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The Impact of Foreign Direct Investment on Economic Growth and Development (1980-2010)

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Abstract

The study examines the impact of foreign direct investment on the economic growth and development in Nigeria from 1980-2012. The study employed the use ordinary least square techniques (OLS) which also employs secondary data obtained from central bank of Nigeria (CBN) statistical bulletin and federal office of statistics (FOS). The main findings from the sample model revealed that there is a relationship between the variables under study which was identified together with the impact of foreign direct investment, its contributions and limitations to economic growth and development in Nigeria. The model also suggests a positive linear relationship among the foreign direct investment, exchange rate and the gross domestic product (GDP), but a negative linear relationship between the inflation rate and the gross domestic product. Finally it is recommended that foreign direct investment should be encouraged in Nigeria in order to promote economic growth and development in the country.

1.0 Introduction

A general literal text of foreign direct investment is an investment made to acquire a listing management interest (normally 10 percent rating stock) in a business operating in a country other than that of the investor defined according to residency (world bank, 1996) such investment (also called "mortar and Brock" investment) or merger and acquisition of existing interest rather than new investment. In corporate government, ownership of at least 10 percent of the ordinary shares or voting stock is the critical for the existence of a direct investment relationship. Ownership of less than 10 percent is recorded as portfolio investment. Foreign Direct Investment (FDI) comprises of not only mergers and acquisition and new investments, but also reinvested earnings and loans and similar capital transfer between parent companies and their affiliate's countries could be both hosts to foreign direct investment projects in their own country and a participant in investment project in other countries. A country's inward foreign direct investment position is made up of the hostage projects, foreign direct investment while outward comprises of foreign direct investment those investment projects owned abroad. One of the most salient features of today's globalization drive is conscious encouragement of cross-border investments, especially by transactional corporations and firms (TCF). Many countries and continent (especially developing) now see attracting foreign direct investment as an important element in their strategy for economic development. This is amalgamation of capital, technology marketing and management.

Sub-Sahara as a region now has to depend heavily on foreign direct investment for so many reasons, some of which are amplified by Asiedu (2001). The preference for foreign direct investment stem from its acknowledged advantages (Sjoholm, 1999 and Obwona, 2001). The effort by several African countries to improve their business stems from the desire to attract foreign direct investment. In fact, one of the pillars on which the New Partnership for African's Development (NEPAD) was launched to increase available capital to United States and $46 billion through a combination of reforms, resource mobilization and a conductive environment for foreign direct investment (Funke and Msouh, 2003). Unfortunately, the efforts of most countries in Africa to attract foreign direct investment has been futile. This is in spite of the perceived and obvious need for foreign direct investment in the continent. The development is disturbing, sending very little hope of economic development and growth for these countries.

Furthermore, the patterns of foreign direct investment that exist is often skewed towards attractive industries, meaning that the differential rate of foreign direct investment inflows into sub-Sahara African countries has been adduced to be due to natural resource, although the size of the local market may also be a consideration (Morriset, 2002 and Asieda, 2009). Nigeria is a a country, given her natural resources base and large market size, qualifies to be a major recipient of foreign direct investment in Africa and indeed is one of the three leading African countries that consistently received foreign direct investment in the past decade. However, the level of foreign direct investment attracted by Nigeria is mediocre (Asiedu, 2003) compared with the resource base and potential need. The empirical linkage between foreign direct investment and economic growth in Nigeria is yet to be clear, despite numerical studies that have examined the influence of foreign direct investment on Nigeria's economic growth with varying outcomes (Oseghale and Amoukhienam, 1987, Odozi andOyinola 1995, Adelegan 2000 and Akinlo 2004.)

Most of the previous influential studies on foreign direct investment and growth in Sub-Sahara Africa are multi country studies. However, recent evidence affirms that the relationship between foreign direct investment and growth may be country and period specific. Asiedu (2001) submits that the determinants of foreign direct investment in countries within a region may be different from one another and from one period to another. Result of studies carried out on the linkage between foreign direct investment and economic growth in Nigeria are not unanimous in their submissions. A class examination of their previous studies reveals that conscious effort were not made to take care of the fact that more than 60 percent of the foreign direct investments inflow into Nigeria is made into the extractive (old) industry. Hence, these studies actually modeled the influence of natural resources on Nigeria's economic growth and development is more contentions in empirical than theoretical studies, hence the need to examine the dispensations. There is the further problems of endogeneity, which has foreign direct investment may have a positive impact on economic growth leading to an enlarge market size, which in turn further attracts foreign direct investment. There is an increasing resistance to further liberalization with the economy. This limits the options available to the government to source funds for foreign direct investment developmental purpose makes the options of seeking much more critical.

