FOREIGN DIRECT INVESTMENT AND ECONOMIC OUTPUT IN NIGERIA (1984-2019)

Lukuman O. Lamidi
Federal College of Animal Health and
Production Technology, Ibadan

Muideen A. Isiaka
Abeokuta Business School
Crescent University, Abeokuta
dr.isiaka@gmail.com

Nsikan Sam
Bells University of Technology
Ota

ABSTRACT

Most developing nations need foreign support in order to fill their infrastructural gap. This is also true for Nigeria. One major source of foreign inflow is the Foreign Direct Investment (FDI). This study examines the impact of FDI on economic output, measured by real GDP, in Nigeria while accounting for the moderating impact of Inflation Rate (INFR), Interest Rate (INTR) and Exchange Rate (EXR). Using Autoregressive Distributed Lag (ARDL) Model, the findings suggest that FDI have a significant positive impact on real GDP only at one period lag. The study recommends that government should encourage FDI inflow for long term project in order for its benefit to be maximized in Nigeria.

Key Words: Foreign Direct Investment, Economic Output, Inflation Rate, Interest Rate, Exchange Rate

1.   Introduction

Foreign investment is essential for economies of the world seeking for economic progress. Foreign investment inflow provides a variety of benefits to the host economy. Hence its demand by countries especially developing countries that view foreign investment as a means to addressing a number of the economies challenges, including poverty and unemployment (Knill, 2005; Adelegan, 2000; Omisakin, *et al*. 2009; Kondyan & Yenokyan, 2019; Arain *et. al*., 2021).

Since the 1980s, the financial integration of emerging market economies such as Nigeria with international markets has gained momentum rising more rapidly in the mid-1990s (Humanicki, Kelm, & Olszewski, 2013). This is on account of a variety of factors including structural adjustment reforms undertaken by developing countries during the 80s which featured financial liberalization as part of the reforms. Consequently there has been significant inflow of foreign capital into developing countries. Foreign Direct Investment (FDI) has been the most popular form of these capital inflows.

Nigeria's economic growth remains below target and hence its quest to use foreign investment, especially that of direct investment, to address her economic challenges. Substantial foreign investment inflow to Nigeria can help to bridge the resource gap in different sectors, like agricultural mechanisation, manufacturing and industry, mining and the financial sector (Dauda, 2007; Umah, 2007; Nuzhat, 2009; Otepola, 2012).

As highlighted by Amassoma and Ogbuagu (2014), fiscal and financial reforms have been undertaken in the past decades by most developing countries, including Nigeria. However Nigeria continues to face challenges not only in respect to achieving high levels of growth but also related to that of creation of employment opportunities, and reduction of poverty. FDI has provided various benefits to emerging economies such as that of Nigeria, including promoting inflow of technology, creation of jobs, promoting better living standards, and development of local industries. In addition, FDI inflow has the potential to enable Nigeria achieve its long term economic potential. Nigeria as one of the major FDI recipients in the world, receiving up to US$8.84 Billion in 2011, ought to derive significant benefits from FDI (UNCTAD, 2014; UNCTAD 2019). Since efforts to attract further FDI inflows to Nigeria necessarily involve some economic cost, it is essential that the expected benefit of FDI inflows on Nigeria's economy justify the cost (Humanicki, Kelm, & Olszewski, 2013; Alabi, 2019). Thus, this study examine if FDI inflow has contributed significantly to the Nigeria's real GDP. And if yes, is the impact realised instantaneously or with lag?

2. Literature Review

Theories of economic growth like the Harrod-Domar economic growth model highlights the existence of a savings-investment gap which foreign investment can fill in developing countries (Thong & Hao, 2019). The different forms of foreign investment include wholly foreign-owned enterprises, joint ventures, special contract

arrangement, management and marketing agreement, subcontracting, co-production and specialization (Ali *et. al*., 2018; Makiela & Ouattara, 2018; Carbonell & Werner, 2018; Billas, 2020)**.**

In the joint venture form, the foreign partner takes charge of certain aspects of the joint operations while the domestic partner takes charge of other aspects. Subcontracting is the simplest in the group, it resembles manufacturing under license and consists of manufacturing components, semi-processed or finished products, on the basis of specification and know-how provided by the foreign investor. Subcontracting arrangements are commonly short-term contracts renewable on an annual basis. Co-production takes the concept of subcontracting to a more advanced stage as it includes the determination of the components of a final product, drawing up the specification for these components and the distribution of their production among domestic and foreign' investors. In specialization, the partners adopt a deliberate policy of specialization and consequently share the manufacturing of components as well as finished products. The obvious advantages here are the production of greater output, facilitation of supply of materials and acquisition of greater skills (Obiwona, 2004; Adeolu, 2007; Dutse, 2008; Humanicki, Kelm, & Olszewski, 2013).

