



# THE EFFECT OF FOREIGN DIRECT INVESTMENT ON THE ECONOMIC DEVELOPMENT OF NIGERIA

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## ABSTRACT

The study examined the effect of Foreign Direct Investment (FDI) on development in Nigeria. The ultimate goal of developing countries is to attain development. Most studies on the effect of Foreign Direct Investment on the development of the Nigerian economy used growth proxied by GDP as a measure of development. This study however uses the Human Development Index (HDI) which is a complementary measure of development as it considers the three aspect of development (health, knowledge and standard of living). Current data from secondary data source. were used Secondary data were collected and OLS estimation method was used for the analysis of data. The result shows that the stock of FDI inflow has a positive and statistically significant effect on Economic development in Nigeria. Therefore to experience sustainable development, government should aim at providing infrastructure and conducive trade and investment environment for both foreign and local investors.

## INTRODUCTION

The effect of FDI has been debated upon in different literature. Some studies views FDI as having a positive effect on economic development (Adegbite and Ayadi, 2011) while others are of the opinion that it has contributed insignificantly to economic development of developing nations (Akinlo 2004). However the role of FDI in any economy cannot be overemphasized.

All over the world there is so much difference between developed and less developed countries. However developing countries want to enjoy the position of security and offer high quality of living as advanced countries so their focus is development And to achieve the desired development, they need capital to invest in industry, technology, and on an educated population. Since this capital cannot be gotten from internal sources the need for Foreign Direct Investment (FDI) becomes imperative.

Over the years, Nigeria has been able to attract FDI significantly, despite her poor economic situation probably because of oil reserve and it's consumption potential of a large population. However, the problem is inspite of the increase in FDI inflow over time into the Nigeria economy the nation still, remains relatively underdeveloped. Recent reports from the World Bank (2022) says "deep structural reforms guided by evidence are urgently needed to lift millions of Nigerians out of the poverty". This is because over 40% Nigerians still live below the poverty line. So the question is, has Foreign Direct Investment any significant relationship to economic development as measured by Real Gross Domestic Product and Human Development Index? The situation calls for a critical examination of the effect of FDI on economic development in Nigerian.

## LITERATURE REVIEW AND THEORETICAL FRAMEWORK

### 2.1 Conceptual Issues on Foreign Direct Investment

Foreign Direct Investment (FDI) occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage the asset. The management dimension is what distinguishes FDI from portfolio investment in form of stocks, bonds and other financial instrument. In most instances, both the investor and the asset it manages abroad are business firms

Foreign Direct investment serves as a means of transferring technology, managerial skill, experience and new way of production from developed countries to developing countries. (Orji et al 2019). However this is oppose to the view of Melnyk et al(2014) who see additional inflow of FDI to have pushed out other firms without FDI.(Market stealing effect) .



## 2.2 Concept of Economic Growth and Development in Relation to FDI

Economic growth is a rise in the production of Economic goods and services at a particular period compared with the former period (Charles 2023). It is triggered by steady increase in workforce, technology, human capital and production of capital goods (Max 2021) Economic Growth is concerned about quantity and can be achieved in a short while without any efforts from the government. (Byju's, 2023) One common measure of economic growth is the rate of growth of real gross national product (GNP).

Unlike economic growth, economic development is qualitative in nature and takes time to achieve i.e. it is only attained when there are policies from the government. It is multi-dimensional since it is not only concerned about increase in GDP but also about improvement in living standards. The area it covers is wider than that of growth. Growth is thus a sub-set of the development process. (Amarty Sen 2013)

## 2.3. Empirical Literature on Foreign Direct Investment

An investigation by Anetor (2019) found that FDI accounts for significant growth in the Nigerian economy compared with other capital inflow into the economy, using data from 1961-2016, estimated by using the structural vector autoregression model (SVAR) to evaluate the effect of private capital inflow in the growth of Nigeria economy.