As investors search the globe for the highest returns, they are often drawn to places endowed with bountiful natural resources but are handicapped by weak or ineffective environmental laws, many people and communities are harmed as the environment that sustains them is damaged or destroyed. Foreign direct investment also promote western-style consumerism, boosting car ownership, paper use, and big mac consumption rates towards the untenable levels found with grave potential consequences for the health of the natural world, and the stability of the earth's climate and the insecurity of food supplies. Unstable policy environment for foreign direct investment for instance, Odozi (1995) reports on the factors affecting foreign direct investment inflow into Nigeria in both the pre and post structural adjustment programme (SAP) eras and found that the macro policies in turn discourages foreign investors. Inefficiency in situational capacity which tend to threaten the security and safety of foreign investors for instance, the investors discovering lapses in the institutional capacity such as lack of respect for property right, high rate of correction, lack of transparency and accountability.

The main focus of this study is to examine the magnitude of the inflow of macroeconomic environment on the inflow of foreign direct investment for the period under review. Hence the specific objectives of the study are as follows:

i. To identify the origin and rationale behind Nigeria's participations and benefits of capital inflow

ii. To examine the contributions and benefits of capital inflows to the economic growth on Nigeria

iii. To explore the empirical relationship between foreign direct investment and GDP in Nigeria.

iv. To examine the effects of manufacturing foreign direct investment on economic growth and development in Nigeria

v. To ascertain the long run sustainability of the foreign direct investment induced growth process

vi. To proffer situations of policy options.

2.0 Literature Review

The role of foreign direct investment in economic development has been discussed several times and still debate is on going. Most of the studies debate is on the impact of foreign direct investment on the domestic economy or the domestic market size, economic growth, technological capability, government policy, and other factors. Foreign direct investment plays an import role in promoting economic development and growth, raising a country's technological level and creating employment. Foreign direct investment work as a means of integrating underdeveloped countries into the global market and raising capital availability for investment.

In brief, foreign direct investment serves as an important engine for growth in developing countries through two models of action.

i. Expanding capital stocks in host countries and

ii. Brining employment, managerial skills and technology several frameworks have evolved for analyzing the determinants and effects of foreign direct investment.

Anyanwu (1998) and Iyoha (2001) have studied the determinant of foreign direct investment in Nigeria. Major limitations of these studies are the traditional econometric technique and non-consideration of natural resources in determination of foreign direct investment inflow. Using time series econometric techniques on annual data of Nigeria, this study examines the effect of the country's natural resources export, along with openness, market size and macroeconomic risk variables like inflation and foreign exchange rate on foreign direct investment inflow during 1970-2006.

Foreign direct investment, according to International Monetary Fund (IMF) is defined as investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of investor's purpose being to have an effective voice in the management of the enterprise. The foreign entity or group of associated entities that make the investment is termed the direct investor. The unincorporated or incorporated enterprises, a branch or subsidiary in which direct investment is made, is referred to as the direct investment enterprise. As for the theoretical basis of foreign direct investment, varying views abound which depend on whose part of view you approach, the issue, whether of less developed countries which crave for increasing inflow of foreign capital resources to compliment their economic shortfalls or developed countries. Capital exporting nations that frowns at its outlook or the foreign investors that see the entire global economy as their constituency of operation. However, attempts have been made by economic researchers as well as international lawyers to come up with some common explanation of why nations engage in foreign investment.

i. Theory of foreign direct investment

This theory as propounded by Dunning (1981) tends to combine the various influence discussion above into an integrated theory of foreign direct investment combining the role of technology in perfect competition and internalization it contends that firms undertake foreign direct investment as part of their overall business strategy whenever and wherever they desire that most from internalizing activities in response to market forces and structure.

