



# IMPACT OF FOREIGN DIRECT INVESTMENT ON THE ECONOMIC GROWTH OF NIGERIA

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## ABSTRACT

*This paper examined the impact of foreign direct investment on economic growth in Nigeria from 1981 to 2013. Gross domestic product, government capital expenditure and government revenue were used as proxies for economic growth. It made use of 3 specific objectives, 3 research questions and 3 hypotheses. Ex-post facto research design was adopted. Secondary data covering the period were collected from CBN Statistical Bulletins, National Bureau of Statistics and World Bank Statistical Data, (2013). Pearson Product Moment Correlation Coefficient was employed in the analysis of data. It was found, among others, that there is a significant, strong and positive relationship between foreign direct investment and gross domestic product between 1981 and 2013 in Nigeria. This implies that increase in foreign direct investment in Nigeria, if well managed, could be used to enhance gross domestic product. The study concluded that a very high, positive and significant relationship exists between foreign direct investment and economic growth in Nigeria. The study recommended, among others, that Nigerian government should create conducive business environment that will attract more foreign direct investment into the country.*

**Keywords:** *Foreign direct investment, economic growth, Nigeria, capital expenditure, government revenue.*

## 1.0 Introduction

### 1.1 Background to the Study

In order to seek the highest return on capital, economists and other professionals tend to favour the free flow of capital across national borders. It is against this backdrop that multinational companies seek investment in foreign countries with reasonable risk (Carkovic & Levine, 2002). Nigeria as a country, is believed to be a high-risk market for investment because of factors such as bad governance, unstable macroeconomic policies, insecurity, policy inconsistency, increased window dressing in presentation of financial statements, etc (Akinlo, 2004). Since the introduction of the Structural adjustment programme in 1981, the expectation was that

it will place the government in advantage position to attract foreign direct investments..

The need for foreign direct investment is born out of the underdeveloped nature of the Nigeria's economy that essentially hindered the pace of her economic development. Generally, policies and strategies of the Nigerian government towards foreign investments are shaped by two principal objectives of the desire for economic independence and the demand for economic development. Asiedu (2011) argues that there are four basic requirements for economic development namely.

- i) Investment capital
- ii) Technical skills
- iii) Enterprise
- iv) Natural resources

Without these components, economic and social development of the country would be a process lasting for many years. The provisions of the first three necessary components present problems for developing countries like Nigeria. This is because of the fact that there is a low level of income that prevents savings big enough to stimulate investment capital domestically or, to finance training in modern techniques and methods (Ayanwale & Bamire, 2011). One of the ways out of this problem is through acceleration of the economy by external sources of money (foreign investment) and technical expertise. Foreign direct investment is therefore, supposed to serve as a means of augmenting Nigeria's domestic resources in order to carryout effectively, her development programmes and raise the standard of living of her people.

## **1.2 Statement of the Problem**

Nigeria is unarguably buoyantly blessed with enormous mineral and human resources but is believed to be a high risk market for investments especially foreign investments. Also, decades of bad governance has almost crippled the nation's economy with corruption and misappropriation of funds becoming the norm rather than an exception. This has denied the country various investment opportunities from foreign investors. It should be noted that one of the major economic problems in less developed countries (LCD) like Nigeria is low capital formation to finance the necessary investments for economic growth. Capital is regarded by most economists as the principal obstacle to economic development and that is why a lot of attention is paid to capital formation. The role of capital in economic growth is crucial as encapsulated in the theory of 'big push' and the concept of 'vicious cycle'. For instance, the theory of 'big push' states that a stagnant and undeveloped economy like Nigeria needs huge and sudden injection of large capital from foreign direct investment to kick-start the economy.

Nigeria as a nation has the potential of becoming the largest economy in Africa, and

a major player in the global economy because of its rich human and natural resources with which she can build a prosperous economy (Oloyode & Obamiyi, 2000). The human and natural resources are some of the factors that can attract the developed countries to increase its foreign direct investment outflow to the advantage of Nigeria.

Studies on FDI-growth issues in Nigeria include those by Oyedipo and Oladele (2010) which provided conceptual framework for the analysis of the macroeconomic effects of volatile capital flows. He argues that it can stimulate growth of the real sectors when the initial conditions are right. It could retard growth however, due to macroeconomic shocks that could undermine the stability of real sector and impose higher adjustment cost on the economy. Therefore, he recommends capacity building as a way of maximizing benefits and minimizing risks from capital flows.

