

## Review

# An empirical study on foreign investment in Nigerian economic development (1998-2009)

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### Abstract

The role played by foreign investment in the last (20) years in the Nigerian economy have been remarkable. Despite most policies adopted by the nation such as the Nigerian Enterprises Promotion Decree of 1977 which restricted the activities of foreign investors in investing in the Nigerian economy. Foreign investment still account for a greater promotion of cash flow in the gross domestic product (GDP) of the nation. The amount of funds available to every investment depends on the level of savings and consumption. It is general rule that every frugal economy assumed that  $I = S$  (where  $I =$  investment,  $S =$  Savings,  $C =$  Consumption and  $Y =$  Income). The objective of this study is to basically evaluate the roles play by foreign investments in the Nigerian economy using the period between 1998 and 2009. The gap filling theory was adopted to serve as the foundation bases of this work. Various readings and review of relevant textbooks, journals, magazines and internet were use as data collection.

**Keywords:** Foreign Investment, gross national product, economic growth, direct investment, multi –national corporation, portfolio investment, indigenious industry.

## INTRODUCTION

The evolution of investment could be dated back to the early form of capitalism, where the means of production, distribution, exchange of goods and services are allowed to be owned and controlled by private and corporation bodies; they accumulate funds through savings and invest them in profit yielding ventures. Investment involves commitment of capital to a project or venture with a view for profit. Majorly, purchasing of stocks and shares or bonds would be an investment. Foreign investment is a means of filling economic gaps which could not be attained by the nation given her resources and level of resources utilization, (Todaro 1977).It implies that the external commitment of funds into the Nigerian economy other than the people of the country, which increases the stock of capital available in the economy with the aim of getting a section.

Now about 52 years after independence, the picture of foreign investment in Nigerian economy has changed. The Nigerian economy has grown and more resources are needed to maintain the growth. There are increase in

the number of industries due to foreign capital inflow over what was had in the 1970's.Late 1980's the rate of foreign investment has showed, some of the existing foreign investors were already diverting and divesting their interest in the country. The federal government in an effort to find a solution to the problem, introduced (SAP) Structural Adjustment Programme. Since the reforms, the government has continued to gear up effort towards creating a conducive environment for inflow of foreign investments. With the economy deregulations and many of the existing laws (restrictions) removed, it improved inflow of capital from foreign investors. The adjustment programme among others include:

- Creation of second tier foreign exchange market, resulted from the abolition of import licensing system.
- Permission for foreign investors to own about or up to 100% equity in new business in the country.

About 25 years ago, foreign investment has been playing a very vital role in the growth and development of the nation's economy. Severally, economic growth and development has been used interchangeably. Essang S.M and Olayide S.O (1974), defined economic growth as an increase in real per capital income over time; while economic development a process whereby the real per

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capital income increases over time. Therefore, one can see that in considering economic development, all characteristics of the economy which make possible sustained and cumulative growth in the real per capita income are obtained.

They include qualitative improvement in labour, a rational system of resources allocation in the interest of efficiency, the development of administrative, political and physical infrastructure, and a distribution of income conducive to national integration. The activities of foreign investors in investing in the Nigerian economy have helped in advancing the country both in technical know-how, managerial efficiency and entrepreneur ability.

Political instability that have been existed in Nigeria for a longtime, contributed to the slow in the investment activities of most foreign investors. Foreign investors' exploitative orientation, foreign monopoly capital, inherent tendency to resist and hamper local industrialization and to perpetuate mercantile capitalism and deliberate effort to retard the growth of indigenous entrepreneurship are associated with the problems of foreign investment in Nigeria.

### **Literature Review and Conceptual Framework**

Addressing foreign investment problems is important because of the need to avoid the ills caused by foreign investment activities in the Nigerian economy. Apart from causing social menace, foreign investment amounts to high dependence and exploitative orientations. The relevance and effectiveness of foreign investments in the Nigerian economy should be thrown light to, so as to enable the government to pursue those policies that will encourage foreign investment inflow to the economy.

The concept of foreign investment lacks a generally acceptable definition. Todaro (1977) defined foreign investment as a means of filling certain economic gaps which could not be attained by the nation given her resources and level of resources utilization. Kobrin (2004), defined foreign investment as the external commitment of fund into any economy other than the people of the economy which increase the stock of capital available in that economy with the view of profit.

