

## EFFECT OF FOREIGN DIRECT INVESTMENT ON NIGERIAN ECONOMIC GROWTH

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### ABSTRACT

This paper determined the relationship between foreign direct investment, exchange rate and gross domestic product. Using time series data, data for the study were collected from CBN Statistical Bulletin from 2008 to 2013. Pearson Correlation was used to test the hypothesis with aids of SPSS version 20.0. The findings revealed that there is a significant relationship between FDI, EXR and GDP, indicates that economic growth in Nigeria is directly related to foreign direct investment and exchange rate. The paper thereby recommends among others that there is need for government to be formulating investment policies that will be favorable to local investors in order to compete with the inflow of investment from foreign countries.

**Keywords:** FDI, Exchange rate and economic growth.

### INTRODUCTION

The rapid growth of interest in foreign direct investment (FDI), stand from the perceived opportunities derivable from utilizing this form of foreign capital injection into the economy, to augment domestic savings and further promote economic development in most developing economies (Aremu 2005). According to Alfaro, (2006) Policymakers believe that FDI produces positive effects on host economies. Some of these benefits are in the form of externalities and the adoption of foreign technology.

Olokoyo, (2012) stated that Foreign investment inflow, particularly foreign direct investment (FDI) is perceived to have a positive impact on economic growth of a host country through various direct and indirect channels. It augments domestic investment, which is crucial to the attainment of sustained growth and development. Governments have been trying to lift the country out of the economic crisis without achieving success as desired. Each of these governments has not focused much attention on investment especially foreign direct investment which will not only guarantee employment but will also impact positively on economic growth and development. FDI is needed to reduce the difference between the desired gross domestic investment and domestic savings (Eravwoke & Eshanake, 2012).

Most studies on FDI and growth are cross country studies. However FDI and growth debates are country specific. Among Nigeria studies like those by Chowdhury and Mavrotas (2006); Olokoyo, (2012); Omankhanlen, (2011); Cuadros, Orts and Alguacil (2001); Lumbila (2005); Ayashagba and Abachi (2002); Saibu and Keke (2014) examined the importance of

FDI on growth for several period and the channel through which it may be benefiting the economy. In the literature there exist a direct positive link between export growth and the growth of an economy. This growth in export can further be traced down to the level of investment which in most cases can be domestic or foreign investment.

Considering the various criticism of empirical studies on how foreign direct investment in Nigeria affects its economic growth, there is need for further studies to be carried out on how FDI affects the economic growth of the Nigeria after the financial crisis. This is so given that foreign investment remains the sure way of economic growth. Given this fact assessment will be based on the existing link among Foreign Direct Investment, Exchange rate and Gross Domestic Product.

### **Hypothesis (null)**

**H<sub>0</sub>:** There is no significant relationship between FDI, Exchange Rate and economic growth in Nigeria.

## **REVIEW OF RELATED LITERATURE**

### **Conceptual Framework**

Jenkin and Thomas (2002) are of opinion that FDI is expected to contribute to economic growth include the provvision of foreign capital as well as 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.

Adegbite and Ayadi (2010) stated that 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.

Foreign direct investment includes; external resources including technology, managerial and marketing expertise and capital. All these generate a considerable impact on host nation's productive capabilities and the success of government policies of stimulating the productive base of the economy depend largely on her ability to control adequate amount of FDI comprising of managerial, capital and technological resources to boast the existing production capacity (Omankhanlen, 2011).

Kumar (2007), described Direct Foreign Investment (DFI) in several ways. First and most likely it may involve 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 short-or foreign investment as a share of Gross Domestic Product has grown rapidly, becoming the largest source of capital moving from developed nations to developing nations.

### **Empirical Framework**

Omankhanlen, (2011) deals with the effect of Foreign Direct Investment on the Nigerian economy over the period 1980-2009. He examined empirically if the following growth determining variables in the economy-Balance on current account (Balance of payment), Inflation and Exchange rate have any effect on Foreign Direct Investment. Also if Foreign Direct Investment have any effect on Gross Domestic Product (GDP). The study developed Econometric models to investigate the relationships between the aforementioned variables

and foreign direct investment. Based on the data analysis it was discovered that foreign direct investments have positive and significant impact on current account balance in Balance of payment. While inflation was seen not to have significant impact on foreign direct investment inflows.