It is therefore, necessary to carry out a study of this nature to determine the impact of FDI on the economic growth of Nigeria

## **1.3 Objectives of the Study**

The broad objective of the study is to examine the impact of foreign direct investment (FDI) on economic growth in Nigeria for the period 1981 – 2013. Specific objectives are to:

- a. To ascertain the relationship between foreign direct investment and gross domestic product in Nigeria for the period 1981 – 2013.
- b. To determine the relationship between foreign direct investment and government expenditure in Nigeria for the period 1981-2013.
- c. To ascertain the relationship between foreign direct investment and government revenue in Nigeria for the period 1981 - 2013.

## **1.4 Research Questions**

The following questions guided the attainment of the research objectives:

- a. What is the relationship between foreign direct investment and gross domestic product in Nigeria for the period 1981-2013?
- b. What relationship exists between foreign direct investment and government expenditure in Nigeria for the period 1981 – 2013?
- c. What is the relationship between foreign direct investment and government revenue in Nigeria for the period 1981-2013?

### 1.5 Research Hypotheses

These hypotheses were tested in the course of the study:

**Ho<sub>1</sub>** There is no significant relationship between foreign direct investment and gross domestic product in Nigeria for the period 1981 – 2013.

**Ho<sub>2</sub>**: Foreign direct investment has no significant relationship with government capital expenditure in Nigeria for the period 1981 – 2013.

**Ho<sub>3</sub>**: There is no significant relationship between foreign direct investment and government revenue in Nigeria for the period 1981 – 2013.

### 1.6 Scope of the Study

The study focused on the impact of foreign direct investments on economic growth in Nigeria for the period 1981 and 2013. The study was restricted to the period between 1981 to 2013. The choice of 1981 as the base year for the study is appropriate because that year marked the introduction of structural adjustment programme in Nigeria with its attendant consequences on the nation's economy. Again, the scope of the study examined the impact of foreign direct investment on economic growth in Nigeria with specific reference to gross domestic product, government revenue and expenditure.

### 2.0 Review of Related Literature

This study reviewed related literature under the following sub-headings: conceptual framework, theoretical foundation and empirical review.

## 2.1 Conceptual Framework.

### 2.1.1. Foreign direct investment.

Foreign direct investment, a major component of international capital flows, refers to investment by multi-national companies with headquarters in developed countries (De Gregorio, 2013). This investment ranges from transfer of funds to whole package of physical capital, techniques of production, managerial and marketing expertise, products, advertising and business practices for the maximization of profit.

Foreign direct investment (FDI) is an investment in a business by an investor from another country for which the foreign investor has control over the company purchased. The Organization of Economic Cooperation and Development defined control as owning 10 percent or more of the business. Businesses that make foreign direct investments are often called multinational corporations (MNCs) or multinational enterprises (MNEs). A MNE may make a direct investment by creating a new foreign enterprise, which is called a greenfield investment, or by the acquisition of a foreign firm, either called an acquisition or brownfield investment.

In the context of foreign direct investment, advantages and disadvantages are often a matter of perspective. An FDI may provide some great advantages for the MNE but not for the foreign country where the investment is made. On the other hand, sometimes the deal can work out better for the foreign country depending upon how the investment pans out. Ideally, there should be numerous advantages for both the MNE and the foreign country, which is often a developing country. For instance, multinational enterprises could gain from foreign direct investment in so many ways to be analyzed in this study.

The chief benefit of foreign direct investment, according to Chenery & Stout (1966) is the accompanying "package deal" of technical and managerial skill. This may be costly, difficult or impossible to obtain in other alternative investment means. The less developed a country is, the less able it is as a rule to utilize patents, technical advice and

contract management assistance without taking the whole package.

However, some analysts (known as the dependence school) are strongly opposed to pro foreign direct investment perspectives. Their arguments are based on series of studies and researches carried out.

### 2.1.2 Concept of Economic Growth

The concept of economic growth usually refers to the increase in the inflation-adjusted market value of the 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), usually in per capita terms. Growth is usually calculated in *real* terms – i.e., inflation-adjusted terms – to eliminate the distorting effect of inflation on the price of goods produced. Measurement of economic growth uses national income accounting. Since economic growth is measured as the annual percent change of gross domestic product (GDP), it has all the advantages and drawbacks of that measure.

## 2.2 Theoretical Foundation

Initially, the theories of capital market and portfolio investments were used to describe the initiation of FDI. Originally, direct investment was an international capital movement only (Nunnenkamp & Spatz, (2013). In fact, prior to 1950, FDI was regarded as a subset of portfolio investment. Accordingly, it was asserted that the most important reason for capital flows lay in the differences in interest rates. This approach stated that when there were no uncertainties or risks, capital tended to flow to the regions where it gained the highest return. However, this context failed to incorporate the fundamental difference between portfolio and direct investment. Direct investment entails control. Thus, the important theoretical shortcoming of the interest rate theory is that it does not explain control. If interest rates are higher abroad, an investor will consider lending money abroad, but there is no logical necessity for that investor to control the enterprise to which he or she lends the money (Okodua, 2009).