Meier (2009), described foreign investment as a means of increasing resources devoted to capital formation over and above what the economics of the nation provide thus supplementing domestic saving of the nation they needed for economic development. From the above definitions, one could perceive foreign investment as an instrument of capital formation which helps in supplementing the domestic savings of the country. The inflow of foreign investment capital helps in economic growth and development through their financial support, technological transfer, managerial and entrepreneurial spirit sown in the county. Sometimes activities of foreign

investors lead to economic recession. It is only through policies that are capable of creating better conducive environment for foreign investments and enhancement of economic activities in the economy that can save the country from the social menace that are common with foreign investment. I can then draw a conclusion that, foreign investment connotes the activities of foreigners in the economy which increases the amount of funds committed to investment in the country with the hope of getting some returns to be remitted to their home country.

Majorly, foreign investment could be in form of portfolio investment or direct investment."Direct investment" does not acquire securities rather it has full control of the enterprise investment. It involves foreign firms or investors setting up factories or services in another country. This means that establishing companies by foreign firms to the advantage of indigenous which could not have afforded the investment by them. While "Portfolio investment" involves foreigner acquiring equity shares in the enterprises in another country. This means that foreign investors will only invest their funds in the economy by acquiring existing shares or buying shares in that particular country. They do not have full control of the investment.

A review of literature on the role of foreign investment in the Nigerian economy reveals that foreign investment has both positive and negative roles in the Nigerian economy. Todaro (1977) pre-occupied himself with the 'gap filling theory'. He argued that foreign investment capital fills the gap existing between targeted investment and locally mobilized savings. Also fills the gap which exist as a result of a divergence between government targeted revenue and locally raised tax in the economy. And help to solve the problem of balance of payment. According to Todaro in this theory, the Nigerian government unlike every other national human being has numerous investment target to be achieved but the resources available cannot meet up with these targets and hence the need for external help.

Meier (1976) was of opinion that in view of the redefining of development objectives by the developing countries, he asserted that the greatest advantage of foreign investment to a nation is the access of foreign knowledge. He holds the fact that the rate of technological advance in any country is tightly dependent on the rate of capital flow. He believed that because foreign investment on any industry makes its product cheaper, other industries that uses its product as inputs benefits from the lower price, thereby generating profits and so stimulates expansion in the secondary industry. This leads to an increase in the country's gross national product (GNP) in a multiplier technique.

Oyaide (1997) argued that the benefits of foreign investment to Nigeria based on the development of import-export trade has not only led to the absorption of Nigerian national economy but also entrenched her firmly in the political and economic orbit of the donor countries

thereby pushing her along the path of economic development.

In examining the effects of foreign investment in the less developed countries (LDC), one can see that the Nigeria external reserves are being continuously depleted as a result of over pricing of foreign products and capital goods, this affects Nigerian balance of payment adversely. The manufacturing sector which is dominated by the foreign investors is characterized by low technology, high import dependence, and value added. Multi-national corporations reap very high profit mainly through the exploitation of cheap labour, monopoly power, and tariff protection. Other researchers observe that the displacement effect of (MNCS) Multi-national corporations or foreign investors on the economy's technological developments, local capital, indigenous market shares shows that they inhibit the peace of indigenous manufacturing. For the fact that the technology is capital intensive it leads to labour saving and since the essential inputs are imported it is also foreign exchange intensive.

Taylor and Samo (1997) argued that the foreign investors reinforced the dependence of the less developed countries (LDCS) to the rich nations. The attainment of independence in (1960), the economic dependence of the country became transformed. These foreign investors lacked economic planning, their existence in Nigeria some years ago could not affect certain changes in the economy, such as solving the problems of inequality income distribution, unemployment, poverty that have remained with the under development nations for years now. One can believe that the multinational corporations (MNCS) are in this country to make cheap profits and interests through the exploitation of Nigerian's natural endowments. The presence of their superior technology which is lacking in the developing countries including Nigeria enable the foreign investors to exploit much of the mineral deposits in the country (Nigeria) and offer whatever price they deemed favourable to them not the nation and move away with huge profits to their home country.

Generally, they remove much revenue and raw materials at cheap rates at the expense of the host countries (under-developed nations). Such are processed at their home countries and re-exported to such developing countries at exorbitant prices.