FDI can be defined as an increase in the book value of the net worth of investment in one country held by investors of another country, where the investments are under the managerial control of the investor (Pooja & Puri, 2018; Wang *et al.* 2021). Benefits of FDI to the destination country include use of modern techniques, increasing employment, revenue to the government, improved Balance of Payment (BOP) position and economic growth (Hagan & Amoah, 2019; Khan, Xie & Saleem, 2019; Cicea & Marinescu, 2020).

One of the downside to FDI is that the related facilities and concessions often involve absorbing huge resources that could be utilized elsewhere by the government. This can lead to lopsided development. Foreign investors set up industries in big cities and town where infrastructural facilities are easily available while the backward areas remain undeveloped. Thus, increasing regional disparities in destination countries (Owusu-Nantwi & Erickson, 2019; Osei & Kim, 2020; Chanegriha, Stewart & Tsoukis, 2020).

FDI often lead to the emergence of monopolies in certain fields of production thereby driving out local enterprise. Monopolies can exploit the domestic consumers by overpricing products. Foreign direct investors are like fair wealthier friends. They invest when they expect high profit. But they withdraw their capital when they expect low profits. In the latter case, the host country is engulfed in a financial crisis and recession as happened in the East Asian countries (Anyanwu, 2007; Macaulay, 2012; Nwankwo *et al*, 2013 and Ugochukwu, 2013, Onuorah, 2012). FDI can also place a burden on the BOP of a country in the early stage of development. For example, the time lag between the starting of new business

concerns and the reaping of profits could be substantial. Moreover, profits are likely to be small in the earlier stages of production. (Hill, 2009, Colen, 2009, Otepola, 2012).

Studies that confirm positive relationship between FDI and economic growth, employment and/or BOP include Imoudu, 2012; Olusanya, 2013, Ehimare, 2011, Adigwe, Ezeugba and Francis, 2015, Mojekwu and Ogege, 2012, Yaqub, Adam, and Ayodele, 2013, Adeleke, Olowe, Fasesin, 2014, Ndem, Okoronkwo and Nwamuo, 2014. None of these papers specifically indicate whether FDI has instantaneous or lagged impact on Real GDP. For example, Imoudu (2012) considered the impact of sectoral FDI on economic growth in Nigeria between 1980-2009 using co-integration and vector error correction methodology. The finding indicated that FDI in telecom has a significant positive impact while those in other sectors like mining, petroleum, agriculture and manufacturing is very little. Adigwe, Ezeugba and Francis (2015) used Pearson correlation to examine impact of FDI on economic growth in Nigeria over the period 2008 and 2013. They included exchange rate as the control variable. The results indicated that both FDI and exchange rate had significant positive impact on economic growth in Nigeria. However, the methodology used cannot distinguish between instantaneous and lagged impact. Studies that obtained no significant relationship between FDI and economic growth include Ahmed, *et al.* 2012, Gatson and Issouf, 2009, Olokoyo, 2012).

3. Methodology

This research study modifies the model of Okpoto (2015) which was employed in achievement of the objective of examining whether Foreign Private Investment (FPI) contributes significantly to growth in Nigeria. The model of Okpoto (2015) is specified in Equation (1) .

$$GDP = f(FPI, INFR, EXR, INTR) \quad (1)$$

Where FPI=foreign Private Investment, INFR=Inflation rate, EXR=Exchange rate, INTR=Interest rate.

The model in equation (1) is modified in present study by replacing foreign private investment with foreign direct investment and the resulting model is as in Equation (2).

$$RGDP = f(FDI, INFR, INTR, EXR) \quad (2)$$

Where RGDP is real GDP.