Subsequently, other theories emerged to explain the concept of foreign direct investment, among them is MacDougall-Kemp Hypothesis.

This is one of the earliest theories developed and further elaborated by Kumar (2007). The theory assumes a two country model- one being the investing country and other being the host country. The price of capital being equal to its marginal productivity. The theory further explains that capital moves freely from a capital abundant country to a capital scarce country and in this way marginal productivity of capital tends to equalize between the two countries.

Eclectic Paradigm. This is another theory that explains the concept of FDI. It is propounded by Dunning. It is a combination of the major imperfect market based theories of FDI that is industrial organization theory, internalization theory and location theory.

The assumption of the theory is that at any given time, the stock of foreign assets owned by a multi-national firm is determined by a combination of firm specific ownership advantage (O), the extent of location bound endowments (L) and the extent to which these advantages are marketed within the various units of the firm (I). Dunning further stated that configuration of the O-L-I advantages varies from country to country and from one activity to the other. Foreign investment will be greater where the configuration is more pronounced.

The basic hypotheses of eclectic theory therefore is that international production only occurs when there is a juxtaposition of three types of advantages related to a specific firm. Ownership specific advantage (O), location specific advantage (L), and market internalization advantage (I). it is assumed that an MNE must possess some ownership advantage. This advantage takes the form of intangible assets that can be manifested in technology product differentiation and managerial skill.

The second assumption or necessary condition for international production is the

presence of location specific advantages in host countries. International production will not occur if it is unprofitable to use at least one factor input with a firm's ownership advantages.

With O and L advantages, international production would not occur if it were not for the advantages of internalizing the use of O advantages. In Dunning's O-L-I theory, MNE's enter to the field production only when it is beneficial to exploit the O advantages themselves rather than relinquish them to the markets.

Macroeconomic approach. This originated from Kiyoshi Kojima. It states that the flow of FDI originates from the comparative disadvantages of home countries and the comparative potential advantages of host countries regarding certain industries. This Kojima referred to as "the principle of DFI (Direct Foreign Investment).

Its benefits over other theories include:

- Its intention to integrate international trade and fdi.
- More flexible and all-embracing as it is based on law of comparative advantage.
- Industries seeking for fdi identified by macroeconomic approach are trade oriented and complement each other than hinder international trade.

### **2.3 Empirical Review**

Instant studies have shown that the contribution of FDI to growth is positive. Using different data and methodologies, many researchers have concluded that FDI has positive impact on growth. Bende (2012) investigated the relationship between foreign direct investment and economic growth in Nigeria. The work covered a period of 1981 – 2009 using annual data from Central bank of Nigeria statistical bulletin. Ordinary least square (OLS) method was used to ascertain the relationship between FDI and economic growth in Nigeria within the stated period. The findings of the study indicated that FDI has a positive but insignificant impact on Nigeria economic growth for the period.

explored the casual link between Direct Foreign Investment (DFI), domestic

investment and economic growth in China between 1988-2003 using the multivariate VAR and ECM. Their results indicate that there is bi-directional casualty between domestic investment and economic growth. They concluded that there is a higher level of complementation between DFI and domestic resources.

Nunnenkamp & Spatz (2013); and Bengos and Sanchez (2003), in a survey of African countries identified poor corporate governance, unstable political and economic policies, weak infrastructure, unwelcome regulatory environment and global competition for FDI inflows as impediments standing in the way of attracting significant FDI inflows. This corroborates the findings of Jerome and Ogunkola (2004) in the study which assessed the magnitude, direction and prospect of FDI in Nigeria.

Asiedu (2011) investigated the impact of globalization on foreign direct investment in Nigeria. The study applied descriptive and narrative statistics using secondary data. It was found that Nigeria has benefited from FDI inflow in the area of transfer of technology, encouragement of local enterprises, e.t.c.

The relationship between Foreign Direct Investment and growth is conditional on the macro-economic dispensation the country in question is passing through. In fact, Zhang (2001) asserts that the extent to which Foreign Direct Investment contributes to growth depends on the economic and social conditions or in short, the quality of the environment of the recipient country. In essence, the impact of Foreign Direct Investment on the growth of any economy may be country and period specific.

### **3.0 Research Materials and Methodology**

The study adopted ex-post facto design. The chosen design helped to preserve the integrity of the data collected. Secondary data used for this study were sourced from CBN Statistical Bulletins, National Bureau of Statistics and analysis of data was done with Pearson Moment Correlation Coefficient.

#### 4.0 Data Presentation and Discussion

Results of data analysis are presented. See appendix 1 for details.

HO<sub>1</sub>: There is no significant relationship between Foreign Direct Investment and Gross Domestic Product in Nigeria for the period 1981 – 2013.

