FOREIGN DIRECT INVESTMENT AS AN ENGINE OF ECONOMIC GROWTH IN NIGERIA

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Abstract

Nigeria has the potential to become Sub-Saharan Africa's largest economy because of its rich human and natural resources. These vast natural resources qualify Nigeria to be a major recipient of foreign direct investment. Foreign Direct investment in turn is believed to be an engine of economic growth in that it brings about the transfer of technology, managerial skills, international production, and access to market. A number of studies have been conducted on the Impact of Foreign Direct investment on Economic Growth, with most of those studies focusing on cross—country studies. Yet, results about the relationship between foreign direct investment and economic growth come with varying outcomes. This study focused exclusively on analyzing the role foreign direct investment has played as an engine of economic growth in Nigeria. Therefore, the study recommends that there is a need for government to provide an enabling environment that will encourage foreign investors to invest in Nigeria economy by addressing the insecurity problems in the country, providing investment friendly environment by improved regulatory framework as well as encourage domestic investment.

Keywords: Foreign Direct Investment and Economic growth

Introduction

Recent studies have shown that Foreign Direct Investment (FDI) is what is needed to bridge the savings and investment gap that exists in Africa and Nigeria in particular. Foreign Direct Investment (FD1) was not seen as an instrument of economic development. The perception of FDI as parasitic and retarding the development of domestic industries for export promotion had engendered hostility to multi-national companies and their direct investments in many countries. However, the consensus studies have shown that FDI is an engine of economic growth as it provides the much needed capital for investment, increases competition in the host country industries and aids local firms to become more productive by adopting more efficient technologies or by investing in human and/or physical capital. Foreign Direct Investments contribute to economic growth in a substantial manner because it is more stable than other forms of capital flows (Ajayi, 2006).

Dauda (2007), argues that FDI is generally believed to propel economic growth in developing countries as it makes significant contributions to the host country's development as it makes significant contribution to the host country's development process especially through easing of the constraints of low levels of domestic savings and investment as well as foreign exchange shortages. He further argues that FDI increases the GDP and generates a stream of real incomes in the host country. The increased productivity benefit local income groups through higher wages and expanded employment, lower product prices paid by consumers, rent to local resource owners, and high tax revenue or royalties to the government. Though the FDI-growth linkage is still ambiguous, most macroeconomic studies nevertheless support the notion of a positive role of FDI within particular economic conditions. There are three main channels through which FDI can bring about economic growth. The first is through the release it affords from the binding constraint of domestic savings. In this case, Foreign Direct Investment augments domestic savings in the process of capital accumulation. Second, FDI is the main conduit through which technology spillovers lead to an increase in factor productivity and efficiency in the utilization of resources, which leads to growth. Third, FDI leads to increase in exports as a result of 'increased capacity and competitiveness in domestic production. This linkage is often said to depend on another factor, called "absorptive capacity", which includes the level of human capital development, type of trade regimes and degree of openness to trade (Ajayi, 2006; Borensztein et al., 1998).

FDI is an engine of economic growth in one side and economic growth attracts Foreign Direct Investments into Nigeria in the other side.

Theoretical Framework

The United Nations defined Foreign Direct Investment (FDI) as investment in enterprise located in one country but "effectively controlled" by residents of another country (UNCTAD, 2009). Agada and Okpe (2012) saw FDI as an attempt by individuals, groups, companies and government of a nation to move resources of productive pose across its country to another country with the anticipation of earning some surplus.

Foreign Direct Investment is the distinctive feature of multinational enterprise hence; a theory of Foreign Direct Investment is also a theory of the multinational enterprise as an actor in the world economy (Ekpo, 2010). Based on this theory, Foreign Direct Investment is not simply (or even primarily) an international transfer of capital but rather, the extension of an enterprise from its home country into foreign host country. The extension of enterprise involved flows of capital, technology, and entrepreneurial skills and, in more recent cases, management practices to the host economy, where they are combined with the local factors in the production of goods and services (Chenery & Stout, 2006).

Kumar (2007) described Direct Foreign Investment (DFI) in three different ways. First, it involves parent enterprise injecting equity capital by purchasing shares in foreign affiliates. Second, it may take the form of reinvesting the affiliate's earning. Third, it may entail foreign investment as a share of Gross Domestic Product (GDP) that has grown rapidly, becoming the largest source of capital moving from developed nations to developing countries.

Foreign Direct Investment represents a veritable source of foreign exchange and technological transfer, especial1y 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).

International capital flows which provide some of the basic ingredients for economic growth had recently been marked, by a sharp expansion in net and gross capital flows arid a substantial increase in the participation of foreign investors and Multilateral Financial Institutions (MFIs) in the financial markets of developing countries (World Bank, 2010).

The MFIs conditionality attached to such assistance often cut budgets in the social sectors, thus accentuating poverty, leading to exchange rate crisis, massive devaluation of local currency and terms of trade determination (Todero, 2001).

