Foreign Direct Investment and Economic Growth in Nigeria: An Empirical Investigation

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Abstract
This study was carried out to empirically investigate the impact of foreign direct investment on the growth of Nigerian economy over the period, 1981-2014. The study captured foreign direct investment (FDI), government capital expenditure (GCE), exchange rate (EXR), interest rate (IR) and growth domestic product (GDP) proxied for economic growth. It employed econometric tools of unit root test, co-integration and error correction model to analyze the influence of these variables on economic growth. The study found that FDI has significant positive impact on the growth of Nigerian economy. Contrary to the supposed positive impact of GCE to economic growth, the study found that it exact negative influence which the authors assumed may partly be as a result of high rate of abandoned government capital projects on which large sum of funds are committed to thereby inhibiting the expected contributions of these projects to the growth of the economy. The study therefore recommends that government should ensure stability in the economy in other to attract more foreign direct investment. On the other hand, for the successive governments to ensure continuity of policies that have positive impacts in the economy, hence to see that projects in progress are completed to curb the incessant cases of uncompleted or abandoned projects. The multiplier effect of this will again stimulate the growth of FDI and general economic growth.

1.1   Introduction

A nation that desires economic growth must save and invest a reasonable proportion of its national income. But developing countries are by definition poor and characterized by low savings and investment rates which in turn, have contributed to their remaining poor. An inflow of foreign resources is expected to supplement the domestic resources and assist in enhancing the growth of the economy. It is for this reason that most developing countries including Nigeria have designed and implemented a number of programmes to attract foreign investment.

In view of the forgone, Nigeria has actively sought to attract FDI and the nation has been a major beneficiary of such flows. But in spite of the tremendous inflow of FDI, it is not clear what influence FDI has had on the economy. This study therefore, seeks to investigate the extent to which FDI influenced economic growth in Nigeria. The study is limited to foreign direct investments in Nigeria, covering 1981–2014. The paper is divided into five sections. The section of introduction, literature review section, methodology, presentation and discussion of findings, and conclusion and recommendations sections.

2.0   REVIEW OF RELATED LITERATURE
2.1   Concept of Investment, FDI and Economic Growth

Ayashagba and Abachi (2002) refer to investment as an addition to capital stock of the society. Ajegi (2002) agrees with this definition by regarding investment as an addition to the existing stock of capital and involves present sacrifice with the prospect of future gain. The foregoing definitions depicts that investment is the addition to the total capital stock in the society which could be inform of inventory, machinery, houses, plant, etc.

Foreign Direct Investment (FDI) on the other hand, is according to Mariloman (2003) 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. Similarly, Mallampally and Sauvant (1999) describe it as investment by multinational corporations in foreign countries in order to control assets and manage production activities in those countries. They aver further that FDI does not only comprise of merger and acquisition and new investment, but also reinvested earnings and loans and similar capital transfer between parent companies and their affiliates. This is to mean that, countries could be both host to FDI projects in their own countries and a participant in investment projects in other countries.

On Economic Growth, Schumpeter (1946) refers it as a gradual and steady change in the long-run which is brought about by a gradual increase in the rate of savings and population. Jhinghan (2003) regards it as the quantitative sustained increase in the countries per capital output or income accompanied by expansion in its labor force, consumption, capital and volume of trade. Kindleberger (1965) on the other hand, sees economic growth as increase in the level of output without a change in institutional and technological arrangement. Samuelson (2006) sees economic growth as the expansion of a country's potential GDP or national output. He explains it further as when a nation's productivity frontier shifts outwards. From the above definitions we can infer that economic growth is the process which leads to sustained increase in the national output over a period of time.

