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Exchange Rate and Foreign Private Investment in Nigeria

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Abstract
Exchange Rate is identified as the most important determinant of Foreign Private Investment in Nigeria and should therefore be given due attention in order to maximize all the benefits accrue to Foreign Private Investment in Nigeria. It can be said that some reform policies of government with regards to Foreign Private Investment have been successful in attracting foreign investment inflows in Nigeria. Our paper examined literature on the effect of exchange rate and foreign private investment and concluded that foreign investment would flow freely only if the investment policies are considered investor – friendly.
Keywords: Exchange Rate, Foreign Private Investment, Nigeria

1.0 Introduction

According to Ariyo (1988), Foreign Private Investment can be classified as Foreign Direct Investment (FDI) and Foreign Portfolio Investment (PFI). FDI is an investment in real assets where real assets consist of physical things such as factories, land, capital goods, infrastructure and inventories. The Multinational Corporations (MNCs) is chief source of DFI. This may come in both joint ventures as well as fully owned subsidiaries. Whereas, international investment in financial assets such as shares, debentures and bonds are called PFI (Foreign Portfolio Investment).

The need for foreign capital to supplement domestic resources was felt by the developing economies, in view of growing mismatch between their capital requirements and saving capacity. Further, many developing countries view foreign capital as a key element in their development strategy against the other forms of foreign financing as it aids in upgrading technology in hi-technology concentrated industries. Foreign capital generates employment in the host country when a multinational enterprise directly employs a number of host country citizens. It is argued that Foreign Private Investment (FPI) would play an important role in the future as a source of capital, managerial expertise, and technology for both developing economies and economies in transition. The direct and indirect benefits from appropriate FPI are substantially greater than normally assumed, but host countries have problems in realizing these flows.

2.0 Literature Review

Foreign Private Investment is a significant component of foreign private capital flows that provide much needed finance to increase the use of existing capacity to stimulate new investment in developing countries. FPI has two major components: portfolio investment and direct investment. Portfolio investment is the form of equity capital either thus empowers its owner to flow dividends. On the other hand, foreign direct investment enables the foreigner to own the physical productive assets, which operates. Large multinational or transnational corporations essentially carry out this flow of resources with headquarters in the developed nations. Flow of financial capital is by private international banks (Ekpo, 1997).

According to Obadan (2004) foreign private capital flows do not constitute economic aid, as they do not provide resources to developing countries on concessionary terms even though they may yield substantial benefits. They are flows that originate in the private sectors of the donor/lending country and are almost always motivated by normal commercial considerations of profit maximization. He further maintained that, business transactions, private trade and capital movements among more and less developed countries are undertaken only if they yield returns to the exporters as well as importers.

Foreign direct investment is a form of lending or finance in the area of equity participation. It generally involves the transfer of resources, including capital, technology, and management and marketing expertise. Such resources usually extend the production capabilities of the recipient country (Odozi 1995). Foreign portfolio investment consists of the acquisition of assets by a foreign national or company in a domestic stock/market. In order words, it refers to the holding of transferable securities(issued or guaranteed by the government of the importing country), equity shares; debentures, bonds, promissory notes and money market instruments issued in a domestic market by the nationals of some other countries. The money market instruments include treasury bills,

commercial papers, bankers' acceptances and negotiable certificates of deposits (Obadan, 2004).

According to Ekpo (1997) the factors influencing foreign direct investment include; inflation, exchange rate, uncertainty, credibility, government expenditures as well as institutional and political factors. He further said that, for Nigeria, the factors affecting FDI include; return on investment in the rest of the world, domestic interest rates, rate of inflation, debt service, per capita income ratio of world oil prices to world price of industrial countries manufactured goods, credit rating and political stability or instability.

In the words of Iyoha (1998), private investment can be significantly affected by such factors as macroeconomic instability, macroeconomic policy (monetary, fiscal, and exchange rate); the incentive structure and the response to it, uncertainty and irreversibility, and credibility of policy reforms. Bamidele et. al. (1998) posits that the basic objective of Nigeria's exchange rate policy has been to ensure both internal and external balance as well as overall macroeconomic stability through the preservation of the value of the domestic currency, maintenance of favourable external reserves and price stability.

According Iyoha (1998) for a developing country like Nigeria that is highly dependent on trade, the exchange rate, which is the price of foreign exchange, plays a significant role in the ability of the economy to attain its optimal productive capacity. In addition, the exchange rate level has implications for balance – of – payments viability and the level of external debt. For example, if the exchange rate is overvalued, then this will result in unsustainable balance – of – payments deficits an escalating external debt stock. These will in turn, lead to a declining level of investment. Thus, it is imperative to let the exchange rate find its equilibrium level. It is only when the equilibrium exchange rate prevails that there is viability of the balance – of – payments position. In general, a stable foreign exchange rate regime will lead to macroeconomic stability and encourage investment and growth. Note also that an overvalued exchange rate tends to encourage capital flight. Stability of the exchange rate regime will therefore, reduce capital flight and encourage capital inflows in the form of foreign private investment.

