

Impact of Foreign Direct Investment on Nigeria Economic Growth

Adeleke Kunle M.

Department of accountancy
Federal Polytechnic, Offa, Kwara State, Nigeria

Olowe S.O.

Department of accountancy
Osun State College of Technology, Esa-Oke, Nigeria

Fasesin Oladipo Oluwafolakemi

Department of Accountancy
Osun State Polytechnic, Iree, Nigeria

DOI Link: <http://dx.doi.org/10.6007/IJARBSS/v4-i8/1092>

Published Date: 18 August 2014

Abstract

The study analyzed the impact of foreign direct investment on Nigeria economic growth over the period of 1999- 2013. The main type of data used in this study is secondary; sourced from various publications of Central Bank of Nigeria, such as; Statistical Bulletin, Annual Reports and Statement of Accounts. The regression analysis of the ordinary least square (OLS) is the estimation technique that is being employed in this study to determine the relationship between and impact of the Direct Foreign Investment on economic growth. The findings revealed that economic growth is directly related to inflow of foreign direct investment and it is also statistical significant at 5% level which implies that a good performance of the economy is a positive signal for inflow of foreign direct investment. This implies that foreign direct investment is an engine of economic growth. The paper recommended that government should liberalize the foreign sector in Nigeria so that all barriers to trade such as arbitrary tariffs; import and export duties and other levies should be reduced so as to encourage investors.

Key words: Foreign Direct Investment, Economic Growth, OLS, CBN, Nigeria

Introduction

Foreign direct investment (FDI) is a direct investment into production or business in a country by an individual or company of another country, either by buying a company in the target country or by expanding operations of an existing business in that country. Foreign direct investment is in contrast to portfolio investment which is a passive investment in the

securities of another country such as stocks and bonds. World Bank (1996) conceptualized Foreign Direct Investment (FDI) as investment that is made to acquire a lasting management interest (usually 10% of voting stock) in an enterprise and operating in a country other than that of the investors (define according to residency) the investors purpose being an effective voice in the management of earning either long term capital or short term capital as shown in the nations balance of payments account statement (Macaulay, 2012). Broadly, foreign direct investment includes mergers and acquisitions, building new facilities, reinvesting profits earned from overseas operations and intra company loans. In a narrow sense, foreign direct investment refers just to building new facilities. Todaro, (1977) believed that FDI encourages the inflow of technology and skills and fills the gap between domestically available supplies of savings, foreign exchange and government revenue. It also encourages the inflow of technology and skills. Onu, (2012) asserted that the contributions of foreign investment to Japan after the World War II and in South Korea after the Korean War has tremendously assisted the economic growth of these countries by providing the local economy with a source of foreign skill, technology, management expertise and human resource development through international training and collaboration.

Macaulay, (2012) asserted that Nigeria's foreign investment can be traced back to the colonial era, when the colonial masters had the intention of exploiting our resources for the development of their economy. There was little investment by these colonial masters. With the research and discovery of oil foreign investment in Nigeria, but since then, Nigeria's foreign investment has not been stable. The Nigerian governments have recognized the importance of FDI in enhancing economic growth and development and various strategies involving incentive policies and regulatory measure have been put in place to promote the inflow of FDI to the country. According to Lall, (2002), privatization was also adopted, among other measures, to encourage foreign investments in Nigeria. This involved transfer of state-owned enterprises (manufacturing, agricultural production, public utility services such as telecommunication, transportation, electricity and water supply), companies that are completely or partly owned by or managed by private individuals or companies. Shiro (2009) noted that since the enthronement of democracy in 1999, the government of Nigeria has taken a number of measures necessary to woo foreign investors into Nigeria. These measures, he noted, include the repeal of laws that are inimical to foreign investment growth, promulgation of investment laws, various oversea trips for image laundry by the President among others. Thus, this study assesses the impact of FDI on economic growth in Nigeria within the period 1999-2013.

Literature Review

Foreign direct investment represents a veritable source of foreign exchange and technological transfer, especially to a developing economy like Nigeria. It can be analyzed in terms of inflow of new equity capital (change in foreign share capital), re-invested earning (unremitted profit), trade and supplier's credit, net inflow of borrowing and other obligations from the parent company or its affiliates (Nwankwo et al, 2013). Olopoenia (1985) observed that foreign investment could be seen as an additional factor of production and as a supplement to the national savings effort of the capital importing country. This is meant to relax both the foreign exchange and savings constraint on the rate of growth of output in the recipient country. Agada and Okpe (2012) saw FDI as an attempt by individuals, groups, companies and government of a nation to move resources of productive purpose across its country to another country with the anticipation of earning some surplus. Otepola (20012), asserted that

FDI has emerged as the most important source of external resource flows to developing countries over the years and has become a significant part of capital formation in these countries, though their share in the global distribution of FDI continue to remain small or even declining. Caves (1996) also observed that the rationale for increased efforts to attract more FDI stems from the belief that FDI has several positive effects. Among these are productivity gains, technology transfers, and the introduction of new processes, managerial skills and know-how in the domestic market, employee training, international production networks, and access to markets.