2.2   Determinants of Foreign Direct Investment

Existing literature on FDI shows that several frameworks had been employed to analyze the determinants of FDI. To date, the most comprehensive framework is the one known as 'electric theory' of Dunning (1981) because of its flexibility and increasing popularity. The theory argues that FDI is determined by three sets of advantages namely:

a.   Firm specific (or ownership) advantages, (Hymer, 1960). These set of advantages which give a firm competitive advantage in global markets, including, technological skills, productive efficiencies, size and concentration.

b.   Internalization advantages, (Buckley and Casson, 1976). These advantages exist when the internalization of cross-border transactions within a firm becomes a more efficient form of servicing markets that arms' length transactions. Put differently, it is the sum of commercial benefits accruing from an FDI or intra-firm activity rather than an arm's length or licensing relationship.

c.   Location Advantages, (Veron, 1966). These occur when the local conditions of potential host countries make them a more attractive site for FDI operations than the home country. These advantages include large markets, lower cost of resources or superior infrastructure among others.

Akinkugbe (2003) argues that location advantages constitute what earlier theoretical and empirical studies classified as 'pull factor'. The pull-factor examines the relationship between host country specific conditions and the inflow of FDI. At the centre of location advantages to the investor, which makes the return on investment sufficient to warrant the additional risk and uncertainty that accompanies investment outside the familiar home environment. In the case of natural resources, the incentives to FDI are clear: mineral deposits, forest and fisheries do not move toward financial centers, the belief that FDI is a product of rent-seeking on a global scale. Under this 'pull-factor', FDI is either classified as import-substituting, export increasing or government initiated (Moosa, 2002).

As to the pull – factor, Akhter (1993) posits that host-country specific conditions might embrace a number of socioeconomic and political factors within a country where FDI is made. These factors tend to determine available business opportunities and pending political threats within the host countries. Among others the socioeconomic and political factors commonly cited in this strand of the FDI literature include availability of natural resources, infrastructure, market size, level of human capital development, distance from major markets, labor cost, openness of the economy to international trade, exchange rate, fiscal and other non-tax incentives, political stability, monetary policies and the extent of liberalization or otherwise of the financial sector, availability of modern information and communication technology.

The above determinants of FDI are not exhaustive because of the complexity attributed to the structural diversity of countries (both supplying and receiving).

2.3   Impact of FDI on Economic Growth in Nigeria

With reference to Nigerian economy, while a number of studies (Odozi, 1995, Aluko, 1996, Obina, 1983, Endozien, 1968, Ariyol, 1998, Ayanwale and Bamire, 2001, etc) have argued that FDI contributes positively to economic growth, others (Ogiogio, 1995, Adelagun, 2000, Oyinlola, 1995, etc) have debunked this fact from their findings, that it has negative impact.

On the positive impact of FDI, the consensus has been that FDI increases growth through productivity and efficiency gains by local firms-spillover effect. However, the FDI spillovers according to Obwona (2004) depend on the host country's capacity to absorb the foreign technology and the type of investment climate.

2.4   Theoretical Framework

The first two theories are theories of FDI, while the other three are theories of economic growth.

2.4.1   Production Cycle Theory of Vernon

Production cycle theory developed by Vernon in 1966 was used to explain certain types of FDI made by US companies in Western Europe after the Second World War in the manufacturing industry.

Vernon believes that there are four stages of production cycle: innovation, growth, maturity and decline. According to Vernon in the first stage the US transnational companies create new innovative products for local consumption and export the surplus in order to serve also the foreign markets. According to the theory of the production cycle, after the Second World War in Europe, increased demand for manufactured products like those produced in USA. Thus, American firms began to export, having the advantage of technology on international competitors.

If in the first stage of the production cycle, manufacturers have an advantage by possessing new technologies, as the products develops, also the technology becomes known. Manufacturers will

standardize their products, but there will be companies that will copy it. Thereby, European firms have started initiating American products that US firms were exporting to these countries. US companies were forced to perform production facilities on the local markets to maintain their market shares in those areas.

2.4.2   Theory of Exchange Rates on Imperfect Capital Markets

This is another theory which tried to explain FDI. Initially, the foreign exchange risk has been analyzed from the perspective of international trade. Cushman (1985) shows that increase in real exchange rate stimulates FDI made by USD, while a foreign currency appreciation has reduced American FDI. Cushman concludes that the dollar appreciation has led to a reduction in US FDI by 25%. However, currency risk rate theory cannot explain simultaneous foreign direct investment between countries with different currencies.