Since domestic savings cannot solely finance a country's demands, there is a need for Foreign Direct Investment (FDI) and foreign portfolio investment (FPI) because of its roles such as managerial skills, marketing connection, technical knowledge, training of local work force, transmits hard currency into the country, it carries with it financial resources, it does not create debts to the government. Nigeria needs substantial amounts of foreign investment to speed up her economic growth and to promote development.

Foreign Direct Investment is known for improving economic efficiency through gains resulting from increases in international trade, international competitiveness and improved access to foreign markets for domestic products and training of labour force. Considering the fact that domestic capital formation (i.e. Domestic Investment Resources (DIR) is still at its infancy and is relatively low in developing nations, like Nigeria (Wakil, 2004).

FDI as an Engine of Economic Growth in Nigeria

There are several Nigeria-specific studies on the relationship between FDI and economic growth in Nigeria. Some of the pioneering works include Aluko (1961), Brown (1962) and Obinna (1983). These authors separately reported that there is a positive linkage between FDI and economic growth in Nigeria. Oseghale and Amonkhienan (1987) found that FDI is positively associated with GDP, concluding that greater inflows of FDI will spell a better economic performance for the country. Odozi (1995) placed special emphasis on the factors affecting FDI flows into Nigeria in both pre and post Structural Adjustment Programme (SAP) eras and found that the macro policies in place before SAP where discouraging investors. This policy environment led to the proliferation and growth of parallel markets and sustained capita1 flight. Ekpo (1995) also, reported that political regime, real income per capita, inflation rate, world interest rate, credit rating and debt service were the key factors explaining the variability of FDI inflows into Nigeria. Similarly, Ayanwale and Bamire (2001) assessed the influence of FDI on firm level productivity in Nigeria and reported positive spillover of foreign firms on domestic firm productivity.

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 in the country. Furthermore, there is no reliable evidence that all the investment variables included in his analysis have any perceptible influence on economic growth. He therefore suggested the need for an institutional rearrangement that recognizes and protects FDI in the country.

Jenkin and Thomas (2002) assert that FDI is expected to contribute to economic growth not only by providing foreign capital but also by crowding in additional domestic investment. By promoting both forward and backward linkages with the domestic economy, additional employment is indirectly created and further economic activity stimulated.

According to Adegbite and Ayadi (2010), FDI helps fill the domestic revenue -generation gap in a developing economy, given that most developing countries' governments do not seem to be able to generate sufficient revenue to meet their expenditure needs. Other benefits are in the form of externalities and the adoption of foreign technology. Externalities here can be in the form of licensing, imitation, employee training and the introduction of new processes by the foreign firms (Alfaro, Chaida, Kalemii- Ozean and Sayek 2006).

Carkovic and Levin (2002) note that the economic rationale for offering special incentives to attract DFI frequently derives from the belief that foreign investment produces externalities in the form of technology transfers and spillovers. Curiously, the empirical evidence of these benefits both at the firm level and at the national level remains ambiguous. DeGregorio (2003) while contributing to the debate on the importance of DFI, note that DFI may allow a country to bring in technologies and knowledge that are not readily available to domestic investors, and in this way increases productivity growth throughout the economy, DFI may also bring in expertise that country does not possess, and foreign investors may have access to global markets. In fact, DeGregorio (2003) found increasing aggregate investment percentage point of GDP and increased economic (DFI) is associated with higher economic growth

Otepola (2002), examines the importance of direct foreign investment in Nigeria. The study empirically examined the impact of DFI on growth. He concluded that DFI contributes significantly to growth especially through exports. This study recommends a mixture of practical government policies to attract Direct Foreign Investment (DFI) to the priority sectors of the economy.

Zhang (2001) argued that Direct Foreign 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's economic performance. The literature reviews have therefore, shown that Direct Foreign investment (DFI) is not as exploitative as shown by many authors, a situation which has created love — hate relationship between foreign investors and host countries instead, such direct foreign investment has not only avoided creating an overhang of debts, but also facilitated the transfer of technology and managerial skills and hence, it is directly tied to productive investment in the country. Many research works have shown that the contribution of DFI to growth is positive using different data and methodologies, many researchers have concluded that DFI has positive impact on growth.

Some research work agrees that the DFI contribution to growth is positive but depends on some factors in the host country. Alfaro (2003) affirmed that the contribution of DFI to growth depends on the sector of the economy where the DFI operates. He claimed that DFI 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. Lall (2002) opined that DFI 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 DFI on economic growth is far from being conclusive the role of DFI seems to be country specific and can be positive, negative or insignificant, depending on the economic, institutional and technological conditions in the recipient countries.

Finally, the relationship between Direct Foreign Investment as an engine of economic growth is conditional on the macroeconomic dispensation the country in question is passing through. In fact, Zhang asserts that "the extent to which Direct Foreign Investment contributes to growth depends on the economic and social conditions or in short, the quality of the environment of the recipient country.

An Overview of the Trends and Performance of FDI in Nigeria

Nigeria receives the largest amount of Foreign Direct Investment in Africa. FDI inflows have been growing enormously over the course of the last decade, from $l.l4biliion in 200l and

$2.billion in 2004. Nigeria's FDI reached $1billion in 2009 according to UNCTAD making the country the nineteenth recipient of FDI in the world (Bello, 2011).

