

# **Improving the Investment Climate in Nigeria: Issues and Policy Options**

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## CHAPTER ONE

### INTRODUCTION

#### 1.1 Background Of The Study

The potential contribution of foreign Direct Investment (FDI) to economic development is now widely recognized. It assumed prime importance in the wake of declining concessional aid, which has created a preference for long-term and more stable financial inflows.

FDI potentially boosted the growth of a country by crowding in other investments with an overall increase in total investments, as well as hopefully creating positive “Spillover effects” from the transfer of technology, knowledge and skills to domestic firms. It can also stimulate economic growth by spurring competition, innovation and improvements to a country’s export performance. The indirect impacts of FDI on the domestic economy are the main reasons for the intense political focus on FDI in most countries, which has led to unprecedented levels of public subsidies, diplomatic efforts and promotional activities to attract investors (*Mabey and McNally, 1998*).

FDI does have some potential negative impacts, the most potent being anti-competitive and restrictive business practices by foreign affiliates, tax avoidances, and abusive transfer pricing. Volatile investment flows and related payments may be deleterious to balance of payments, while some FDI is seen as transferring pollution activities and technologies. Moreover, there is often fear that FDI may have excessive influence on economic affairs, with possible negative effects on industrial development and national security. The intensity of concerns about these types of impact is diminishing. FDI has grown dramatically and is now the largest and most stable source of private capital for developing countries and economies in transition, accounting for nearly 50% of all those flows in 2002 (*Ogunkola et al, 2010*).

The increasing role of FDI in host countries has been accompanied by a change of attitude, from critical wariness toward multinational corporations to sometimes uncritical

enthusiasm about their role in the development process. The domestic policy framework is critical in determining whether the net effects of FDI are positive (*UNCTAD, 1999*). Thus, instituting (designing and implementing) a policy mix that maximizes the potential benefits and minimize the potential negative effects is very important. FDI, when handled properly, can make a positive contribution to development.

The growing globalization of production, trade and finance and the success story of the Asian tigers compelled African countries to embark on major policy, structural and institutional reforms with a view not only to stem the tide of economic decline and fluctuations, but also to launch the continent on the path to sustainable development.

In the post independence years, many African countries, Nigeria inclusive, regardless of ideological orientation, had embarked on massive medium to long term plans in which public enterprises in all sectors were to serve as engines of growth and instrument for achieving economic independence. But African governments were realistic and able to recognize an important role for the private sector, mostly foreign investment. The increase in private capital inflows offers opportunities for Nigeria to invest in infrastructure and facilitate trade finance to foster a self-reinforcing cycle of sustained capital flows, economic growth and poverty reduction (*Udejah: 2005*). It becomes imperative for Nigeria to seek to tap international capital to meet their evening demands and foster economic development by establishing transparent rules with the assurance that contracts will be respected, local capital market strengthened, public-private risk mitigating instruments developed and public providers of infrastructural services assisted to achieve commercial standards of credit-worthiness

Sub – Saharan Africa as region now has to depend very much on foreign direct investment (FDI) for so many reasons, some of which are amplified by *Asiedu (2012)*. It is worthy to say that rapid growth requires high level of investment, which in the absence of FDI must derive from high saving rates. Although rapid gross national product (GNP) gains are possible through such ‘inward’ looking policies, they are historically rare in Nigeria (*Anochiwa, 2010*). Often, the most rapidly growing economies have been driven by an external engine (*Moon B. and W. Dixon, 1993*). An example of such is FDI.

The preference for improving the Nigerian investment climate steams from its acknowledged advantages (*Akinlo, 2004*). In fact, the New partnership for Africa development (NEPAD), a programme floated by Africa's statesmen to address the downward spiral of poverty and set Africa on the road to globalization was launched to increase available capital in the sub region to US\$64 billion through a combination of reforms resource, mobilization and enabling environment for investment (*Funke and Nsouli, 2003*).

It is the desire to attract investment, particularly FDI that has informed many economic reforms in Nigeria. The economic rationale for offering special incentives to attract FDI frequently derives from the belief that it promotes growth not only directly by augmenting capital formation in the recipient countries, but also indirectly by improving human capital development, helping technology transfers and strengthening competition (*Qi, 2007*).