2.4.3   Ragnar Nurkse's Balanced Growth Theory

The balanced growth theory is an economic theory pioneered by the economist, Ragnar Nurkse (1907-1959). The theory's hypothesis is that the government of any undeveloped country needs to make large investments in a number of industries simultaneously. This will enlarge the market size, increase productivity and provide an incentive for the private sector to invest. Nurkse was in favor of attaining balanced growth in both the industrial and agricultural sectors of the economy.

2.4.4   The unbalanced Growth Theory

The growth theory was popularized by Hirschman (1958). He opined that the deliberate unbalancing of the economy according to a pre-designed strategy is the best way to achieve growth in undeveloped countries. The unbalanced growth theory emphasized that investment should be made in selective sectors rather than simultaneously in all sectors. He regards development and growth as a chain of disequilibria of which profits and losses are systems in competitive economy.

2.4.5   Harrod-Domar Theory of Growth

It is used in development economics to explain an economy's growth rate in terms of the level of savings and productivity of capital. It suggests that there is a natural reason for an economy to have balanced growth. The model was developed independently by Sir Roy F. Harrod in 1935 and Domar in 1946. The Harrod-Domar model was the precursor to the exogenous growth model.

Though, the Harrod-Domar model was initially created to help analyze the business cycle. It was later adapted to explain economic growth. Its implication was that growth depends on the quantity of labor and capital. More investment leads to capital accumulation which guarantees economic growth.

This study adopts the production cycle theory of Vernon and the Harrod-Domar theory of economic growth to hold that, host countries of multinational companies should appreciate innovation and attempt to copy the production techniques of the multinationals to produce such

products they produce, and to increase saving and investment since growth in an economy does not just happen naturally. Thus, innovation and imitation which has the tendency of developing local productive capacity as well as increase in the economy's level of investment will bring about growth of the economy.

3.0   RESEARCH METHODOLOGY
The necessary data (GDP, GCE, FDI, EXR, and IR) for this work will be sourced from statistical bulletin of Central Bank of Nigeria and National Bureau of Statistics of various years.

3.1   Model Specification
The model for estimating impact of foreign direct investment on economic growth in this study is adopted from the work of Omoniyi and Omobitan (2011) with a slight modification, the inclusion of government capital expenditure and exchange rate. The inclusion of GCE and exchange rate is premised on the fact that capital development and exchange rates affects FDI. The model therefore is

GDP = f (FDI, GCE, EXR, IR)…………………1 Put in linear form, it is

$GDP = \beta_0 + \beta_1 FDI + \beta_2 GCE + \beta_3 EXR + \beta_4 IR + U$…………….2

Introducing log transformation to equ 2, we have

$lnGDP = \beta_0 + \beta_1 lnFDI + \beta_2 lnGCE + \beta_3 lnEXR + \beta_4 lnIR + lnU$……..3

Where:

GDP = Gross Domestic Product

GCE = Government Capital Expenditure on Infrastructure

FDI = Foreign Direct Investment

EXR = Exchange Rate

IR = Interest Rate

Ln = logarithm

β_0 = Constant Intercept

β_1, β_2, β_3 and β_4 = Parameters to be estimated

U = Error term.

The signs of the coefficient of GCE and FDI are expected to be positive because increase in GCE and FDI are expected to contribute meaningfully to economic growth. On the other hand, the signs for the coefficient of IR and EXR are expected to be negative. This is in line with economic theory which states that, increase in IR will discourage borrowing and when borrowing is discouraged, investment will be injured leading to slumps in economic activities, thus declining or retarding GDP. In the same vein, increase in EXR may retard the growth of GDP, Nigeria, specifically being an international price taker. Imports will be at high prices and hence may have negative effect on GDP.