Akpokodje (1998) argues that there is an ambiguous about the direction of the effect of real exchange rate on the rate of investment. On one hand, a real depreciation raises the cost of imported capital goods, and since a large chunk of investment goods in developing countries is imported, domestic investment would be expected to fall with a real depreciation. On the other hand, a real depreciation, by raising the profitability of activity in the tradable goods sector, would be expected to stimulate private investment in this sector but depress investment in the non tradable goods sector.

Interest rates can have a substantial influence on the rate and pattern of economic growth by influencing the volume and productivity disposition of savings as well as the volume and productivity of investment. The Keynesisan theory implies that low interest rate as a component of cost of funds encourages borrowing for investment. On the other hand, view administered low interest rates as detrimental to increased savings and hence investment demand. They argued that high interest rates induces savings which can be channeled into investment while the phenomenon of negative real interest rate over a prolonged period of time results in negative consequences of which include discouragement of savings (as the true opportunity cost of capital is rarely reflected), misallocation of resources, credit rationing by government, and the promotion of financial or market dualism and capital flight (Onyido, 1997).

According to Akpokodje (1998), In Tobin- Model, a high rate of inflation lowers the real interest rate, thereby moving portfolio adjustments away from real money balances towards real capital. Thus a high rate of inflation is expected to include higher real investment. But in Nigeria where the capital and financial markets are large underdeveloped, the Tobin-Mundell effect does not apply. Instead, a high rate of inflation in Nigeria lowers private investment. Furthermore, a high rate of inflation in Nigeria is an indication that government lacks the ability to manage the economy (Akpokodje, 1998). Therefore, high rates of inflation are expected to lead to lead to a contraction of private investment.

Mankiw (1994) say GDP equals;

- the total income of everyone in the economy, and
- the total expenditure on the economy's output of goods and services.

GDP is a gauge of economic of economic performance because it measures something people care about – their incomes. Similarly, an economy with a large output of goods and services can better satisfy the demands of households, firms and the government. Portfolio investment is a recent phenomenon in Nigeria. Up to the mid 1980s, Nigeria did not record any figure on portfolio investment (inflow or outflow) in her balance of payments account. The nil return on the inflow column of the account is attributable to the absence of foreign private investors in Nigeria's economy. This is largely because of the non – internationalization of the country's money and capital markets as well as the non – disclosure of the information on the portfolio investments in foreign capital/money markets (Obadan, 2004).

Foreign Private Investment flows to Nigeria comprise portfolio investment and foreign direct investment; Portfolio is far more recent and less significant. Greater attention will be paid on foreign direct investment in this study. Nigeria is reputed to be buoyantly blessed with enormous mineral and human resources. However, the country is believed to be a high-risk market for investment. Also, decades of bad governance have almost crippled the national economy with corruption and misappropriation of funds becoming the norm rather than the exception. What is the way out of this delirium economic state? Many analysts and experts alike have given a thumb up for Foreign Direct Investment (FDI) as a veritable booster to kick-start the Nigerian economy. With the enthronement of democratic governance in 1999, the government has taken a number of steps to woo foreign investors into Nigeria.

According to Obadan (2004) international flows of capital reduce the risk faced by owners of capital by allowing them to diversify their lending and investment. Second, the global integration of capital markets can contribute to the spread of best practices in corporate governance, accounting rules, and legal traditions. Third, the global mobility of capital limits the ability of governments to pursue bad policies. Four, FDI allows for the transfer of technology – particularly in the form of new varieties of capital inputs – that cannot be achieved through financial investments or trade in goods and services. FDI can also promote competition in the domestic input market. Five, recipients of FDI often gain employee training in the course of operating the new businesses, which contributes to human development in the host country. Lastly, profits generated by FDI contribute to corporate tax revenues in the host country.

The Principal investors in Nigeria are the UK, US Germany, Japan and the Netherlands. According to World investment report 1998, United States has invested $1.7 billion since the early 1990s followed by the UK ($1.6 billion), Holland ($*)& million) and Germany ($700 million). Investment by these four countries accounted for a little over 80 per cent of total FDI stocks in Africa (Giwa, 2000). One striking feature of FDI flows is that their share in total inflows is higher in riskier countries, with risk measured either by countries' credit ratings for sovereign (government) debt or by other indicators of country risk.

3.0 Conclusion

Exchange Rate is identified as the most important determinant of Foreign Private Investment in Nigeria and should therefore be given due attention in order to maximize all the benefits accrue to Foreign Private Investment in Nigeria. It can be said that some reform policies of government with regards to Foreign Private Investment have been successful in attracting foreign investment inflows in Nigeria, however, it could be inferred from the results of this study that foreign investment would flow freely only if the investment policies are considered investor – friendly.

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