Empirical Review on the Relationship between FDI and Economic Growth

Previous studies on the Foreign Direct Investment (FDI) and economic growth in Nigeria and other countries provided inconclusive evidence. Lall (2002) opined that FDI inflow affects many factors in the economy and these factors in turn affect economic growth. This review shows that the debate on the impact of FDI on economic growth is far from being conclusive. The role of FDI seems to be country specific and can be positive, negative or insignificant, depending on the economic, institutional and technological conditions in the recipient countries. For instance, Solomon and Eka (2013) investigated the empirical relationship between Foreign Direct Investment and economic growth in Nigeria. The work covered a period of 1981-2009 using an annual 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 techniques indicated that FDI has a positive but has insignificant impact on Nigerian economic growth for the period under study. Alejandro (2010) explained that FDI plays an extra ordinary and growing role in global business and economics. It can provide a firm with new markets and marketing channels, cheaper production facilities access to new technology products, skills and financing for a host country or the foreign firms which investment, it can provide a source of new technologies, capital processes products, organization technologies and management skills and other positive externalities and spillover that can provide a strong impetus to regional economic growth. Obwona (2001) noted in his study of the determinants of FDI and their impact on growth in Uganda that macroeconomic and political stability and policy consistency are important parameters determining the inflow of Foreign Direct Investment (FDI) into Uganda and that Foreign Direct Investment (FDI) affects growth positively but insignificant. Foreign Direct Investment (FDI) also contributes to economic growth via technology transfer.

Zhang (2001) argued that Foreign Direct Investment has positive growth impact that is similar to domestic investment along with partly alleviating balance of payment deficit in the current account. He opined that via technology transfer and spillover efficiency, the inflow of direct foreign investment might be able to stimulate a country economic performance.

Ewe-Ghee Lim (2001) summarized recent arguments and findings on FDI and its correlation with economic growth focusing on literature regarding spillovers from FDI and found that while substantial support exists for positive spillovers from FDI, there is no consensus on casualty.

Otepola (2002) also examined the importance of direct foreign investment in Nigeria. The study

empirically examined the impact of FDI on growth. He concluded that FDI contributes significantly to growth especially through exports. Ricardo, Hwang and Rodrick (2005) argued that Foreign Direct Investment (FDI) provide a path for emerging nations to export the products developed economies usually sell, in effect increasing their export sophistication.

Many developing countries pursue FDI as a tool for export promotion, rather than production for the domestic economy. Typically foreign investors build plants in nations where they can produce goods for export at lower costs. Bende-Nabende (2002) also found that direct long term impact of Foreign Direct Investment (FDI) on output is significant and positive for comparatively economically less advanced Philippines and Thailand, but negative in the more economically advanced Japan and Taiwan. In the same line, Ariyo (1998) studied the investment trend and its impact on Nigeria's economic growth over the years. He found that only private domestic investment consistently contributed to raising GDP growth rates during the period considered (1970–1995).

However, Alfaro *et al*, (2003) affirmed that the contribution of FDI to growth depends on the sector of the economy where the FDI operates. He claimed that FDI inflow to the primary sectors, tends to have a negative effect on growth, however, as for the service sector, the effect of DFI inflow is not so clear. Durharm (2004) for example, failed to establish a positive relationship between Foreign Direct Investment (FDI) and growth but instead suggests that the effects of Foreign Direct Investment (FDI) are contingents on the absorptive capability of host countries. Nwankwo *et al*, (2013) investigated the impact of globalization on foreign direct investment in Nigeria-since the world has become a global village. The methodology used is purely descriptive and narrative and the data used is secondary. It was found out that foreign direct investment (FDI) has been of increased benefit to Nigeria in the area of employment, transfer of technology, encouragement of local enterprises etc. But there are certain impediments to the full realization of the benefits of foreign direct investment. Adelegan (2000) also explored the seemingly unrelated regression model to examine the impact of FDI on economic growth in Nigeria and found out that FDI is pro-consumption and pro-import and negatively related to gross domestic investment. In the same line, Ogiogio (1995) reported negative contributions of public investment to GDP growth in Nigeria for reasons of distortions. Oyinlola (1995) also conceptualized foreign capital to include foreign loans, direct foreign investments and export earnings. Using Chenery and Stout's two-gap model (Chenery and Stout, 1966), he concluded that FDI has a negative effect on economic development in Nigeria.