Chowdhury and Mavrotas (2006) examines the causal relationship between FDI and economic growth by using time-series data covering the period 1969-2000 for Chile, Malaysia and Thailand. The study used the Toda and Yamamoto causality test approach. Their findings revealed that GDP causes FDI in the case of Chile and not vice versa, while for both Malaysia and Thailand, there is strong evidence of a bi-directional causality between the two variables.

Olokoyo, (2012) examined the effects of Foreign Direct Investment (FDI) on the development of Nigerian economy. The paper tried to answer the question: what are the FDI determinants in Nigeria and how do they affect the Nigerian economy? The study employed the use of Ordinary Least Square (OLS) regression technique to test the time series data from 1970 – 2007. The Cochrane-Orcutt iterative method was also used to correct for autocorrelation. The model used hypothesizes that there is a functional relationship between the economy development of Nigeria using the real gross domestic product (RGDP) and Foreign Direct Investment. The regression analysis results evidently do not provide much support for the view of a robust link between FDI and economic growth in Nigeria as suggested by extant previous literatures. Though the result does not imply that FDI is unimportant, the model analysis reduces the confidence in the belief that FDI has exerted an independent growth effect in Nigeria.

Cuadros, Orts and Alguacil (2001) studied the nature of the causal relationship between output level, inward foreign direct investment and trade in latin American countries; Argentina, Brazil and Mexico from the middle seventies to 1997. Utilizing a vector autoregressive (VAR) model the result of the study suggests a significant impact of foreign direct investment on economic growth and trade in the analyzed countries.

Ayashagba and Abachi (2002) investigate on the effects of foreign direct investment on economic growth from 1980 to 1997. Their result revealed that foreign direct investment had significant impact on economic growth in Nigeria. However, the study concludes that the presence of foreign direct investment in the LDCs particularly in Nigeria is not totally useful.

Eravwoke and Imide (2013) analyzed corruption, foreign direct investment and its impact on exchange of the Nigerian economy. The ultimate objective of this study centers on an empirical investigation of the impact of corruption, foreign direct investment and its impact on exchange rate of the Nigerian economy. In order to achieve these objectives the study used the ordinary least squares regression analyses, augmented dickey fuller unit root test and the co-integration test. The unit root test revealed that all the variables were stationary at first difference and the short run result revealed that corruption is very high in Nigeria and that have help to depreciate the currency of the country with regards its exchange to other currencies.

Adewumi (2006) examine the impact of foreign direct investment on economic growth in Africa using graphical and regression analysis. The study revealed that the contribution of foreign direct investment to growth is positive in most of the countries but not significant.

While contributing to the debate on the joint effects of aid and FDI in economic development estimated a panel data for countries in the Southern Africa region.

In another line of study, Makki and Somwaru (2004) analyzes the role foreign direct investment and trade in economic growth of developing countries within the endogenous growth-theory framework. The study used cross-section data relating to a sample of 66 developing countries over three decades. Findings revealed that foreign direct investment and trade contribute toward advancing economic growth in developing countries and that foreign direct investment is often the main channel through which advanced technology is transferred to developing countries.

Saibu and Keke (2014) examined the impact of Foreign Private Investment on economic growth using annual time series data from Nigerian economy. The paper employed Cointegration and Error Correction Mechanism (ECM) techniques to empirically analyze the relationship between foreign private investment and economic growth and to draw policy inferences on the observed relationship. The study revealed that there was a substantial feedback of 116% and 78% from previous disequilibria between long-run economic growth and foreign private investment respectively. The findings also indicated that a substantial proportion of capital inflow were not productively invested however the relatively small proportion (22%) of net capital inflows invested, contributed significantly to economic growth in the Nigerian economy. The political environment was found to be unfavorable and overwhelmed the positive impact of foreign private investment.

Bailliu and Jeannine (2000) used panel data from 40 developing countries from 1975–95. The study specified a model which accounted for potential endogeneity of the explanatory variables and the result shows that capital inflows foster higher economic growth, above and beyond any effects on the investment rate, but only for economies where the banking sector has reached a certain level of development.