**Table 1: Relationship of FDI and GDP**

	GDP	Decision
Pearson correlation	.965	Reject the null hypothesis
Sig. (2-tailed)	.000	
N	33	

**Source:** Authors' analysis of data, 2017.

Table 1 shows a correlation coefficient of .965 and 2-tailed significant value of .000. This shows a very strong and positive relationship exists between foreign direct investment and Gross Domestic Product. Since the significant value of .000 is less than 0.01, the null hypothesis is rejected. This implies that the relationship between the two variables is significant. These results differ from the findings of Bende (2012) which showed that FDI have a positive but insignificant impact on the economic growth of Nigeria. The reason for the difference in the results could be attributed to different methodologies used by the authors. However it stands to reason that since FDI has very strong and positive relationship with gross

domestic product from these studies, it is likely that it will impact significantly on the economic growth especially if well harnessed.

In between the two extreme views, Zhang (2011) provides a link. He asserts that the extent to which foreign direct investment contributes to growth depends on the economic and social conditions or the quality of the environment of the recipient country.

HO<sub>2</sub>: Foreign Direct Investment has no significant relationship with Government Capital Expenditures for the period 1981 – 2013.

**Table 2: Relationship of FDI and Government Capital Expenditure.**

	Govt. Cap. Expenditure	Decision
Pearson correlation	.916	Reject the null hypothesis
Sig. (2-tailed)	.000	
N	33	

**Source:** Authors' analysis of data, 2017.

Data in table 2 above show a correlation coefficient of .916 and 2-tailed significant value of .000. This depicts a very strong, positive and significant relationship between FDI and government capital expenditure within the period under study. This is in agreement with the findings of Jerome and Ogunkola (2004) which emphasized the importance of magnitude direction and prospects of FDI in Nigeria.

volume of FDI into Nigeria has reached a level where it can significantly influence government capital expenditure. If the enabling social and economic factors are sustained, FDI could become a catalyst for domestic development of recipient nations.

HO<sub>3</sub>: There is no significant relationship between Foreign Direct Investment and Government Revenue in Nigeria for the period 1981-2013.

Since the impact of FDI appears to be country and period specific, it is suspected that the

**Table 3: Relationship of FDI and Government Revenue**

	Govt. Revenue	Decision
Pearson correlation	.902	Reject the null hypothesis
Sig. (2-tailed)	.000	
N	33	

Source: Authors' analysis of data, 2017.

Examination of table 3 above reveals a correlation coefficient of .902 and a 2-tailed significant value of .000. This indicates a very high positive and significant relationship between FDI and government revenue. This finding is in consonance with those of Tang and Selvanathan (2008) in which they found a bi-directional casualty between domestic investment and economic growth which informed their conclusion of a high level complementation between FDI and domestic resources. This implies that FDI could be used to boost domestic resources required for overall development of the country. For this to be possible, all forms of internal violence and hostilities should be kept under check.

### 5.0 Conclusion and Recommendations.

The results of the study were consistent in showing a very high, positive and significant relationship between foreign direct investment and gross domestic product, capital expenditure and government revenue. The implication of this is that FDI could be harnessed for all round development of the country.

Based on the findings and conclusion of the study, the following recommendations are proffered:

1. Nigerian government should do everything possible to create conducive business environment that will attract more FDI into the country.
2. Government should make deliberate efforts to prevent and/or manage domestic violence and conflicts in such a way that they will not repel foreign investors or compel them to repatriate their earnings to their host countries.
3. The fight against corruption should not only be sustained but extended to all sectors of the economy to make the impact of FDI on government revenue and capital expenditure more meaningful.

### 6.0 Suggestions for Further Studies.

These areas are suggested for further studies in view of some constraints encountered in the course of the study:

- (1) A similar study in Nigeria that will make use of more indices of economic growth.
- (2) A comparative study on the topic that will involve Nigeria and other African countries that share similar economic and historical antecedents.

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### Appendix 1: Result of Correlation Analysis.

	Govrev	Govcap	GDP	FDI
Govrev Pearson Correlation	1	.902**	.965**	-.161
Sig. (2-tailed)		.000	.000	.372
N	33	33	33	33
Govcap Pearson Correlation	.902***	1	.965**	-.073
Sig. (2-tailed)	.000		.000	.688
N	33	33	33	33
GDP Pearson Correlation	.965**	.916**	.965**	-.151
Sig. (2-tailed)	.000	.000	.000	.403
N	33	33	33	33
FDI Pearson Correlation	-.161	.902**	-.073	1
Sig. (2-tailed)	.372	.000	.688	
N	33	33	33	33

\*\* Correlation is significant at the 0.01 level (2-tailed)