinary least square regression in analyzing the data collected. The analysis was done with the aid of e-views version 8 econometric software.

DATA PRESENTATION, RESULT AND DISCUSSION

<table>
<thead>
<tr>
<th>Dependent Variable: GDP_N_BILLION_</th>
</tr>
</thead>
<tbody>
<tr>
<td>Method: Least Squares</td>
</tr>
<tr>
<td>Date: 01/11/19 Time: 05:30</td>
</tr>
<tr>
<td>Sample: 1990-2018</td>
</tr>
<tr>
<td>Included observations: 29</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP_N_BILLION</td>
<td>-35495.91</td>
<td>20956.38</td>
<td>-1.693800</td>
<td>0.1023</td>
</tr>
<tr>
<td>FDI_N_BILLION</td>
<td>2.845383</td>
<td>0.902445</td>
<td>3.152973</td>
<td>0.0040</td>
</tr>
<tr>
<td>EXR</td>
<td>603.1686</td>
<td>207.5039</td>
<td>2.906782</td>
<td>0.0074</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.787231</td>
<td>0.770864</td>
<td>0.571007</td>
<td>0.2484071</td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>0.778064</td>
<td>0.758345</td>
<td>0.517007</td>
<td>0.612973</td>
</tr>
<tr>
<td>S.E. of regression</td>
<td>24.88501</td>
<td>24.98216</td>
<td>24.83071</td>
<td>24.98216</td>
</tr>
<tr>
<td>Log likelihood</td>
<td>-357.1903</td>
<td>24.88501</td>
<td>24.98216</td>
<td>24.88501</td>
</tr>
<tr>
<td>F-statistic</td>
<td>48.09920</td>
<td>1.767939</td>
<td>1.767939</td>
<td>1.767939</td>
</tr>
<tr>
<td>Prob(F-statistic)</td>
<td>0.000000</td>
<td>1.767939</td>
<td>1.767939</td>
<td>1.767939</td>
</tr>
</tbody>
</table>

From the result presented above the following facts emerged prominently. The equation has FDI and EXR as independent variables. FDI has a positive sign and shows a positive relationship between GDP and FDI. It is statistically significant at 0.0040. Exchange rate has a positive sign and shows a positive relationship between GDP and exchange rate. It is statistically significant at 0.0074.

R- Square (R2) in this model is 0.79 (2.dp) implying a good fit for the model. This implies that the independent variable can explain 79% 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 48.09920, therefore it is accepted. Durbin-Watson statistic of approximately 1.77 shows evidence of no auto-correlation.

CONCLUSION

Foreign direct investment no doubt has many beneficial effects for the growth and development of the national economy and Nigeria is not an exception. The present study sought to empirically analyze the nexus between foreign direct investment and economic growth in Nigeria from 1990 to 2018. The objective of this study was to find out whether foreign direct investment has positive or negative relationship with economic growth in Nigeria from 1990 to 2018. The findings of this study uncovered that foreign direct investment has a positive effect on economic growth in Nigeria.

Recommendations

Based on the findings of this study, the following recommendations were given:

1. Nigeria should adopt its own growth and development strategy not on the basis of ideology but based on its own geographical, historical, economic, political and socio cultural realities.
2. The government should improve the state of infrastructure in the country. This will encourage meaningful investments in the economy.
3. Appropriate policy measures to attract foreign capital should be formulated and implemented to boost economic growth.
4. Nigeria should develop and strengthen institutions and bureaucracies to support its economic development agenda.
5. The Nigerian Government needs to embark on capital projects, which will enhance the infrastructural facilities with which foreign investors can build on.
6. Government should strive to put under check corrupt and fraudulent practices, encourage self-employment, provide access to loan such as micro financing and above all eradicate terrorism that has be-deviled Nigeria.
7. The Central Bank of Nigeria should come up with policies that will help to stabilize the Naira exchange rate vis-à-vis major currencies of the world, like the United States Dollar. This will boost the investors’ confidence in the economy.

References


