

## Foreign Direct Investment and the Performance of the Nigerian Economy

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**Abstract** Foreign Direct Investment (FDI) is investment that is made to acquire a lasting management interest (usually 10% of voting stock) in an enterprise and operating in a country other than that of the investors (Jhingan, 1998). This paper examines FDI and the performance of the Nigerian economy. It investigates how FDI impacts economic growth in Nigeria. The paper recommended among other things, that there should be policies and programmes that will promote or improve FDI and macroeconomic variables in the economy.

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### Introduction

An agreed framework definition of Foreign Direct Investment (FDI) exists in the literature. That is, FDI is an investment made to acquire a lasting management interest (normally 10% of voting stock) in a business enterprise operating in a country other than that of the investor defined according to residency (World Bank, 1996). Such investments may take the form of either "Greenfield" investment (also called "mortar and brick" investment) or merger and acquisition (M&A), which entails the acquisition of existing interest rather than new investment.

In corporate governance, ownership of at least 10% of the ordinary shares or voting stock is the criterion for the existence of a direct investment relationship. Ownership of less than 10% is recorded as portfolio investment. FDI comprises not only merger and acquisition and new investment, but also reinvested earnings and loans and similar capital transfer between parent companies and their affiliates. Countries could be both host to FDI projects in their own country and a participant in investment projects in other countries. A country's inward FDI position is made up of the hosted FDI project, while outward FDI comprises 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 transnational corporations and firms (TNCs).

Many countries and continents (especially developing country like Nigeria) now see attracting FDI as an important element in their strategy for economic development. This is most probably because FDI is seen as an amalgamation of capital, technology, marketing and management.

Sub-Saharan Africa as a region now has to depend very much on FDI for so many reasons, some of which are amplified by Asiedu (2001). For a developing country like Nigeria, the inflow of a foreign capital may be significant in not only raising the productivity of a given amount of labour, but also allowing a large labour force to be employed (Sjoholm, 1999). The effort by several African countries like Nigeria, to improve their business climate stems from the desire to attract FDI. In fact, one of the pillars on which the New Partnership for Africa's Development (NEPAD) was launched to increase available capital to US \$ 64 billion through a combination of reforms, resource mobilization and a conducive environment for FDI (Funke and Nsouli, 2003).

Nigeria as a country, given her natural resource base and large market size, qualifies to be a major recipient of FDI in Africa and indeed is one of the top three leading African countries that consistently received FDI in the past decade.

However, the level of FDI attracted by Nigeria is mediocre (Asiedu, 2003) compared with the resource base and potential need. Further, the empirical linkage between FDI and economic growth in Nigeria is yet unclear, despite numerous studies that have examined the influence of FDI on Nigeria's economic growth with varying outcomes (Adelegan, 2000 and Akinola, 2004). However, recent evidence affirms that the

relationship between FDI and growth may be country and period specific. Asiedu (2001) submits that the determinants of FDI in one region may not be the same for other regions. In the same vein, the determinants of FDI in countries within a region may be different from one another and from one period to another.

The results of studies carried out on the linkage between FDI and economic growth in Nigeria are not unanimous in their submissions. A closer examination of these previous studies reveals that conscious effort was not made to take care of the fact that more than 60% of the FDI inflows into Nigeria is made into the extractive (oil) industry. Hence, these studies actually modeled the influence of natural resources on Nigeria's economic growth.

### **Foreign Direct Investment and the Performance of the Nigerian Economy**

According to Jhingan (1998) direct investment is the formation of a concern (business) in which company of the investing country has a majority holding. The formation of the business concern may be financed exclusively from foreign source leading to the creation of fixed assets. In the same vein, the World Bank (1996) conceptualized Foreign Direct Investment (FDI) as investment that is made to acquire a lasting management interest (usually 10% of voting stock) in an enterprise and operating in a country other than that of the investors (define according to residency) the investors purpose being an effective voice in the management of earning either long term capital or short term capital as shown in the nations balance of payments account statement.

Nigeria's foreign investment can be traced back to the colonial era, when the colonial masters had the intention of exploiting our resources for the development of their economy. There was little investment by these colonial masters. With the research and discovery of oil foreign investment in Nigeria, but since then, Nigeria's foreign investment has not been stable.

With the end of oil boom in 1982, Nigeria found herself in a quagmire of economic problems. The external sector, these problems include unsustainable balance of payment deficits, a rapid escalating debt stock and a crushing debt service burden. Internally, the economic problems include unsustainable fiscal deficit, rising unemployment and galloping inflation. Above all, investment has collapsed and this contributed strongly to a reduction in real output and per capita real income level. In the late 1980's and early 1990's despite Nigeria's implementation of SAP, beginning from 1986, investment remained low and refused to recover significantly, the decline in investment in the late 1980's and the low investment ratio which persisted into the 1990's no doubt partly explains the slow growth of output during this period. It is certain that with significant recovery of investment, particularly foreign investment, a meaningful resurgence in output growth would remain elusive. And also if foreign investment remains at the current low level of per capita consumption and income and endanger the sustainability of the adjustment effort and hopes of poverty alleviation.

### **Impact of Foreign Direct Investment on Economic Growth in Nigeria.**

There have been some studies on investment and growth in Nigeria with varying results and submissions. For example, Odozi (1995) reports on the factors affecting Foreign Direct Investment (FDI) flow into Nigeria in both the pre and post structural adjustment programme (SAP) eras and found that the macro policies in place before the SAP were discouraging foreign investors. This policy environment led to the proliferation and growth of parallel markets and sustained capital flight.