Unfortunately, the effort of Nigeria to attract FDI and catch-up with the industrialized world appears to be marked with great difficulties. This development is disturbing, sending very little hope of economic development and growth for Nigeria. Worse still, the pattern of the FDI that does exist is often skewed towards extractive industry, meaning that the differential rate of FDI inflow into sub-Saharan African countries has been adduced to natural resources, although the size of the local market may also be a consideration (*Morriset, 2009*). But to achieve higher growth is an urgent priority for Nigeria. For one thing Nigeria has suffered economic isolation for decades that has crippled Nigeria economically.

The foreign investment promotions in post-colonial Nigeria were primarily anchored on Import Substitution Industries (ISI). For example, the second National Development Plan 1970 – 1974, third plan 1975 – 1980 and the Fourth 1981 – 1985 were characterized by increasing government involvement in industrial activities (*Nwogwugwu, 2005*). It is the failure of some of these policies to enhance the economic growth of Nigeria that reinforced the need for foreign capital. The decision to encourage FDI inflow was to all- purposed and intent, far-reaching several reasons have been adduced.

- The dwindling fortune of the indigenization policies

- The unattractiveness of portfolio investment both in the domestic and international capital market.
- The advantages associated with FDI in the theoretical literature.
- The key ingredient of growth-centered assets such as technology, learning experience and organizational competence- are not only becoming more mobile across national boundaries but are also being increasingly housed in MNC system.
- The failure of the Nigeria Structural Adjustment programme (SAP).
- The compelling logic of the remarkable success of the economies of East Asia.
- Nigeria, given her natural resource endowment and large market size, qualifies to be a major recipient of FDI in Africa. “However, the level of FDI attracted by Nigerian is mediocre (*Asiedu, 2003*) compared to resource based and potential need”. In terms of enhancement of growth, results of studies carried out on the linkage between FDI and economic growth in Nigerian (*Oseghale and Amonkhienan, 1987, Odozi, 1995; Adelegan, 2000*) reveals that conscious effort was not made to take care of the fact that more than 40% of the FDI inflows into Nigeria is made into the extractive oil industry, an industry that is deficient in both backward and inward linkages.

## **1.2 Statement Of Problem**

During the late 1970s and early 1980s, most developing countries including Nigeria experienced an unprecedented and severe economic crisis. This economic downturn manifested in different forms including persistent macroeconomic imbalances, widening saving- investment gap, high variable rates of inflation, chronic balance of payments problems and huge budget deficits. Although many reasons were advanced for the poor economic performance, among them is the decline in the investment rates of the affected economies. In Nigeria, for instance, domestic investment as a ratio of gross domestic product (GDP) declined from an average of 24.4 percent during the 1973 – 81 periods to 13.57 percent during 1982 – 1996. The average investment rate during the period shows that Nigeria barely replaces its depreciating capital. The record is disappointing given the enormous potentials for investment in Nigerian.

Theoretical and empirical studies lay much emphasis on the important role of investment in determining the rate of physical capital accumulation, and also as an important factor in the growth of productive capital, as well as its contributions to the growth of the economy. Therefore, for Nigeria to be able to meet the Millennium Development Goals (MDGs) and achieve the desired economic growth of 7% there is need for increased emphasis on facilitating and sustaining the investment environment to make it more conducive for both domestic and foreign investment. To achieve such paradigm shift in investment rate, Nigeria will first have to re-examine why investment rates have declined and remained at low levels, following which they need to come up with policy and institutional measures required to revitalized investment.

Nigeria's effort to attract FDI by liberalizing the economy in the late 80s would seem to have paid off by being among the third largest recipient of FDI in subs-Saharan (*Asiedu, 2004*). However, the slow growth of our per capital GDP makes one to doubt the impact of FDI in Nigeria. The impact of FDI on economic growth has become to some people "remarkable and to some" debatable. Since the International Monetary Fund (IMF) structural Adjustment Program of 1985 failed, the impact of FDI as alternative policy has been the preoccupation of various government of Nigeria.

As we consider the growth pattern of Nigeria over the years, one can hardly resist the temptation to draw parallels between FDI and failure. Perhaps it may be the type of FDI received, or our absorptive capacity for capital from abroad is weak, or is it the enabling environment or the political will. It might seem natural to argue that FDI can convey great advantages to host countries but such gains might differ across primary, manufacturing and service sectors (UNCTAD, 2000). Most studies in the past did not take serious attention to the issue that FDI in Nigeria largely goes to the extractive industry which apparently lacks linkages as the other sector will promote spillovers.