Trany, Duc, Anh & Thang (2019) used VECM Fully Modified OLS (FMOLS) to analyse the impact of FDI in developing countries and found out that FDI resulted growth in the long run but not in the short run. Sokang, (2018) noticed a positive effect of FDI on growth of Cambodia after using time series data between 2006 and 2016. He utilized correlation matrix and multiple regression to analyse the effect of FDI on growth

Benedict & Jignesh (2023) investigated the relationship between foreign direct investment (FDI) inflows and economic growth in Tanzania during 1990–2020. using the autoregressive distributed lag model and Granger causality tests to analyze the relationship. The findings show that there exists a long-run relationship among the variables under considerations in Tanzania. Abab et al (2022) investigated the impact of foreign and domestic private investment over the period 1980–2022 with evidence from developing and emerging economies. The findings clearly reveals that Disposable Income must be completed with adequate investment from foreign sources.

Bentrix et al (2023) examine the link between FDI and economic growth using data from 1970 to 2018. The result shows that FDI has a positive and significant effect on growth.

Yusuf et al (2020) examined the role of Foreign Direct Investment, financial development, democracy and political (in)stability on economic growth in West Africa, using data from 1996 to 2016 and Pesaran (2007) technique. The findings shows that although there is not relationship between FDI and growth in the short run, there exist a significant relationship in the long run, reaffirming the fact that FDI is a necessary avenue for the transfer of technology and managerial knowledge. Emako et al (2022) investigated the impact of FDI on structural transformation in developing countries using panel data from 44 developing countries and four newly industrialized countries from 1990 to 2018, making use of the generalized method of moment approach of Arellano-Bond (1991) The results show that FDI has a positive significant effect on structural transformation in developing countries.

Burlea-Schiopou et al (2021) examined the impact of FDI on the development of emerging countries in the European Union. The result of the findings show that the GDP of seven out of nine countries in the region were positively affected by the net FDI inflow. Antony Orji et al (2019) investigated the effect of foreign direct investments on the growth of the Nigerian economy from 1981 to 2017 using the autoregressive distributive lag modeling approach and ordinary least square in the analysis and found out that FDI has a positive in significant relationship with economic growth in Nigeria within the period. The study recommended that policies by the Nigerian economy should be formulated to attract more FDI in all sectors of the economy especially in the service and manufacturing sectors. The study also suggested government should make better educational policy to improve the stock of human capital so that that will influence the productivity of FDI in the economy

## 2.4. Theoretical Framework

The theoretical framework of the study is based on the Harrow Domar model, The model emphasizes that to propel economic growth or achieved growth sustainably, savings ratio has to rise or capital/output ratio has to fall (meaning capital is becoming more efficient). Assuming capital/output as given, what is critical to growth is the

proportion of income a nation saves as a rise in savings can propel investment in developing countries. To close up the existing savings gap, developing countries look up to foreign sources. FDI is thus an indispensable tool needed for development. The focus of the study is whether FDI had had any significant impact on development in Nigeria, bearing in mind that growth is not all that matters because growth is a numerical measure.

## METHOD OF STUDY

### 3.1 Nature of the Research Design

The quantitative technique that is adopted in analyzing the data collected is ordinary least square (OLS) method using economic view package (E-View) Multiple regression equations was also adopted because multiple equations provide a picture of the real world which is better than a single equation model. Descriptive analysis, was in this research work also adopted in analyzing the trend of the different variables mentioned below over the time period specified.