Methodology

The main type of data used in this study is secondary; sourced from various publications of Central Bank of Nigeria, such as; Statistical Bulletin, Annual Reports and Statement of Accounts. The models used in this study are estimated using data on Direct Foreign Investment (DFI) and some macro-economic indicators, which includes: Gross Domestic Products (GDP) Exchange Rate (EXR) and Export (Exp) for the period 1999 – 2013.

The regression analysis of the ordinary least square (OLS) is the estimation technique that is being employed in this study to determine the relationship between and impact of the Direct Foreign Investment on economic growth proxy by Gross Domestic Product (GDP).

TABLE 1: Domestic Products (GDP), Exchange Rate (EXR) and Export (EXP) for the period 1999 – 2013.

Year	FDI	GDP	EXP	EXR
1999	4, 035.50	117, 000	1,188,969.80	92.693
2000	16, 453.60	121, 000	1, 945,732.30	102.105
2001	4, 937.00	126, 000	1, 867,953.90	111.943
2002	8, 988.50	131, 000	1, 867,953.90	120.970
2003	13, 531.20	136, 000	1, 867,953.90	129.356
2004	20, 064.40	145, 400	1, 867,953.90	133.500
2005	26, 083.70	156, 004	1, 867,953.90	131.661
2006	41,734.00	169, 304	5,752,747.79	128.651
2007	4, 324,86	634, 656	6, 838,888.94	134.054
2008	4, 659.156	674, 888	7, 0530, 650	132.372
2009	3, 810.251	716, 949	6, 808,831	132.601
2010	3, 810.25	801, 700	6, 764, 450	128.270
2011	5, 304.112	901, 300	2, 011, 317	146.680
2012	3, 199 .89	261, 855	2, 011, 3117	150,20
2013	6, 7400.00	285, 655	1, 646,175	156.00

Source: Central Bank of Nigeria Statistical Bulletin

Model Specification

Model which specifies that economic growth (GDP) is significantly influenced by the Foreign Direct Investment indices (Direct foreign investment, Export and Exchange Rate) are formulated as follows;

$$GDP = f (DFI, EXP, EXR)$$

$$\ln GDP = \beta_0 + \beta_1 \ln DFI + \beta_2 \ln EXP + \beta_3 \ln EXR$$

LnGDP = Gross Domestic Product

LnDFI = Direct Foreign Investment

LnEXP = Export Earnings

LnEXR = Exchange Rate

β = intercept

$\beta_1 - \beta_3$ = Coefficient of the independent variables

Note: All variables are in their natural logarithm form.

Table 1:

Variable	Coefficient	Std.Error	T-Value	P
Direct foreign investment	0.364	0.201	1.889	0.030
Export Earnings	0.850	0.601	2.890	0.001
Exchange Rate	0.275	0.178	1.546	0.053
Constant	0.500	0.446	1.088	0.031
R ²	0.641			
Adj. R ²	0.534			
F – value	5.964			
Probability	0.013			

The result obtained using the Ordinary Least Square (OLS) estimation technique.

$$GDP = 0.5000 + 0.364DFI + 0.850EXP + 0.275EXR.$$

The result in table 1 shows that the predictor variables (i.e Direct foreign investment, export earnings and exchange rate) were significantly joint predictors of Gross Domestic Product ($F(3, 10) = 5.964$; $R^2 = 0.641$) at 5%level. The predictor variables jointly explained 64.7% of GDP, while the remaining 35.3% could be due to the effect of extraneous variables.

Furthermore, it can be deduced from the result obtained that the constant parameter in the long – run is positive.This implies that if all the explanatory variables are held constant, GDP will increase by 0.50 units. This result is agreed with Oyatoye *et al* (2011); Alejandro (2010); Lall (2002); Otepola, (2002) and Ariyo, (1998) that Direct Foreign Investment is inevitable in economic growth of a nation.

The coefficient of Foreign Direct Investment is 0. 364, it has a positive relationship with GDP (t = 1.889, $P < .05$) showing that a unit increase in real foreign direct investment (FDI) will increase GDP by 0. 364. The coefficient of Export Earnings is 0.850, it has a positive relationship with GDP (t = 2.890, $P < .01$) showing that a unit increase in export earnings (EXPT) will increase GDP by 0.850. Also, the coefficient of exchange rate is 0.275, it has a positive relationship with GDP (t = 2.890, Pns) showing that a unit increase in real exchange rate (EXR) will increase GDP by 0.275.

Conclusion and Recommendations

The study analyzed the impact of foreign direct investment on Nigeria's economic growth over the period of 1999- 2013. The findings revealed that economic growth is directly related to inflow of foreign direct investment and statistically significant at 5% level. This implies that a good performance of the economy is a positive signal for inflow of foreign direct investment. It can be concluded that foreign direct investment is an engine of economic growth. Therefore, there is need to have a stable political and economic environment and improve on the critical infrastructure, level of security at all levels in the country, systems of

governance should be based on accountability, transparency, effective and efficient resource. Furthermore, government needs to liberalize the foreign sector in Nigeria so that all barriers to trade such as arbitrary tariffs; import and export duties and other levies should be reduced so as to encourage investors.