Further on the eclectics theory of foreign direct investment, during (1980, 1981) classified thee groups of factors as locational advantages, ownership advantages and internationalization advantages.

ii. International trade explanation

Base on the theory of international trade, foreign investors are said to move their capital resources in response to changes in the rate of form capital abundant countries to a capital scarce country in response to a higher productivity of capital, one fact about this theory is that while it sufficiently explains portfolio investment, it says noting about control or effective voice in the management of foreign direct investment enterprise.

iii. The product cycle theory

This theory was developed by Raymond Vernon the theory argues that every technology or product evolves through three phases in its life history. The first phase is the introductory or innovative stage. The level where the firm is located in the most advanced industrial economics. The second phase is known as the maturing or process development stage at which the manufacturing process continues to improve to the extent that a similar firm producing the same product is sited in other industrially advanced countries based on foreign demand for the product. The third stage is the standardization or maturity stage which allows for expansion in less developed countries especially in newly industrializing countries (NICs). This theory is said to be responsible for the turning around of capital from the former rural economies to newly industrializing countries group (NICs).

An overview of foreign direct investment in Nigeria

Within the arena of domestic and foreign policies narrowing towards a common international economic order induced by globalization, foreign direct investment now represents a major form of cross broder resources flow among countries. More than ever before, more firms in numerous industries and in many countries are expanding abroad through foreign direct investment (either direct or portfolio). The magnitude of direct investment (either direct or portfolio) within the past few years has compelled discussions as to the desirability of Multilateral Investment Agreement (MIA). The debate between proponents of MIA essentially centers around a long standing (and unsettled) question as to how far government intervention is necessary to improve investment allocation and economic performance, and to what extent such intervention may lead to further distortions and inefficiencies. In addition, while proponents argue that foreign direct investment is development; opponents contend that foreign direct investment leads to increased poverty isolation and neglect of local capabilities.

Policy objectives and strategies towards foreign direct investment

Attempt at attracting foreign direct investment into Nigeria have been based on the need to maximize the potential benefits derived from them, and to minimize the negative effects, their operation could impose on the country. The desire of the government to intervene in the foreign direct investment operations on the country was motivated by two primary types of market failure; information or coordination failures in the investment or coordination failures in the investment process. The divergence and social private interests of investors from the economic and social interests of investors form the economic and social interests of the economy.

In formulating policy objectives towards, foreign direct investment three basic issues are of paramount importance, particularly to developing countries like Nigeria. First, it must be understood that developing countries differ from developed countries with regard to the possible role and impact of foreign direct investment in their economies while the former are typically not importers of foreign direct investment the developed countries in most cases present a foreign direct investment more balanced pattern of inward and outward flows. To this end, in the context of foreign direct investment and international investment agreements (IIAs) the primary focus of most developing countries is usually on issues relating to their ability to attract foreign direct investment and benefit from it.

However, on the other hand, the weak domestic capabilities do hinder the ability of developing countries to fully enjoy the expected benefits of foreign direct investment inflow. While it may be argued that the possible positive spill over effects of foreign direct investment could upgrade the national productivities of recipient countries, it may equally lead to a crowing out effect on domestic firms, or anti competitive behavior that could result in welfare losses.

Thirdly, IIAs usually involve binding commitments policies may lead to convergence of national that would eventually limit the policy autonomy of the contracting parties to an agreement. It is thus important in developing countries to deepen their understanding of what polices foreign direct investment as well as policy instrument want to implement and what commitment can be sought from home countries of the foreign investors to support their developmental objectives.

Benefits of foreign direct investment

Foreign direct investment can make significant contributions to the host country's economic growth and development. It has the potential to address less developed countries constraints of low levels of domestic investment and foreign investment in foreign exchange, supplement domestic saving and raise the level of investment.

3.0 Theoretical framework and model specification

To further elaborate on the impact of foreign direct investment on economic growth and development. Foreign direst investment is positively correlated with economic growth and development which emphasis the role of improved technology, efficiency and productivity.