### 3.2 Specification of the Model

The Research will be adapting the following model

$$RGDP = \alpha_0 + \alpha_1 FDI + \alpha_2 GCF + \alpha_3 INF + \alpha_4 EXR + \alpha_5 EXD + U_{1t} \dots (1)$$

$$HDI = \alpha_0 + \alpha_1 FDI + \alpha_2 GCF + \alpha_3 INF + \alpha_4 EXR + \alpha_5 EXD + U_{2t} \dots (2)$$

Where,

RGDP = Real Gross Domestic Product (per Capita)

FDI = Foreign Direct Investment Growth

EXR = Exchange Rate

EXD = External Debt

GCF = Gross Capital Formation (as a major of domestic investment)

HDI = Human Development Index

GCF = Gross Capital Formation (as a major of domestic investment)

INFR = Inflation Rate

$U_{1t}$  = Error term for model 1

$U_{2t}$  = Error term for model 2

The a priori expectation patterns of the behaviour of the independent variables in terms of their parameters to be estimated are:

$$\alpha_1 > 0, \alpha_2 > 0, \alpha_3 > 0 \text{ and } \alpha_4 < 0$$

$$b_1 > 0, b_2 < 0, b_3 > 0 \text{ and } b_4 < 0$$

### 3.3. Analytical Tools Adopted

The analytical tool adopted in the research work is the Ordinary Least Square (OLS) with aid of Economic View (Eview). After the main test other tests were done. Criteria for decision making under Regression Analysis involves the various tests that were carried out in order to derive information from our data analysis.

## DATA ANALYSIS

### 4.1. Descriptive Statistics

Table 4.1 below presented the descriptive statistics of all the variables under consideration:

	RGDP	FDI	EXR	EXD	GCF	HDI	INFR
Mean	47126.86	7781.575	146.9780	3119.795	3206.577	0.484067	18.55133
Median	34821.07	3318.325	130.7550	1509.415	1743.190	0.484500	12.55000
Maximum	102543.8	69880.00	414.0000	15855.23	9835.010	0.541000	72.84000
Minimum	17082.56	146.3500	17.30000	438.8900	71.11000	0.410000	5.380000
Std. Dev.	29014.64	12699.59	106.0281	3788.501	3389.936	0.045829	16.78257
Skewness	0.565806	4.075229	0.815137	1.970341	0.708805	-0.128270	2.073673
Kurtosis	1.802255	20.43929	3.084584	6.414683	1.960434	1.572804	6.169012
Jarque-Bera	3.393925	463.1984	3.331188	33.98628	3.862896	2.628378	34.05391
Probability	0.183239	0.000000	0.189078	0.000000	0.144938	0.268692	0.000000
Sum	1413806.	233447.3	4409.340	93593.84	96197.30	14.52200	556.5400
Sum Sq. Dev.	2.44E+10	4.68E+09	326016.7	4.16E+08	3.33E+08	0.060910	8167.987
Observations	30	30	30	30	30	30	30

**Table 4.1: Summary of Descriptive Statistics**

**Source: Researcher's Compilation (2022)**

From table 4.1 above, the mean values of RGDP, FDI, EXR, EXD, GCF, HDI, and INFR clearly indicates that, majority of the studied variables did not deviate much far away from their mean value.



#### 4.2. Ordinary Least Square-OLS Regression Result

Owing to the fact that, the study captured economic development using both real gross domestic product per capital and human development index, two models were stated. These two models' OLS estimates are presented in table 4.2 and 4.3 below:

Table 4.2: OLS Summary-Model One

$$RGDP = \alpha_0 + \alpha_1 FDI + \alpha_3 GCF + \alpha_4 INF + U_{1t} \dots (I)$$

Dependent Variable: RGDP

Method: Least Squares

Date: 12/01/22 Time: 12:30

Sample: 1992 2021

Included observations: 30

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	10.13618	1.878250	5.396608	0.0000
FDI	0.948963	0.064099	14.80470	0.0000
GCF	0.768926	0.071838	10.70368	0.0000
EXR	0.000333	0.002888	0.115290	0.9093
EXD	-0.380649	0.045542	-8.358133	0.0000
INFR	-0.002147	0.002992	-0.717795	0.4804
R-squared	0.957386	Mean dependent var	10.56998	
Adjusted R-squared	0.943827	S.D. dependent var	0.633166	
S.E. of regression	0.150065	Akaike info criterion	-0.655381	
Sum squared resid	0.495432	Schwarz criterion	-0.281728	
Log likelihood	17.83071	Hannan-Quinn criter.	-0.535846	
F-statistic	70.60920	Durbin-Watson stat	2.129939	
Prob(F-statistic)	0.000000			

