Article

Foreign Direct Investment and Growth Nexus: Further Evidence from Africa's Largest Economy

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Abstract

The study investigated the effect of foreign direct investment (FDI) on economic growth in Nigeria, which is currently Africa's largest economy, and also determined the long-run relationship between FDI and economic growth in Nigeria from 1981 to 2017. The study adopted the autoregressive distributed lag modelling approach and ordinary least square in the analysis. The empirical results revealed that FDI has a positive and significant relationship with economic growth in Nigeria within the period under review. The study concluded and recommended that Nigerian Government should formulate policies that will attract more FDI in all sectors of the economy especially in the service and manufacturing sectors, so as to improve the infrastructural facilities and production of goods in the country and also expand its labour force. Finally, there is need to improve the educational policy of the country in order to raise the stock of human capital in the country that will make useful policies for the attraction for productive FDIs in the country.

JEL Classification: E22, F21, F23, F43

Keywords

Foreign direct investment, economic growth, autoregressive distributed lag, OLS, Nigeria

1. Introduction

Foreign direct investment (FDI) is viewed as an investment in the form of a controlling ownership in a business in a specific nation by an individual or organisation situated in another nation. FDI involves mergers and acquisitions, building new facilities, reinvesting benefits earned from abroad tasks and intercompany loans (Orji et al., 2019). FDIs are usually made in open economies that offer a talented workforce and development possibilities of the financial specialists that are better than expected, as opposed to tightly regulated economies. It continually includes something other than a capital venture, however incorporates provisions of management or technology as well. From the perspective of

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International Monetary Fund (1993) and Organisation for Economic Cooperation and Development (1996), direct investment uncovers the points of getting an enduring enthusiasm by an inhabitant substance of one economy (a direct investor) in an endeavour that is an occupant in another economy (the direct enterprise). The investment is direct when the investor, which could be a foreign individual, organisation or group of entities, needs to control, oversee or have a critical impact over the foreign enterprise. For as long as two decades, FDI has gotten progressively significant in the developing world with a growing number of developing nations prevailing with regards to pulling in considerable and rising measures of inward FDI inflow. Most economic theories on FDI have distinguished various channels through which FDI inflows might be helpful to the economy (Anthony-Orji, Orji and Ogbuabor 2018).

Policymakers around the globe accept that FDI helps the efficiency of host nations and promote economic growth and development. The reality about the confidence in FDI is that it doesn't just gives capital financing yet, in addition, realises positive externalities through the appropriation of foreign technology and technical know-how (Alfaro et al. 2006). Asian Development Outlook (2004) uncover it as of late that FDI has altogether expanded because of numerous components, for example, rapid technological progress, emergence of globally integrated production and marketing networks, existence of bilateral investment treaties, recommendations from multilateral development banks and positive evidence from developing countries that have opened their doors to FDI.

Since the end of Bretton Woods' system, researchers in their different studies have investigated the contribution of inward FDI to the development of the developing countries such as West African countries or the sub-Saharan African countries, where FDI now serves as an important means of private external finance (Anthony-Orji et al. 2018a). For a developing country like Nigeria, FDI is considered as a way of transforming technology and capital from other developed and even developing countries to the domestic economy. Melnyk et al. (2014) believe that when FDI comes to a domestic country (in specific business), that firm receives a competitive advantage due to the usage of new technology, experience, ways of production and management. Melnyk et al. (2014) also opined that FDI contributes significantly to human resources development, capital formation and organisation and management skills of the people in an economy.

According to Umah (2007), the reforms resulted in the adoption of liberal and market-oriented economic policies, the stimulation of increased private sector participation and elimination of bureaucratic obstacles which hinders private sector investment and long-term profitable business operations in Nigeria. This, for instance, is to encourage the existence of foreign multinational and other private investors in some strategic sectors of the Nigerian economy like the oil industry, banking industry, communication industry and others. Furthermore, the Nigerian Government has enacted various policies, laws even institutions aimed at encouraging FDI, for example, in 1995, the Nigeria Investment Promotion Commission, was established through Decree No 16 of 1995. To ensure proper protection, the Nigeria Investment Promotion Commission Decree repealed the Industrial Development Coordination Committee Decree No 36 of 1998 and the Nigeria Enterprise Promotion Decree of 1972. Dunning (1993), however, noted that FDI is attracted to serve as a means of augmenting Nigeria's domestic resources to effectively carry out her development programmes and raise the standard of living of her people.

In the 1970s and 1980s, several countries in sub-Saharan Africa, especially Nigeria imposed trade restrictions and capital controls as part of a policy of import-substitution industrialisation aimed at protecting domestic industries and conserving foreign exchange reserves. Therefore, improvements in economic policies are needed to enhance macroeconomic performance and attain the minimum growth rate required to meet the Millennium Development Goals set by the United Nations (Akanegbu and Chizea 2017). The Figure 1 shows the FDI in Nigeria from 1981 to 2017.