4.0   Results and Analysis

4.1   Trend Analysis

From Appendix 1 which has data on gross domestic product (GDP), foreign direct investment (FDI), government capital expenditure (GCE), interest rate (IR) and exchange rate (EXR), a comprehensive and close analysis of the trend of foreign direct investment (FDI) and gross

domestic product GDP within the period of study in Nigeria is computed and presented in Figure 4.1 below:

Figure 4.1: The Trend of Foreign Direct Investment and GDP
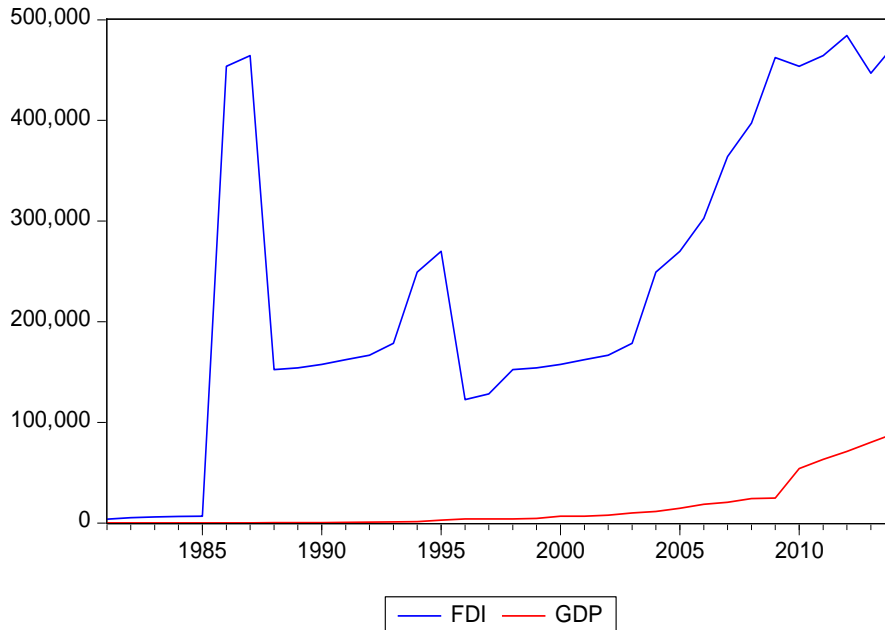
Source: Authors' Computation using Excel

This trend shows that from 1981 to 1985, FDI was increasing steadily, and had a sudden rise from 1985 to 1986. There was a decline from 1986 to 1988 and from 1990 the trend shows a gradual increase until 1996 where there is a decline. From 1999 to 2014 the trend shows a consistent increase in FDI.

4.2 Descriptive Statistics

Table 4.2

Variables/Tests	GDP	FDI	GCE	EXR	IR
Mean	15562.77	236176.4	181562.8	67.87206	12.93941
Median	4110.775	172555.0	25039.26	21.96860	13.00000
Maximum	89043.62	484264.0	769326.2	158.4356	26.00000
Minimum	94.33000	3757.900	2019.710	0.610000	6.000000
Std. Dev.	25101.86	157621.3	261171.7	63.64613	4.187545
Skewness	1.844100	0.250090	1.183831	0.215574	0.740266
Kurtosis	5.070067	1.888748	2.846384	1.238752	4.157045
Jarque-Bera	25.34134	2.103836	7.975018	4.657831	5.001864
Probability	0.000003	0.349267	0.018546	0.097401	0.082009
Sum	529134.3	8029999	6173134	2307.650	439.9400
Sum Sq. Dev	2.08E+10	8.20E+11	2.25E+12	133677.4	578.6726
Observations	34	34	34	34	34

Source: Authors' Computation Using E-views 7.0

The descriptive statistics presented in table 4.2 above describes the data used at a glance. It shows the average, median, standard deviation, minimum and maximum range of the data set. Skewnes explains the normality of the data; GDP, GCE and IR viewed individually are biased in the distribution since they are above zero while FDI and EXR are not. However, viewed collectively, FDI, EXR and IR are normally distributed since their probabilities of the Jarque-Bera test are greater than 5%, while that of the GDP and GCE are not.