References

Adelegan, J. O. 2000, Foreign Direct Investment and Economic Growth in Nigeria: A seemingly unrelated model". African Review of Money, Finance and Banking, Supplementary issue of "Savings and Development" 2000.pp.5-25. Milan, Italy.

Alejandro D. (2010): Bautista conference foreign direct investment Mexico, United States, Canada NAFTA, *Presentation Transcript*.

Alfaro C, A. Chanda, S.Kalemi-Ozean and S.Sayek (2003)"FDI and economic growth: The role of local and financial markets" *Journal of International Economics* forth coming

Agada, G. O and Okpe T.J (2002) Determination of risks of foreign investment. *Journal of Economic and Social Research* Vol I1 No2.Abaci Publishers.

Ariyo, A. (1998)."Investment and Nigeria's Economic Growth". In Investment in Growth Process Proceedings of Nigerian Economic Society Annual Conference 1998, pp.389-415. Ibadan, Nigeria.

Bemde-Nabende, A., J. Ford, S. Sen and Slater J (2002). "Foreign Direct Investment in East Asia: Trends and Determinants". *Asia Pacific Journal of Economics and Business* 6(1): 4-25.

Caves, R.E. (1996).*Multinational Enterprise and Economic Analysis*.2nd edn. Cambridge: Cambridge University Press.

CBN (2013): Statistical Bulletin. *Central Bank of Nigeria*.

Chenery, H. B. and Stout, A. (1966): "Foreign Assistance and Economic Development". *American Economic Review*.55, pp.679-733.

Durham, J.B. (2004): Absorptive capacity and the effects of foreign direct investment and equity foreign portfolio investment on economic growth; *European Economic Review*, 48 (2): 285 – 306.

Ewe-Ghee Lim (2001)" correlation with economic growth"determinant of, and the relation between foreign direct investment and economic growth" *IMF Working paper*.No: 01/175

Lall (2002): Foreign investment transactional and development countries, *Macmillan Press Ltd*, London.

Macaulay, E.D (2012). Foreign direct investment and the performanceOf the Nigerian economy.Proceedings of the 1st International Technology, Education and Environment Conference.Pp 629 -633.

Nwankwo, O.G, Ademola, O. and Kehinde, O (2013). Effects Of Globalization On Foreign Direct Investment In Nigeria. *Lorem Journal of Business and Economics (LJBE)* Volume 1 No 1 pp 11-17.

Obwana, Morios B.(2001), "*Determinants of FDI and their impact on economic growth in Uganda*". African Development Review 2001, Blackwell Publishers Oxford.Uk.46-80.

Ogiogio, G. O. (1995). "Planning horizon, government expenditure and economic growth in Nigeria".In A. Ariyo, ed., *Economic Reform Macroeconomic Management in Nigeria*. Ibadan: The Centre for Public Private Cooperation.

Olopoenia R.A. (1985) foreign investment and the growth rate of capital import countries. A Technical note.*The Nigerian Journal of Economic and social studies* Vol 26 No2

Onu, A.J.C (2012). Impact Of Foreign Direct Investment On Economic Growth In Nigeria. *Interdisciplinary Journal Of Contemporary Research In Business*. 4(5), 64-75.\

Otepola, A. (2002): "*FDI as a Factor of Economic Growth in Nigeria. Dakar, Senega*". African Institute for Economic Development and Planning (IDEP), May. Available online at: [idep@unidep.org, http://www.unidep.org](http://www.unidep.org).

Oyinlola, O. (1995). "External capital and economic development in Nigeria (1970-1991)". *The Nigerian Journal of Economic and Social Studies*, 37 (2&3): 205-22.

Ricardo, H , Hwang, J and Rodrik, D (2005). What you export matters. "Working papers" Center For International Development at Harvard University.

Shiro, A. A. (2009). The Impact of FDI on the Nigerian Economy. Paper delivered at the 2nd National Conference organised by the Department of Finance, university of Lagos, Lagos State. Retrieved from www.unilag.edu.ng/researchview

Solomon, H.C and Eka, O.O (2013).Impact of foreign direct investment on telecommunication sector on nigerian economy. *International Journal of Modern Social Sciences*. 2(3): 195-215.

Todaro, M.P. (1994). *Economic development* (5th Edition). New York and London: Longman.

Wikipedia (2014) .http://en.wikipedia.org/wiki/Foreign_direct_investment

World Bank.(1996). World Debt Tables: External Finance for Developing Countries. Vol.1 (Analysis and Summary Tables). Washington, D. C.

Zhang, K.H. (2001). Does foreign direct investment promote economic growth? Evidence from East Asia and Latin America, *Contemp. Econ. Policy*, 19: 175-185.