In a similar study, Lumbila (2005) examined a panel analysis of the effects of foreign direct investment (FDI) on economic growth from 47 African countries over two decades (1980–2000). Utilizing a seemingly unrelated regressions (SUR) technique of analysis the study revealed that foreign direct investment exerts a positive impact on growth in Africa.

Using data from several investor surveys, the study of Asiedu (2002) suggest that macroeconomic instability, investment restrictions, corruption and political instability have a negative impact on foreign direct investment (FDI) to Africa. Using time series data covering the period 1970-2003.

## METHODOLOGY

This research focused on the effect of foreign direct investment, exchange rate on economic growth in Nigeria. Using time series, data were obtained from the CBN Statistical Bulletin.

**Data required and source:** Data used in this analysis was secondary data and was sourced from central bank of Nigeria. (CBN) statistical bulletin (2008 to 2013). Specifically, Pearson Coefficient was adopted to determine the relationship between GDP and FDI and EXR.

Where in GDP-log of gross domestic product

FDI- foreign direct investment

EXR-exchange rate

**RESULT INTERPRETATION**

		<b>Correlations</b>		
		FDI	EXR	GDP
FDI	Pearson Correlation	1	.585	-.045
	Sig. (2-tailed)		.222	.933
	N	6	6	6
EXR	Pearson Correlation	.585	1	.306
	Sig. (2-tailed)	.222		.555
	N	6	6	6
GDP	Pearson Correlation	-.045	.306	1
	Sig. (2-tailed)	.933	.555	
	N	6	6	6

Indeed, from the above figure, correlation coefficient of 0.585,-0.045 and 0.306 indicates both positive and negative correlation among FDI, EXR and GDP. To get an idea of how much variance the variables share, the coefficient of determination (R) is calculated. R is  $0.585 \times 0.585 = 0.3422$ . It implies that FDI help to explain 34% of the variance in EXR while R is  $-0.045 \times -0.045 = 0.002$ . It implies that FDI help to explain 2% of the variance in GDP. R is  $0.306 \times 0.306 = 0.094$ , implies that GDP help to explain 9% of the variance in EXR .From the above result, the study discovers that the confidence level between FDI and EXR is normal. It means that correlation coefficient is significant at 0.05 level. But the confidence level between FDI and GDP is not normal. It means that correlation coefficient is not significant at 0.05 level while the confidence level between GDP and EXR is normal. It means that correlation coefficient is significant at 0.05 level. Based on the statistical result, the economic growth of the country Nigeria is still at an infant stage, it shows that the extent of growth is still fluctuating. It can be seen that the exchange rate of Naira with that of other foreign countries is very high and this has affected the growth of foreign investment in the country.

**CONCLUSION AND RECOMMENDATIONS**

The study examines an analysis of the effect of foreign direct investment on Nigeria's economic growth using time series data from CBN statistical Bulletin over the period of 2008-2013. The findings revealed that there is a significant relationship between foreign direct investment, exchange rate and gross domestic product. However, it means that economic growth is directly related to inflow of foreign direct investment and the level of exchange rate. it is also implying that the performance of the economy is still fluctuating having been affected by variables like the level of exchange rate and investments needed to improve in order to achieve economic goals.

## Recommendations

In the light of the above findings, the followings, i.e. recommendations are proposed:-

1. Government should provide enabling environment that will be conducive for doing business in Nigeria, so as to attract the inflow of FDI.
2. There is need for government to be formulating investment policies that will be favorable to local investors in order to compete with the inflow of investment from foreign countries.
3. Favorable exchange rate policies should be formulated and implemented to facilitate exchange rate – export growth economically at the Nigerian economy.

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## APPENDIX

**Table 4.1.1: Nigeria Foreign Direct Investment, Exchange Rate and Gross Domestic Product From 1999 - 2013.**

YEAR	FDI (#M)	EXR	GDP at Current Price
2008	20409	84.62	24,296,329.29
2009	26381	98.91	24,794,238.66
2010	41971	97.13	33,984,754.13
2011	54425	99.67	37,409,860.61
2012	34115	98.05	40,544,099.94
2013	52391	96.16	9,493,779.44

Source: CBN Statistical Bulletin