4.3   Result of Augmented Dickey-Fuller (ADF) test

The Augmented Dickey-Fuller (ADF) test was carried out to test for the presence of unit root. It is directed to determine the time series characteristics of the variable. Accordingly, stationarity for the variables were tested and achieved at one differencing, integrated of order one for the variables except for GCE integrated of order 2. The result is presented in table 4.3 below

Table 4.3 Stationarity Test Statistics (ADF)

Augmented Dickey-Fuller statistics of the variable					
Variables	**ADF statistics**	**1%**	**5%**	**10%**	**Order of Integration**
GDP	4.605653	-3.711457	-2.981038	-2.629906	I(1)
FDI	-5.472080	-3.653730	-2.957110	-2.617434	I(1)
GCE	-12.03687	-3.670170	-2.963972	-2.621007	I(2)
EXR	-5.407278	-3.653730	-2.957110	-2.617434	I(1)
IR	-5.913263	-3.661661	-2.960411	-2.619160	I(1)

Source: Authors' Computation Using E-Views 7.0

Having tested for the stationarity of the variables, we proceed to test for the long run relationships of the variables which give us the co-integrating equation presented below

GDP = -3394.277 + 0.017878FDI –0.195627GCE+115.0385EXR +15.362801IR
                       (0.03660)   (0.03528)   (101.033)   (1015.21)

NB: Standard errors in parenthesis.

The result of the Johansen co-integration shows the existence of long run relationship among the variables. From the long run equation, if all the explanatory variables are held constant, GDP will decrease by 3394.277 units in the long run. The coefficient of FDI is 0.017878 implying a positive relationship between FDI and GDP in the long run, which is in line with our a priori expectation. It implies that a unit increase in FDI will bring about 0.018 increases in GDP. The

coefficient of GCE, EXR and IR does not conform to our a priori expectation. Their implications are that, a unit increase in GCE, EXR, and IR will bring about 0.196, 115, 15.36 units respectively decrease in GDP. We further proceed to conduct a vector error correction test, given the one year time lag used to show the speed of adjustment of the dependent variable to the changes in the explanatory variables in the short run and the result is presented below.

Vector Error Correction model (VECM)
GDP_{t-1}= 0.320938GDP_{t-1}+0.003518FDI_{t-1}-0.028101GCE_{t-1}+90.08593EXR_{t-1}-200.6173IR_{t-1}-

(0.187880)   (0.00839)   (0.01655)   (69.8386)   (267.377)

0.236218ECM_{t-1}

(0.08545)

NB: Standard errors in parenthesis

R^2 = 0.554556

Adj R^2 = 0.296668
F-Statistics = 2.150374
Akaike AIC = 20.06630
Schwarz SC = 20.33201
Source: Authors' Computation using E-views 7.0

The result from the above model shows that in the short run, foreign direct investment (FDI) and exchange rate has a positive relationship with GDP in Nigeria while government capital expenditure (GCE) and interest rate (IR) has a negative relationship with GDP. FDI and IR conform to the a priori expectation, while GCE and EXR do not. If all the variables are held constant, the GDP will be positively influenced by 0.320938. All the variables are statistically significant at 5% level. The coefficient of FDI (0.003518) implies that, a unit increase in FDI in the short run leads to a 0.35% unit increases in the GDP. The coefficient of GCE (-0.028101) implies that a unit increase in GCE in the short run leads to a 2.8% decrease in the GDP. This may partly be attributed to long term capital projects embarked by the government which the benefit may not be felt in the short run of which some of them are even abandoned.
Equally, the coefficient of EXR (90.08593) implies that, a unit increase in exchange rate leads to 90.08593 unit increase in the GDP. This might be that high exchange rates attracts more foreign investment as few dollars could buy more naira and may equally make Nigerian export products to be highly demanded in the international market given that Nigerian increases her volume of exports thereby increasing the GDP. This is also in line with the position of the theory of exchange rates on imperfect market as argued by Cushman (1985) which shows that increase in real exchange rate stimulates FDI made by USD, thereby stimulating the growth of GDP.
The coefficient of IR (-200.6173) implies that a unit increase in interest rate will lead to a 200.6173 unit decrease in the GDP.
The coefficient of error correction term is significant with the expected sign. Its magnitude (–0.236218) indicates that if there is any deviation, the long run equilibrium is adjusted where only about 23.6% of the disequilibrium maybe removed each year.