Source: Researcher's Computation Based on E-Views 9.0 (2022)

The model one OLS estimate as reported in table 4.2 reported high explanatory power. The estimates show that, foreign direct investment inflows, and gross capital formation had a positive and high significant effect on economic development (RGDP) of Nigeria.

Table 4.3: OLS estimate-Model Two

$$HDI = \alpha_0 + \alpha_1 FDI + \alpha_2 GCF + \alpha_3 INF + \alpha_4 EXR + \alpha_5 EXD + U_{2t} \dots (II)$$

Dependent Variable: HDI				
Method: Least Squares				
Date: 12/01/22 Time: 14:25				
Sample: 1992 2021				
Included observations: 30				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.137881	0.026568	-42.82921	0.0000
FDI	0.560039	0.153018	3.659949	0.0012
GCF	0.606909	0.273009	2.223038	0.0355
EXR	-0.462752	0.149081	-3.104031	0.0044
EXD	0.003003	0.003544	0.847453	0.4051
INFR	-0.678815	0.182719	-3.715066	0.0009
R-squared	0.985429	Mean dependent var	0.484067	
Adjusted R-squared	0.982393	S.D. dependent var	0.045829	
S.E. of regression	0.012705	Akaike info criterion	-5.716818	
Sum squared resid	0.003874	Schwarz criterion	-5.436579	
Log likelihood	91.75227	Hannan-Quinn criter.	-5.627167	
F-statistic	324.6175	Durbin-Watson stat	1.837161	
Prob(F-statistic)	0.000000			

Source: Researcher's Computation Based on E-Views 9.0 (2022)

The model 2 OLS estimate as reported in table 4.3 shows on the overall, foreign direct investment inflows is highly critical to economic development (RGDP) of Nigeria..



## SUMMARY, CONCLUSION AND RECOMMENDATIONS

### 5.1 Summary

The summary of the findings are given below:

☆ Foreign direct investment has a positive but insignificant effect on exchange rate, external debt, and inflation rate in Nigeria.

☆ Foreign direct investment has a significant positive effect on Domestic Investment (proxied by GCF) Gross domestic product, and human development index (HDI) in Nigeria. Therefore, foreign direct investment has a significant positive effect on economic growth and development in Nigeria

### 5.2 Policy Recommendations

Based on the above findings, the following recommendations are proposed:

i. The Nigerian government should ensure that a conducive environment for doing business is provided in Nigeria in order to attract more FDI inflows into all sectors of the economy.

ii. The federal government and policy makers should formulate policies that do not only aim at exploiting all the potentials of FDI in Nigeria but also put a check on the negative effects of FDI on the social and economic welfare of Nigerians.

### 5.3 Conclusion

At the present level of economic development in Nigeria, foreign assistance, in the form of FDI is necessary for a rapid economic development of Nigeria. Although the process of economic growth could be truncated by only a few elite in the society (Pettinger, 2021). The study therefore concludes that, foreign direct investment inflows are critical to the Nigerian economic development

### 5.4 Contribution to Knowledge

Development not just growth is the ultimate goal of developing nations.. Ceteris paribus, a constant rise in economic growth for a long period of time will bring about development as higher RGDP will enable a nation to spend on health care and education. The study therefore (1) provides a justification for a more even distribution of FDI among various sectors of the Nigerian Economy. (2) Re-affirms the significant positive effects of FDI on human capital development in Nigeria

### 5.5 Suggestion for Further Findings

From the result of the study FDI has been found to be beneficial hence it is important that further study should be carried out to maximize the impact of FDI

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