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Impact of Foreign Direct Investment on Economic Growth in Nigeria

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ABSTRACT

This study investigated the impact of foreign direct investment on economic growth in Nigeria between 1990-2024.It used time series models and tests to investigate the impact of FDI on Nigerian economic growth for the periods. ADF test for unit root result suggests that some variables are integrated of order one I (1), stationary at their first differences and the remaining variables are integrated of order zero I (0), stationary at their level. Bound test of co-integration test indicates the presence of long-run co-integration among the variables. The long run estimates indicated that human capital and Debt can have a positive impact on economic growth in Nigeria. For example, debt can be used to finance investments in infrastructure, education, and healthcare. These investments can lead to increased productivity, higher incomes, and improved living standards. Debt can also be used to finance government programs that support economic growth, such as subsidies for businesses or tax breaks for investors. Additionally, debt can be used to smooth out economic downturns by allowing the government to maintain spending levels even when tax revenues are low on the one hand, inflation, exchange rate and political instability have a significant and negative impact on economic growth in Nigeria, while FDI and trade openness was both insignificant and have negative impact on economic growth of Nigeria. Meanwhile, the estimated coefficient on the error correction term is the speed of adjustment or the adjustment coefficient, which shows that the long-term economic growth shock is adjusted (back to) equilibrium by 79.27% within a year. Foreign direct investment (FDI) has a significant impact on Nigeria's economy. It can lead to job creation, technology transfer, and economic growth. However, it can also have negative consequences, such as environmental damage and exploitation of workers. Base on the findings, the paper now recommends that the government should embark on a policy that encourages inflow of FDI for sustainable economic growth.

Keywords: Economic growth, ECM, Co-integration, FDI, Granger Causality, Nigeria

INTRODUCTION

The world has increasingly recognized that private capital has a vital role to play in development. The United Nation Millennium Declaration explicitly calls for greater foreign direct investment (FDI) to Africa. Over the course of the 1990s, African countries significantly liberalized the environment for foreign investment. Nearly all countries revised their national laws governing FDI and the vast majority lifted controls on capital. Foreign Direct investment (FDI) is an increasingly important channel for resource flows between the industrial and developing countries. Several real and potential benefits apparent from these flows that include technological spillovers, job creation, improved managerial skills and productivity (Ibrahim, & Sare, 2018). Given the capital deficient nature of least developed countries and the benefits accruable from these activities, FDI is essential for growth and development.

One of the economic problems of developing countries is that they do not have enough national savings to finance their investments. They are in constant need of foreign capital in forms of both direct and indirect investments. Initially, they took loans from international commercial banks. But the gradual drying-up of commercial bank lending, because of debt crises, forced many countries to reform their investment policies so as to attract more stable forms of foreign capital, and FDI appeared to be one of the easiest way to get foreign capital without undertaking any risks linked to the debt. Thus, it became an attractive alternative to bank loans as a source of capital inflows. Foreign Direct Investment (FDI) affects economic growth of developing countries positively through transfer of capital, know-how, and technology (Hasan, G., & Ringim, S. H. 2017). The effect can spread to other firms in the country and sectors through technology spillover, human and capital formation and

increasing competition, thus raising productivity for the whole economy. FDI can also accelerate growth in the ways of generating employment in the host countries, fulfilling saving gap and huge investment demand. Foreign direct investment (FDI) plays a significant role in the fast evolving process of globalization and global economic integration. Direct, dependable, and long-term relationships between economies can be built through FDI. It may also serve to improve the competitiveness of both the recipient ("host") and investing ("home") economies by serving as a primary channel for local enterprise development. Foreign direct investment, in particular, encourages the exchange of information and technology across countries. Furthermore, it allows the host country's economy to expand the distribution of its products in overseas markets. FDI is a key source of money for a range of host and home countries, and it also has a favorable influence on the growth of international trade. (OECD, 2008).

The substantial significance that FDI plays in developing nation's development plans has recently come to their attention. It is viewed as a crucial component in Africa in particular for bridging the gap between domestic savings supplies and investment demands, for technology transfers, for enhancing job creation, for adding value to human skills, and for raising host country aggregate productivity (Todaro and Smith, 2012). According to OECD, the policy frameworks for FDI of Africa countries on average are not restrictive than other developing countries (OECD, 2005). However, although the African continent has made notable efforts to attract FDI, the inflows of FDI are very small compared to other developing nations. For instance, among the FDI inflows to developing countries between the periods 2005 to 2010,

African share was only around ten percent and also characterized by uneven distribution among countries in the region (UNCTAD, 2023). This study contributes to the literature in several insightful ways. It contributes to the existing literature by relying on recent data and using alternative proxies of economic growth and foreign direct investment inflows. To the best of my knowledge, this study is among the first studies to examine the impact of FDI inflows on economic growth using recent data and using different measures of economic growth and foreign direct investment in the case of Nigeria. The rest of the article is structured as follows. Section II presents the literature review. Section III presents the methodology. Section IV discusses the results. Section V concludes the study.