The Nigerian market is characterized by excessive dependence on crude oil which poses a major strategic risk for the country's economy, a weak manufacturing sector largely as a result of inadequate power supply, high unemployment, and food insecurity. Other characteristics include weak infrastructure, a weak export base that has created a high level of import dependency, and deteriorated educational and health system. All these characteristics, however, create investment opportunities (Sam. A 2009).

Morrisset (2000) suggests that the most import and

features of developing countries that successfully attract foreign investment is aggressive trade liberalization and privatization programmes. He then argued that stable macroeconomic and political environments are important factors that attract significant levels of investment. Ngowi (2001) also points out that the main factors preventing an increased inflow of foreign investment in Nigeria and in Africa at large is high risk because they are characterized by a lack of political and institutional stability.

Conclusively, foreign investment is beyond how many companies come into the host country as foreign investors but the quality and structure of foreign investment they brought. Because, it is widely believed that foreign investment is essential for development and certainly can play a key role in development of a nation, provided certain conditions are met; but they serve as complements but does not substitute local factors that are essential for development. Therefore, the global economic crisis has led to a downturn of foreign investment flows world-wide, including to Nigeria.

### **The Description of data and methodology**

The research covered Nigeria over the period of 1998-2009. All data was obtained from the various readings and reviews of relevant textbooks, journals/articles, and Statistical Bulletin of Central Bank of Nigeria. The different economy sectors ranging from agricultural sector, industrial sector, manufacturing sector, construction, mining and quarrying sector are been considered. It touches foreign direct investment (FDI) in Nigeria and its effect on the economy of Nigeria and the problems facing foreign capital inflow of foreign investments in the country.

### **Economic Analysis**

Economic model used was Ordinary Least Square Estimation (OLS) with the period under review 1998 to 2009. The model tries to show and find out the degree of foreign investment inflow and contribution to the development of the Nigeria economy. The efficacy of the identified variables under view and test for their significance in influencing the rate of effectiveness in the Nigeria economy was also determined.

The hypothesis tested was whether "Foreign investment has no significant effect on the nation's economy (GDP)", or otherwise.

$$Y = f(x)$$

$$Y = a_0 + a_1 X + u$$

Where

Y = Gross Domestic Product (GDP) Dependent Variable

X = Foreign Investment Independent Variable

$a_0$  = Intercept of the true regression

$a_1$  = Slope of the regression

**Table 1.** Simple Regression Test by using Stata 10

Source	SS	df	MS
Model	316877752	1	316877752
Residual	1207669.26	10	120766.926
Total	318085422	11	28916856.5

**Table 2.** Coefficient Test

Y	Coef.	Std.Err.	T	p>(t)	(95% Conf. Interval)
X	1.609548	-0314219	51.22	0.000	1.539536 1.67956
.Cons	-8.31705	163.8114	-0.05	0.961	-373.3115 356.6774

**Table 3.** Decomposition of IM – test

Source	Chi 2	Df	P
Heteroskedasticity	0.89	2	
Skewness	1.56	1	0.2119
Kurtosis	0.36	1	0.5464
Total	2.81	4	0.5901

U = Unexplained variable /stochastic variable (Table 1-3)

Number of obs = 12  
 F (1, 10) = 2623.88  
 Prob >F = 0.0000  
 R- squared = 0.9962  
 Adj R – squared = 0.9958  
 Root MSE = 347.52  
 Ho: Constant variance  
 Variables: fitted value of Y  
 Chi 2 (1) = 0.83  
 Prob > chi 2 = 0.3625

A simple regression test was conducted to predict the significance of the foreign investment or influence of foreign investment in the national income and growth of the nation (Nigeria). The value of R<sup>2</sup> coefficient of correlation gotten when the data was regressed, shows a positive relationship between the foreign investment and national income (GDP). Using the coefficient of determination, the proportion of the error of the regression line when the GDP is regressed on the foreign investment, the coefficient of determination R<sup>2</sup> = 0.9962. Meaning that 99.62% (percent) of the error is explained mainly by the regression method used. More also the calculated value of t falls in the area of rejection. Therefore Ho is rejected at the level of 0.05 level of significance. This confirms that there is favorable signal of relationship between the foreign investment and economic growth of a nation.

## CONCLUSION

This paper has looked at the role played by the foreign investments as a determinant of the Nigerian economic growth and development. And there was clear evidence that the foreign investments has a favorable influence on the Gross Domestic Product of Nigerian economic if it is well managed. Nigeria should seek foreign investment and ensure the presence of adequate infrastructure, political stability and strong market.

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