The above model is transformed into an econometric model with RGDP and FDI entering the model as Logs on account of their large size, as in Equation (3)

$$LRGDP_t = \alpha_0 + \alpha_1 LFDI_t + \alpha_2 INFR_t + \alpha_3 INTR_t + \alpha_4 EXR_t + \varepsilon_t \quad (3)$$

Where, ε = stochastic error term

α_0, α_1, α_2, α_3, α_4, are the estimated parameters, and t is the time period which in our case is 1984-2019 with a priori as $\alpha_0, \alpha_1, \alpha_3 > 0; \alpha_2, \alpha_4 < 0$

4. Results

4.1 Trend Analysis

From Figure 1, the Nigeria real GDP maintain an upward trend over the entire period. Starting from about ₦13 trillion in 1984 to about ₦19 trillion in 1990. It then remain almost flat for some years and reached ₦20 trillion in 1995.

Figure 1: Trend Analysis of Real GDP
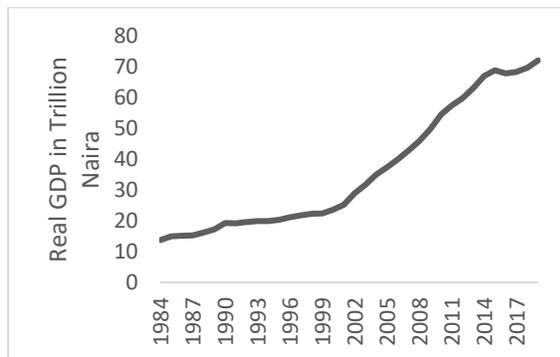
Source: Authors' Computation (2021) using data from CBN statistical bulletin

Since 2000, the real GDP trend became steeper and reached ₦69 trillion in 2015. It reduced to about ₦68 trillion in 2016 and increased gradually again to about ₦72 trillion in 2019.

The trend of FDI is shown in Figure 2. FDI inflow fluctuated over the entire period of 1984 to 2019. From 1984 to 1992, FDI inflow was under US$1 Billion, except in 1989 when it reached US$1.88 Billion. Since 1993, FDI inflow proceeds on an upward trend somewhat gradually rising, although fluctuating till 2011 when it reached its peak of US$8.84 Billion.

Figure 2: Trend Analysis of FDI
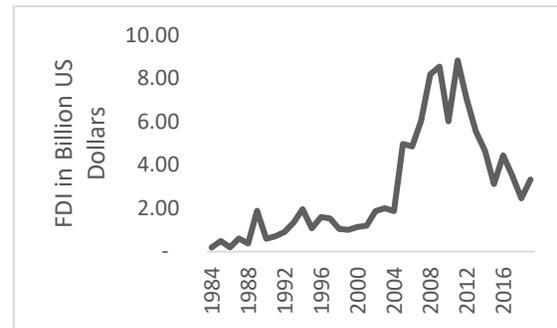
Source: Authors' Computation (2021) using data from World Development Indicators

Then between 2012 and 2015, FDI inflow declines gradually to reach US$3.13 Billion in 2015. It increased again in 2016 when it was US$4.45 Billion and never reached that value again till 2019.

4.2 Descriptive Analysis of variables

The variables employed in estimating the model for this study are described in Table 1. Specifically, key descriptive statistics of the variables are presented. Despite the mean value of GDP of ₦31.76 trillion, the mean of foreign direct investment is at US$2.70 Billion. This suggests a rather low level of foreign direct investment inflow to Nigeria for which a variety of factors may be responsible, including challenges faced by multinational enterprises in establishing businesses in Nigeria through foreign direct investment, in addition to inflation rate, and exchange rates which may be unfavourable for the foreign direct investors. In particular, one observes from the table that the mean of inflation rate of 20.23% is high and the observation that the maximum inflation rate was 73% suggests episodes of high inflation have been experienced in Nigeria.

At the same time, there have been periods when inflation in Nigeria was 4.7% which is the lowest inflation rate recorded in Nigeria over the study period. A low inflation rate of 5% or below is ideal for encouraging foreign direct investment inflow as well as encouraging local demand for goods in Nigeria, while a rate on average of 20% suggests that appropriate policies must be undertaken to address inflationary pressures in Nigeria.