LITERATURE REVIEW

FDI is defined differently by various organizations. For instance, direct foreign investment is among the three elements of global financial movements, along with bank loans from industrialized nations to developing ones and portfolio investments (Todaro and Smith, 2012). Various criteria have been used to identify various FDI kinds. FDI is divided into four categories based on the strategic goal of the investment: seeking market, resources, efficiency, and strategic assets. Investments in resource extraction seek to get components of production that are more efficient than those available in the farm's domestic economy. Market-seeking ventures attempt to preserve or build on existing markets. Efficiency-seeking investments strive to improve organizations' efficiencies by leveraging scale, breadth, and shared ownership advantages (UNCTAD, 2023).

FDI can also be divided into horizontal and vertical categories. Horizontal FDI is the term used to describe the overseas production of goods and services that are comparable to those produced domestically. Multinational corporations that spatially disperse manufacturing processes are referred to as vertical FDI. Because a multinational organization (MNE) creates a product through numerous stages and a variety of manufacturing processes, it is known as vertical (Bakari, S., Mabroukib, M., & Othmani, A. (2018). Several studies in the literature examined the economic effects of foreign direct investment. For instance, Nangpiire et al (2018) assess the effect of ease of doing business on foreign direct investment (FDI) inflows in Sub-African countries. They find that the ease of doing business indicators significantly influence FDI inflows in Sub-Sahara African countries. The authors recommend that the government or policy makers should adjust their ease of doing business procedures to attract foreign direct investment. Contractor et al (2024) examine the impact of regulatory variables in attracting or deterring foreign direct investment in 189 countries. They discovered that countries with stronger contract enforcement and more efficient international trade regulations attract more FDI. Eregha (2019) examines the effect of exchange rate, its volatility and uncertainty on foreign direct investment inflows in West African monetary zone (WAMZ) countries from 1990 to 2014.

The results show that exchange-rate movements in WAMZ countries affect FDI inflow. Some studies examine the case of Nigeria. For instance, Akinwale et al (2018) explore the impact of foreign direct investment on agricultural productivity in Nigeria. They use the Augmented Dickey-Fuller (ADF) test, Johansen test and Error Correction Model to examine the effect of foreign direct investment on agricultural productivity in Nigeria. They find that both foreign direct investment and bank credit to the agricultural sector have a significant effect on agricultural productivity. Aderemi et al (2024) investigate the determinants of FDI inflows in Nigeria from 1990 to 2017. They find that the determinants of FDI inflows in Nigeria are past FDI inflows, market size, exchange rate and growth rate.

These macroeconomic variables have a positive and significant impact on FDI inflows in Nigeria, while the inflation rate discourages FDI inflows in the country. Omodero (2019) investigates the effect of corruption on foreign direct investment inflows in Nigeria from 1996 to 2017 using ordinary least squares. The study finds that corruption has a significant positive influence on FDI. Alabi (2019) investigates the impact of foreign direct investment on economic growth in Nigeria from 1986 to 2017. They find that foreign direct investment has a positive and significant effect on economic growth in Nigeria. Ehigiamusoe and Lean (2019) examine the impact of foreign capital inflows on economic growth in Nigeria from 1990 to 2015. The authors employ the autoregressive distributed lagged (ARDL)-bounds test. They find that foreign direct investment and foreign aid have an insignificant impact on economic growth in Nigeria.

METHODOLOGY

Macroeconomic and macro-financial data for Nigeria were extracted from the World Bank's World Development Indicators. The Nigerian data in the World Bank database was supplied by the Nigerian Bureau of Statistics and the Central Bank of Nigeria. The sample period covers 2010 to 2019 which is a 10-year period. The 2010 cut-off period allows us to isolate and proffer remedial measures on the 2007-2008 global financial crises, so that events from the crisis will not contaminate the data. The

data point ends in 2019 to isolate the effect of the COVID-19 pandemic.