Ogiogio (1995) reports negative contributions of public investment to GDP growth in Nigeria for reasons of distortions. Aluko (1961), Brown (1962) and Obinna (1983) cited in Adeolu (2007) report positive linkages between Foreign Direct Investment (FDI) and economic growth in Nigeria. Endozen (1968) cited into Adeolu (2007) discusses the linkages effects of Foreign Direct Investment (FDI) on the Nigerian economy and submits that these have not been considerable and that the broad linkage effects were lower than the

Chenery-Watanaba average (Chenery and Watanaba, 1958). Oseghale and Amonkhenam (1987) found that Foreign Direct Investment (FDI) is positively associated with Gross Domestic Product (GDP), concluding that greater inflow of Foreign Direct Investment (FDI) will spell a better economic performance for the country.

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 during the period considered (1970-1995).

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 the interest of major partners in the development of the economy.

Examining the contributions of foreign capital to the prosperity or poverty of LDCs, Oyinola (1995) conceptualized foreign capital to include foreign loans, direct foreign investments and export earnings. Using Chenery and stout's two-gap model (Chenery and Stout, 1966) cited in Adeolu (2007) he concluded that Foreign Direct Investment (FDI) has a negative effect on economic development in Nigeria.

Adelegan (2000) explored the seemingly unrelated regression model to examine the impact of Foreign Direct Investment (FDI) on economic growth in Nigeria and found out that Foreign Direct Investment (FDI) is pro-consumption and pro-import and negatively related to gross domestic investment. Akunlo (2004) found that foreign capital has a small and not statistically significant effect on economic growth in Nigeria.

However, these studies did not control for the fact that most of the Foreign Direct Investment (FDI) was concentrated in the extractive industry. In other words, it could be put that these works assessed the impact of investment in extractive industry (oil and natural resources on Nigeria's economic growth).

On firm level productivity spillover, Ayanwale and Bamire (2001) assess the influence of Foreign Direct Investment (FDI) and firm level productivity in Nigeria and report a positive spillover of foreign firms on domestic firm's productivity.

Much of the other empirical work on Foreign Direct Investment (FDI) in Nigeria centered on examination of its nature, determinants and potentials. For example, Odozi (1995) notes that foreign investment in Nigeria was made up of mostly "Greenfield" investment, that is, it is mostly utilized for the establishment of new enterprises and some through the existing enterprises. Aremu (1997) categorized the various types of foreign investment in Nigeria into five: wholly foreign owned; joint ventures; special contract arrangements; technology management and marketing arrangements; and subcontract co-production and specialization.

In his study of the determinants of Foreign Direct Investment (FDI) in Nigeria, Anyanwu (1998) identified change in domestic investment, change in domestic output or market size, indigenization policy, and change in openness of the economy as major determinants of Foreign Direct Investment (FDI) inflow into Nigeria and that effort must be made to raise the nation's economic growth so as to be able to attract more Foreign Direct Investment (FDI).

Jerome and Ogunkola (2004) assessed the magnitude, direction and prospects of Foreign Direct Investment (FDI) in Nigeria. They noted that while the Foreign Direct Investment (FDI) regime in Nigeria was generally improving, some serious deficiencies remain. These deficiencies are mainly in the area of the corporate environment (such as corporate law, bankruptcy, labour law etc). and institutional uncertainty, as well as the rule of law. The establishment and the activities of the economic and financial crimes commission (EFCC), the independent corrupt practices commission, and the Nigerian investment promotion commission are efforts to improve the corporate environment and uphold the rule of law. Has there been any discernible change in the relationship between Foreign Direct Investment (FDI) and economic growth in Nigeria in spite of these policy interventions?

Akinlo (2004) investigates the impact of Foreign Direct Investment (FDI) on economic growth in Nigeria using data for the period 1970 to 2001. His error correlation model (ECM) results show that both private capital and lagged foreign capital have small and insignificant impact on economic growth. This study however established the positive and significant impact of export on growth. Financial development which he

measured as  $M_2/GDP$  has significant negative impact on growth. This he attributed to capital flight. In another manner, labour force and human capital were found to have significant positive effect on growth.

However, an important fact about Foreign Direct Investment (FDI) and growth debate is the endogeneity case in which Foreign Direct Investment (FDI) is theorized to impact positively on economic growth and consequently, lead to greater market which in turn attracts further Foreign Direct Investment (FDI) as well (market size hypothesis). Market size hypothesis states that markets with rapidly expanding economic growth tend to give multinational firms more opportunities to make more sales and profits and therefore become more attractive to Foreign Direct Investment (FDI). This study will therefore make its contributions by examining the contributions of Foreign Direct Investment (FDI) to growth. In addition, analyze the reality or otherwise of endogeneity theory, then determine the contributory variables to Foreign Direct Investment (FDI) flow in Nigeria.

## Recommendations

1. Appropriate policy measures to attract foreign capital should be formulated and implemented to boost increased economic growth.
2. Policies that will bring about improvement in foreign direct investment and the balance of payments (BOP) in the economy should be encouraged.
3. Policies and programmes that would promote or stimulate foreign capital in the form of FDI and reduce unemployment should be encouraged.
4. Programmes and policies that promote FDI and reduce inflation should be promoted.
5. The Federal and the various state governments should as a matter of priority, improve the business environment by consciously providing necessary economic and social infrastructure, which will lower the costs of doing business in Nigeria and attract FDI into the country.

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