The coefficient of multiple determination R^2 (55%) shows that the explanatory variables jointly explain 55% of the movement in the dependent variable with R^2 adjusted of 30%. The fitness of the model is shown by the F-statistic which is significant at 2.150374 which explains the overall significance of all the variables incorporated in the model. The Akaike information criterion (20.06630) also indicates how good the model is.

5.0   Conclusion and Recommendations

Despite the varying findings of various authors on the impact of FDI on Nigerian economy, this study reveals that FDI has significant positive impact on the growth of Nigerian economy. Government capital expenditure which is expected to contribute to economic growth in the long wrong showed reverse result which the author assumed may partly be as a result of high rate of abandoned government capital projects on which large sum of funds are committed to. Hence, the supposed contributions of these projects are not realized. This therefore calls for government to ensure stability in the economy in other to attract more foreign direct investment in the country. Similarly, the study recommends that successive governments ensures continuity of policies that have positive impacts in the economy, hence to see that projects in progress are completed to curb the incessant cases of uncompleted or abandoned projects. The multiplier effects of the forgone will again, bring about increase expansion or diversification of the economy, and increase rate of employment and eventually overall growth of Nigerian economy.

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APPENDIX I

YEAR	GDP	FDI	GCE	EXR	IR
1981	94.33	3757.9	2923.87	0.61	6
1982	101.01	5382.8	3084.95	0.6729	8
1983	110.06	5949.5	3393.64	0.7241	8
1984	116.27	6418.3	3839.43	0.7649	10
1985	134.59	6804	4379.59	0.8938	10
1986	134.6	453673	4716.63	2.0206	10
1987	193.13	464466	6527.22	4.0179	12.75
1988	263.29	152410	8427.55	4.5367	12.75
1989	382.26	154189	10564.63	7.3916	18.5
1990	328.61	157535	13329.58	8.0378	18.5
1991	545.67	162343	15237.8	9.9095	14.5
1992	875.34	166632	16327.72	17.2984	17.5
1993	1,089.68	178478	17219.34	22.0511	26
1994	1,399.70	249221	18606.64	21.8861	13.5
1995	2,907.36	269845	2019.71	21.8861	13.5
1996	4,032.30	122601	21871.46	21.8861	13.5
1997	4,189.25	128332	23805.45	21.8861	13.5
1998	3,989.45	152410	26273.06	21.8861	14.31
1999	4,679.21	154189	28908.54	92.6934	18
2000	6,713.57	157535	32151.94	102.1052	13.5
2001	6,895.20	162343	42079.18	111.9433	14.31
2002	7,795.76	166632	47660.91	120.9702	19
2003	9,913.52	178478	53542.79	129.3565	15.75
2004	11,411.07	249221	374127.6	133.5004	15
2005	14,610.88	269845	301989.2	132.147	13
2006	18,564.59	302843	246518.8	128.6516	12.25
2007	20,657.32	364009	460540	125.8331	8.75
2008	24,296.33	397395	453717	118.8606	9.81
2009	24,794.24	462433	445086.5	148.7316	7.44
2010	54,204.80	453673	587664.7	148.8127	6.13
2011	63,258.58	464466	654437.1	154.1805	9.19
2012	71,186.53	484264	709090.8	155.7584	12
2013	80,222.13	446786	763744.5	157.31	12
2014	89,043.62	475439	769326.2	158.4356	13