Table 1. Descriptive Statistics of Variables

Descriptive Statistic	Real GDP (in Billions of Naira)	FDI (in Billions of US$)	INFR (In %)	INT (In %)	EXR (N/$)
Mean	31757	2.70	20.21	17.60	76.59
Median	22391	1.57	12.75	17.54	57.37
Max.	69023	8.84	73.10	29.80	253.49
Min.	13779	0.19	4.70	7.75	0.61
Std. Dev.	18151	2.64	18.21	4.76	72.04
Skewness	0.87	1.05	1.50	0.19	0.42
Kurtosis	2.32	2.78	4.00	3.48	1.99
N	36	36	36	36	36

Source: Authors' computation (2021)

Further the mean of interest rate of 17.60%, it is quite high as a rate of lending to encourage foreign investors, and a mean exchange rate of ₦76.59/US$ may not be sufficient to encourage exports from Nigeria to stimulate economic growth. Stimulation of exports from Nigeria may act as encouragement to multinational enterprises to establish in Nigeria through foreign direct investment.

4.3   Unit Root test of Variables

Time series data tend to be non-stationary by nature and therefore, for credible data analysis, must be tested for stationarity. This will ensure that the researcher does not have spurious regression. On that basis, the Augmented Dickey Fuller Unit root test procedure was applied to the data employed for in this study, and the results of the test are as presented in Table 2.

Table 2. Unit Root Test Results

Varia-bles	ADF Test Statistic	ADF Test Critical Values			Integ-ration
		1%	**5%**	**10%**	
LRGDP	-7.62	-4.26	-3.55	-3.21	I (2)
LFDI	-5.66	-4.36	-3.60	-3.23	I (0)
INFR	-4.19	-4.25	-3.55	-3.21	I (0)
INT	-4.79	-4.30	-3.57	-3.22	I (0)
EXR	-4.00	-4.25	-3.55	-3.21	I (1)

Source: Authors' computation (2021)

It shows that the variables in the model to be estimated are not all stationary at level but rather are at varying orders of integration. While Log of real GDP (LRGDP) is integrated of order 2, Log of foreign direct investment (LFDI), Inflation rate (INFR) and interest rate (INTR) are respectively integrated of order Zero, and exchange rate is integrated of order 1. In other words, Log of Real GDP must be differenced twice in order to be stationary; Log of foreign direct investment (LFDI), Inflation rate (INFR) and interest rate (INTR) respectively are stationary on their own without the need for differencing while exchange rate needs to be differenced once in order to be stationary.

The varying orders of integration of variables in the model to be estimated has implications for model estimation as it suggest that the most appropriate econometric technique that should be used to estimate the specified model in equation (3) is Autoregressive Distributed Lag Model (ARDL).

4.4 Autoregressive Distributed Lag Model Estimation Results

The results of Autoregressive Distributed Lag Model estimation of the model specified in equation (3) is presented in Table 3. The estimated model has R-squared of 0.998157 implying a well-fitted model. In particular 99.98% of variation in Real GDP is explained by the model. The Durbin-Watson statistic of 1.794623 indicates that the estimated model is free of autocorrelation, while the F-statistic of 1245.712 given its P value of 0.000000 indicates that the model estimated is valid since all parameters of the model are jointly statistically significant.

The constant of the model of 0.534396 is statistically insignificant, while the coefficient of foreign direct investment (LFDI) enters the model in its current year value, one period lagged value (LFDI(-1)) and two-period lagged value (LFDI(-2)). However of all the coefficients of FDI only the one period lagged value of FDI is statistically significant with a coefficient of 0.029581.