The Model

The baseline model adopted for estimating the effect of FDI inflows on economic growth is specified below. The variables used in the model are similar to those adopted in Ibrahim and Sare (2018), Ozili (2024), Acquah and Ibrahim (2024) and Ozili et al (2023a).

$$(GDPG, GDPPCG)t = FDIPt + INFt + INTt + GFCFt + POPt + CREDITt + et \dots \dots \dots eqn1$$

$$(GDPG, GDPPC)t = FDINt + INFt + INTt + GFCFt + POPt + CREDITt + e \dots \dots \dots \dots eqn2$$

Economic growth (EG) is the dependent variable, which is measured using two variables: the real GDP growth rate variable and the real GDP per capita variable. The foreign direct investment inflow variable, which is the focal explanatory variable, is measured using two variables: the FDI inflow as a per cent of GDP (FDIP), and the logarithm of FDI inflow amount in USD (FDIN). The control variables are the inflation rate (INF); gross fixed capital formation (GFCF); real interest rate (INT); total population size (POP); domestic credit to private sector to GDP ratio (CREDIT); 'e' is the error term; and 't' is the year.

DISCUSSION OF RESULTS

Descriptive Analysis

Table 1 reports the descriptive statistics. The FDIP variable is 1.1% of GDP on average. This indicates that foreign direct investment inflows contribute very little to GDP in Nigeria. The average rate of inflation (INF) in Nigeria is 11.8% which is high compared to the real interest rate (INT) at 7.22%. This indicates that the general price level in Nigeria is rising faster than real interest rates. Credit supply to the private sector (CREDIT) is 12.12% of GDP. This suggests that the domestic credit provided to the private sector by financial institutions in relation to the size of GDP is low in Nigeria. Gross fixed capital formation (GFCF) is also below the 30% threshold at 16.46%. This means that capital investment in Nigeria is low. Population size (POP) also has an upward trend in Nigeria.

Correlation Analysis

Table 2 reports the Pearson correlation results. The FDIP variable is inversely correlated with the GDPPC, INT, GFCF, POP and CREDIT variables. This means that high foreign direct investment inflows are associated with low GDP per capita, low real interest rate, low population, low gross fixed capital formation and low domestic credit to private sector in Nigeria during the period. Meanwhile, FDIP is negative and significantly correlated with GDPPC and population size. On the other hand, the FDIP variable is positively correlated with the GDPG and INF variables. This means that higher foreign direct investment inflows are associated with higher real GDP growth and higher inflation rate in Nigeria. Regarding the FDIN variable, the FDIN variable is inversely correlated with the GDPPC, INF, INT, GFCF, POP variables. This means that high foreign direct investment inflows are associated with low GDP per capita, low

inflation, low real interest rate, low population, and low gross fixed capital formation in Nigeria during the period. Meanwhile, FDIN is negative and significantly correlated only with population size. On the other hand, the FDIN variable is positively correlated with the GDPG and CREDIT variables. This means that higher foreign direct investment inflows are associated with higher real GDP growth and higher domestic private credit in Nigeria.

Effect of FDI inflows (% of GDP) on economic growth

Table 3 reports the regression results using the model in equation 1. In column 1, the dependent variable is real GDP growth (GDPG). In column 2, the dependent variable is GDP per capita. The focal explanatory variable is the FDIP variable which represents foreign direct investment inflows as a per cent of GDP (FDIP). The FDIP coefficient is negative and insignificantly related to real GDP growth rate and real GDP per capita in columns 1 and 2. This indicates that FDI inflows are not significantly related to economic growth in Nigeria during the period examined.

This result confirms the findings of Ehigiamusoe and Lean (2019) who document that foreign direct investment has an insignificant impact on economic growth. In contrast, this result does not support the findings of Alabi (2019) and Acquah and Ibrahim (2024) who find a positive relationship between FDI and economic growth. For the control variables, the INF coefficient is negative and significantly related to real GDP growth rate in column 1. This indicates that low inflation leads to higher real GDP growth rate in Nigeria, and vice versa. Meanwhile, the INF coefficient is negative and insignificantly related to real GDP per capita in Nigeria in column 2. This finding supports the findings of Aderemi et al (2024) and Acquah and Ibrahim (2024) who find a negative relationship between inflation and economic growth. The INT coefficient is negative and significantly related to real GDP growth rate in column 1. This indicates that a low real interest rate leads to higher real GDP growth rate in Nigeria, and vice versa.

Meanwhile, the INT coefficient is positive and significantly related to real GDP per capita in column 2. This indicates that a high real interest rate leads to higher real GDP per capita in Nigeria, and vice versa. The GFCF coefficient is negative and significantly related to real GDP growth rate in column 1. This indicates that a low gross fixed capital formation leads to higher real GDP growth rate in Nigeria, and vice versa. Meanwhile, the GFCF coefficient is positive and insignificantly related to real GDP per capita in Nigeria in column 2. This finding does not support the findings of Acquah and Ibrahim (2024) who find a positive relationship between gross fixed capital formation and economic growth.