Model specification

Deriving from the following analytical consideration, the model for the study is as follows,

GDP F = (FDI, EXRT, INFL)

$GDP = a_0 + a_1FDI + a_2EXRT + a_3INFL + U$

$(a_1 > 0, a_2 < 0, a_3 > 0)$

Where

GDP = Gross Domestic Product

FDI = Foreign Direct Investment

INFL = Inflation Rate

U = Stochastic Error Term

From the a prior of the model I the independent or explanatory variables FDI and INFL is positively related to the dependent variable GDP, while the EXRT is negatively related to the dependent variable. All the variables, dependent, independent are expressed in a national log form.

The method of analysis involves the use of the ordinary least square (OLS) multiple regression model with the assumption of best linear unbiased estimate (BLUE) which would be adopted to bring out the relationship between the variables under study. The coefficient of determination significance of the egression model.

4.0 Data presentation and interpretation of results

This section estimates the models which include GDP, INFL, EXRT and FDI. The policy implications of the result also form part of this section.

Analysis of regression estimate

In order to properly assess the impact of foreign direct investment on economic growth and development, the following model was estimated and analyzed.

LGDP = 10.75712 + 0.670002LFDI + 0.9796151

SEI = (1.150507) (0.141444) (0.094322) (0.148138)

t = (9.349894) (4.736863) (10.38565) (-0.936096)

Probability (0.0000) (0.0001) (0.0000) (0.3582)

$R^2 = 0.930245$

Adjusted $R^2 = 0.921875$

F statistic = 111.1328

Prob (F statistic) = 0.000

DW = 2.063133

Signs/magnitude

The model suggests a positive linear relationship among the FDI, EXRT and the GDP, but a negative linear relationship between the INFL and GDP.

Thus, an increase in the FDI and EXRT by a unit will increase the GDP by 0.67002 and 0.97615 units, while an increase in the INFL by a unit decrease the GDP by 0.138671.

R^2/R^{-2}

R^2 is the coefficient of determination and the goodness of fit test. The R^2 suggests that 93 percent of the total variation in the GPD has been explained by the FDI, EXRT and INFL

F test

The f test is used to test the overall hypothesis and significance of the model, the f test with a value of (111.1328) and probability of (0.0000) suggests that the FDI, EXRT and INFL are important actors to be taken into account when explaining the changes in the GDP.

5.0 Summary Conclusion and Recommendations

In summary the study presents a background to the study, recounting the economic experience in Nigeria since the 1970s while laying bare the basis for foreign investment made possible by the imperial expansions of overseas subsidiaries of state trading shift and the affendant sector in balance of the Nigerian economy in favour of the oil sector. The study embodies a review of relevant and sizeable existing literature on foreign direct investment in the global perspective in general and a particular relation to the Nigerian economy in every conceivable ramification.

Finally the study embodies a concise run down of foreign direct investment, suggested recommendations to further attract the growth enhancing opportunities inherent in and of course the including remarks.

Conclusion

Foreign direct investment is the main engine of growth in any economy. Moreover, it is believed at least from theoretically compelling evidence. According to Giwa (1997) "foreign direct investment to a developed economy is just like blood transfusion to an anemic patient". Foreign direct investment is thus critical to an economy but far more critical to an ailing economy. In the current global economic order, Nigeria needs large investments, if she is to maximize her economic potentials and reach the stage where she can compete globally. The role of foreign direct investment on the economic development of Nigeria cannot be overemphasized the study therefore shows that developing countries like Nigeria that desire economic growth and development must regard foreign direct investment as indispensable. It is a fact that foreign direct investment has its disadvantages but its advantages out weighs its disadvantages.

Recommendations

Clearly, evidence from various empirical studies suggests that Nigeria should offer a supportive climate to capture the growth inducing an economy transforming opportunities inherent in foreign direct investment. Hence, the impact of foreign direct investment will go a large extent depend on the institutions and conditions prevailing in the domestic economy.

Against this backdrop, the study suggests the following chief among which are policies, strategies and measures which Nigeria should adopt in view of the envisaged accelerated growth and development. In this regard, government will ensure that the following is put in place. Strategies to remove all bureaucratic battened strategies to ensure consistency and stability policy existence of a favourable macroeconomic environment/framework, stable macroeconomic polices and sound macroeconomic fundamentals.

Existence of investment incentives minimal hassle costs (related to incidence widespread corruption and bureaucratic inefficiency). Improved security checks to safeguard life and properties world bank 1996.

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