Table 3. ARDL Model Estimation Results

Dependent Variable: Log RGDP			Method: Least Squares	
Variable	Coeff.	Std. Error	t-Stat.	Prob.
C	0.5344	0.3013	1.7734	0.0894
LFDI	0.0013	0.0135	0.0960	0.9244
LFDI(-1)	0.0296	0.0125	2.3686	0.0266
LFDI(-2)	-0.0177	0.0137	-1.2929	0.2089
INFR	-0.0013	0.0004	-3.6104	0.0015
INFR(-1)	0.0012	0.0004	2.6509	0.0143
INFR(-2)	-0.0008	0.0004	-1.9835	0.0594
INTR	0.0033	0.0013	2.5361	0.0185
EXR	-0.0006	0.0003	-1.8587	0.0759
EXR(-1)	0.0012	0.0004	3.2604	0.0034
LRGDP(-1)	0.9169	0.0507	18.1013	0.0000
R-squared	0.9982	Adjusted R-squared		0.9974
F-statistic	1245.71	Durbin-Watson stat		1.7946
Prob(F-statistic)	0.0000			

Source: Authors' computation (2021)

This imply that a one percent increase in foreign direct investment inflow in the immediate previous period results in a 0.029581 percent increase in Real GDP in the current period. One possible reason for lag in the impact of FDI might include the time it takes to formalise the business transaction. Government needs to improve ease of doing business for foreign direct investors in order to reduce the transaction time.

Inflation rate enters the ARDL model in its current value as well as its one-period and two-period lagged values, with only the current period inflation and one-period lagged inflation rate having a significant impact on economic output in Nigeria. Current inflation rate has a statistically significant negative impact on economic output while one-period lagged inflation rate has a statistically significant positive impact on economic output in Nigeria. Exchange rate enters the ARDL model in its current and one-period lagged values. While impact of the present period exchange rate is insignificant, one-period lagged exchange rate has a statistically significant positive impact on economic output in Nigeria. Finally, one-period lagged Real GDP has a statistically significant positive impact on current Real GDP.

With regards to interest rate, interest rate has a statistically significant positive coefficient of 0.003276 implying a positive significant impact on economic output. While this may sound counter intuitive, it is in line with the theoretical framework provided by McKinnon and Shaw for developing countries. The positive relationship between interest rate and economic output is due to complementarity hypothesis and well as indivisibility of investment (Santana, 2013, 105-106). Other studies that have made reference to positive relationship between interest rate and economic output/growth include: Obamuyi, 2009; Próchniak & Witkowski, 2012; Imleesh *et al*., 2017; Dell'Ariccia, Rabanal & Sandri, 2018 and Awortu, 2018.

5.   Conclusion and recommendations

The role of Foreign Direct Investment (FDI) for the growth of any economy of the world cannot be underestimated. This is in view of the invaluable benefits that foreign direct investment brings to an economy, especially a developing economy as Nigeria. This present study investigated the impact of foreign direct investment inflow to Nigeria, on aggregate economic output, over the period of 1984 to 2019. The trend of foreign direct investment was examined in addition to the impact of FDI on Real GDP using both Augmented Dickey Fuller unit root test and Autoregressive Distributed Lag model. The findings suggest that foreign direct investment, despite its inflow to Nigeria in the past, has no instantaneous impact on Nigerian economy. Its impact is realised only after one year. This therefore suggests the need for appropriate policies not only to further the increase in FDI but to direct it to the most appropriate sectors of the economy where it will have its most valued and long term impact. It is anticipated that the findings of this study will give rise to improved policies of the government in driving increased FDI inflow to Nigeria in the future.

This study recommends the following:

i.   The Nigeria government should improve ensure the ease of doing business for foreign investors in order to reduce the time it take to realise the impact of the FDI inflow.

ii.   Policy makers should not evaluate the economic impact of FDI based on its short term impact within a year. They should allow at least one year gap for the impact to become materialised.

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Lamidi, Lukuman Olalekan graduated from Federal University of Agriculture Abeokuta (FUNAB) with Bachelor of Science degree in Agricultural Economic and Management. He obtained Master of Science degree in the same field from University of Ibadan. At the time of writing, he is one of the faculty in the department of agricultural extension and management at the prestigious Federal College of Animal Health and Production Technology, Ibadan.

Isiaka, Muideen Adejare is a senior lecturer in the department of Economics and Actuarial Sciences, Crescent University Abeokuta as well as the coordinator of Abeokuta Business School (Crescent University). He possessed a PhD degree in Economics from University of Ibadan. His research interest include financial economics, tourism, entrepreneurship, and business analytics.

Nsikan, Sam graduated from the department of Economics, Accounting and Finance, Bells University of Technology, Ota with Bachelor of Science degree in Economics. The main idea of the paper came out from his final year project work, under the supervision of Dr. Isiaka.