The POP coefficient is positive and significantly related to real GDP growth rate and real GDP per capita in columns 1 and 2. This indicates that a larger population size has positive benefits for economic growth in Nigeria. The finding supports the results obtained in Acquah and Ibrahim (2024) who find a positive relationship between inflation and economic growth. The CREDIT coefficient is positive in columns 1 and 2 but is significantly related to real GDP per capita in column 2. This indicates that higher credit supply to the private sector increases GDP per capita in Nigeria.

Table 1. Descriptive statistics

	FDIP	FDIN	GDPG	GDPPC	INF	INT	GFCF	POP	CREDIT
Mean	1.125	22.22	3.64	2415.59	11.80	7.22	16.46	19.00	12.12
Median	1.02	22.24	3.44	2391.57	11.74	6.14	14.95	19.00	12.19
Maximum	2.18	22.90	8.01	2550.47	16.52	13.59	25.41	19.12	14.61
Minimum	0.50	21.41	-1.62	2280.43	8.06	1.06	14.16	18.88	10.24
Std. Dev.	0.53	0.44	2.98	87.19	2.89	3.73	3.47	0.07	1.52
Observations	10	10	10	10	10	10	10	10	10

Table 2: Pearson correlation matrix

Variable	FDIP	FDIN	GDPG	GDPPC	INF	INT	GFCF	POP	CREDIT
FDIP	1.000 -----								
FDIN	0.914*** (0.00)	1.000 -----							
GDPG	0.451 (0.19)	0.540 (0.11)	1.000 -----						
GDPPC	-0.579* (0.08)	-0.301 (0.39)	-0.152 (0.67)	1.000 -----					
INF	0.121 (0.74)	-0.089 (0.80)	-0.566* (0.08)	-0.529 (0.11)	1.000 -----				
INT	-0.435	-0.172 (0.63)	-0.005 (0.98)	0.939*** (0.00)	-0.671** (0.03)	1.000 (0.21) -----			
GFCF	-0.307	-0.417 (0.23)	-0.142 (0.69)	-0.322 (0.36)	-0.001 (0.99)	-0.408 (0.24)	1.000 (0.38) -----		
POP	-0.820*** (0.00)	-0.849*** (0.002)	-0.748** (0.01)	0.266 (0.45)	0.201 (0.57)	0.105 (0.77)	0.547* (0.10)	1.000 -----	

P-values are reported in parenthesis.***, **, * denote statistical significance atthe1%,5% and 10% levels.

Table 3. OLSregression:impact of FDI inflows (% of GDP) on economic growth		
	(1)	(2)
	Dependentvariable:*RealGDPgrowth*	Dependentvariable:*GDPpercapita*
Explanatory variables	Coefficient (t-statistic)	Coefficient (t-statistic)
FDIP	-1.385(-0.82)	-18.567 (-0.72)
INF	-1.737*** (-4.81)	-2.049(-0.37)
INT	-1.238** (-3.37)	18.947** (3.23)
GFCF	-0.704* (-2.44)	1.160 (0.26)
POP	2.217** (3.23)	111.36*** (10.56)
CREDIT	0.367 (0.94)	15.567* (2.59)
R^2	89.52	97.11
Adjusted R^2	76.42	93.48
Durbin-Watson Test	3.36	3.34
Resultsareestimatedusingtheordinaryleastsquareregressionestimation.T-statisticsarereportedinparenthesis.Regressioncoefficientsarereportedabove thet-statistics.***,**,*denotesstatisticalsignificanceatthe1%,5%and10% level.FDIP=foreigndirectinvestmentnetinflows(asa%ofGDP);INF=inflation rate;INT=realinterestrate;GFCF=grossfixedcapitalformation;POP=total population size;CREDIT = domesticcreditto privatesector(%of GDP).		

CONCLUSION AND RECOMMENDATIONS

This research looks at the short- and long-term consequences of foreign direct investment on Nigeria economic growth time series data utilization spanning from 1990 to 2024. I examined the theoretical and empirical justifications for FDI's impact in Nigeria as well as industrialized and developing nations. The variables are I(0) and I(1), indicating a different order of integration across variables, requiring the use of the ARDL bound test for co-integration. Stationary testing was performed using the ADF test prior to estimation. The study's conclusions demonstrate a long-term relationship between factors including trade openness, inflation, political stability, human capital, foreign debt, and the real effective exchange rate and FDI's effect on Nigeria's economic development.

This study indicates that, in the long run, Nigeria's economic growth is positively impacted by trade openness, external debt, and human capital; in contrast, inflation, political unrest, and the real effective exchange rate have negative effects that are statistically significant at the five percent significance level.

Furthermore, external debt and human capital have a positive and statistically significant influence on economic growth at 5%, whereas foreign direct investment (FDI) has a long-term negative impact on growth that is not statistically significant.

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