Nigeria's most important sources of FDI have traditionally been the home countries of the oil majors. The USA, present in Nigeria's oil sector through Chevron, Texaco and Exxon Mobil, had investment stock of $3 .4billion in Nigeria in 2008. The UK, one of the host countries of Shell, is another key FDI partner — UK FD1 into Nigeria accounts for 20% of the Nigeria's total foreign investment. As China seeks to expand its trade relationships with Africa it too is becoming one of the Nigeria's most important sources of FDI, Nigeria is China's second largest trading partner in Africa , next to South Africa, from $3billion in 2003, China's direct investment in Nigeria is around $6billion. The oil and gas sector receives 75% of China's FDI in Nigeria. Other significant sources of FDI include Italy, Brazil, the Netherlands, France and South Africa.

With the globalization and integration of international capital markets, FDI story of Nigeria today is dominated by the oil industry which was not so, at independence in 1960, there was a widespread of FDI presence in the economy. Therefore policy design thereafter narrowed FDI performance and decades of political instability, endemic corruption and economic mismanagement further reduced Nigeria's ability to attract and retain FDI. The return of democracy in 1999 has created the opportunity for economic renewal and the attraction of more seeking FDI to Nigeria. The Government of Nigeria undertook ambitious measures to reap the benefits from FDI with a view to improve the investment climate, the policy has started bearing fruits and will certainly provide a more conducive environment to private investment and enhance the attractiveness of FDI to the Nigeria's large and growing market.

Umah (2007) asserts that the Nigerian government has instituted various institutions, policies and laws aimed at encouraging foreign direct investment. For instance, in 1995, the Nigeria Investment Promotion Commission (NIPC) was established through Decree No 16 of 1995: The Law provides for a foreign investor to set up a business with 100% ownership which must be registered of the Corporate Affairs Commission (CAC) in accordance with the provisions of the Companies and Allied Matters Decree of 1990. The registration is finalized with the NIPC. To ensure adequate protection, the NIPC Decrees guarantees foreign investments against nationa1ization and expropriation by the government. The NIPC Decree repealed-the Industrial Development Coordination Committee (IDCC) Decree No 36 of 1988 and the Nigeria Enterprise Promotion Decree (NEPD) of 1972 as amended in 1977 and 1989 which, hitherto, reserved for Nigerians the ownership of certain business. The operation of the Autonomous Foreign Exchange Market (AFEM) as provided for in the decree liberalized the FEM operation. The Decree replaced the Exchange Control Act No. 16 of 1962 in its entirety. Dunning (1994), however, noted that FDI is attracted to serve as a means of augmenting Nigeria's domestic resources in order to effectively carryout her development programmes and raise the standard of living of her people,

According to Bello (2003), privatization was also adopted, among other measures, to encourage foreign investments in Nigeria. This involved transfer of state-owned enterprise (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. Qualified foreign firms were open arms to take over most of these establishments to enhance efficiency. This is because such foreign firms are reported to possess the managerial acumen and technical prowess needed to resuscitate and sustain the weak industries in Nigeria (Umah, 2007).

Conclusion and Recommendations

The new administration under President Muhammad Buhari has been working helter-skelter to improve the reputation of the country abroad, and it has started making substantial progress in addressing the issues that have worried outside investors in the past.

The current government was elected on a platform of restoring the rule of law, the dignity of Nigeria and challenging corruption, and much headway has been made in the fight against graft. It is believe that the following policy recommendations would attract more foreign investment that would engineer economic growth and development in Nigeria.

- Government could simplify and improve the screening process of FDI; for example, any foreign investment that brings about significant contribution to national income can be given priority.
- The Nigerian government needs to come up with more friendly economic policies and business environment, which will attract more private investments (both domestic and foreign) into virtually all the sectors of the economy especially in the areas of infrastructural provision, constructions and agriculture.
- There is need to have a stable political and economic environment and improve on the critical infrastructural facilities such as electricity, roads and water level of security at all levels in the country, systems of governance should be based on accountability, transparency, effective and efficient resource.
- Efforts should be made to engage in joint ventures that are beneficial to the economy. Joint ventures provide for a set of complementary or reciprocating matching undertakings, which may include a variety of packages ranging from providing the capital to technical cooperation. The government should intensify the policy to acquire, adopt, generate and use the acquired technology to develop its industrial sectors.
- The indigenization policy should be pursued to the latter as a way of preventing absolute foreign ownership in the key sector of the economy.
- Efforts should continue, this time with more vigor at ensuring consistency in policy objectives and instruments through a good implementation strategy as well as good sense of discipline, understanding and cooperation among the policy makers.
- 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.
- For Nigeria to generate more foreign direct investments, efforts should be made at solving the problems of government involvement in business; relative closed economy; corruption; weak public institutions; and poor external image. It is therefore

advised that the government continues with its privatization programme, external image laundry, seriousness and openness in the fight against corruption, and signing of more trade agreements.

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