A cursory look at the pattern of domestic investment in Nigeria is imperative in order to be able to achieve sustained growth. Over the years, the Nigeria economy has gone through periods of economic and political instability, which have hindered domestic investment into the country. The stability of a country's socio-economic and political system reflects the soundness of its level of governance and this is seen as a major factor in decision-making by

investors. The highly unstable pattern of growth in domestic investment in Nigeria can be attributed to the volatile economic and political environment in the country (*Globerman & Shapiro, 2002*).

Prior to 1986, the Nigerian economy was more of a public sector, in which the government controlled the market system to a larger extent. There were heavy government interventions in the economy, as well as massive expansion of the public sector through the establishment of a large number of state enterprises. This phenomenon was believed to have worsened the distortions in the economy, destroyed incentives to produce, save and invest and necessitated the reform.

Nigeria as a country, given her natural resources and large market size, qualifies to be a major recipient of FDI in Africa and indeed one of the top three leading African Countries that consistently received FDI in the past decade. However, the level of FDI attracted by Nigeria is mediocre compared to the resource base and potential used.

It was expected that the policy shift should put the Nigerian economy on the path of recovery and sustainable development. But despite this structural reform, Nigeria continues to be confronted with a number of economic maladies. Among these problems are low level of savings and investment, high rate of inflation, high level of unemployment and poverty. This situation has caused a lot of concern to the researchers who have described the reform as woes rather than a blessing. Rather than for the economy adjustment into recovery, it continues to deteriorate to the background. The expected role of private sector as an engine of growth never materialized. The calculated withdrawal, an instance of the public sector from the investment leaving the stage to private sector to play its role has not been auguring well for the country. The major expansion in private investment needed to sustain economic growth is yet to be achieved. Nigeria's macroeconomic indicators highlight this poor performance of private investment in Nigeria between 1986 and 2005. For example, private investment declined from 12.3% of GDP in 1991 to 8.3% of GDP in 1992. This may partly be due to decreased public investment, which declined over the period. Private investment then increased to 12.5% in 1993 and to 16.0% in 1994. Thereafter, it declined continuously to 8.3% in 1996. The ratio increased again to 13.0% in 1999 before declining continuously to its lowest level (within the period) of 10.7% in 2000.

Since 2001, there has been a substantial recovery. Between 2001 and 2005, the ratio average 13. %, it peaked to 16.2% in 2005. Since then there has been a gradual increase in the ratio. The perceptible slide in the ratio of private sector investment to GDP despite the emphasis on private sector following the initiation of public sector is all more worrying.

### **1.3 Objective of the Study**

The main aim of the study is to examine the relationship between investment (FDI) inflows and economic growth in Nigerian and the policy implication.

### **1.4 Research Question**

1. What type of relationship exists between FDI and economic growth in Nigerian?
2. Does FDI in different sectors of Nigerian economy contribute evenly to our economic growth?
3. To what extent has the availability or lack of infrastructure (energy) and human capital affected growth?

### **1.5 Research Hypotheses**

In line with the research questions, the following hypotheses and their related alternatives are formulated as follows:

H<sub>0</sub>: The FDI has no effect on economic growth

H<sub>1</sub>: The FDI has effect on economic growth

H<sub>0</sub>: FDI in primary sector has no effect on economic growth.

H<sub>2</sub>: FDI in primary sector has effect on economic growth.

H<sub>0</sub>: FDI in manufacturing sector has no effect on economic growth.

H<sub>3</sub>: FDI in manufacturing sector has effect on economic growth.

H<sub>0</sub>: FDI in service sector has no effect on economic growth

H<sub>4</sub>: FDI in service sector has effect on economic growth.

H<sub>0</sub>: Infrastructure has no effect on economic growth

H<sub>5</sub>: Infrastructure has effect on economic growth

## **1.6 Scope/Delimitation Of Study**

The study takes a broad look at improving the investment climate in Nigeria: Issues and policy option, since 1970 – 2010. The period was characterized by persistent macroeconomic imbalances, including widening savings investment gap, high variable rates of inflation chronic balance of payments problem and huge budget deficit.

## **1.7 The Significance Of The Study**

Investigating on Improving the Nigerian Investment climate is significant on a number of ways: First, this study contributes to the body of knowledge on the relationship between FDI inflows and economic growth in Nigeria. Secondly, the effect of the major components of FDI on economic growth is examined, thereby offering the opportunity to assess the differential impact of FDI in manufacturing, primary and service sectors on Nigeria's economic growth. Finally, the research will help our policy makers on formulating policies that will boost FDI on the primary, manufacturing or service sector of the economy.

This study, generally, augments the existing literature on the Investment Decisions and Policy options in the context of the Nigerian economy. It investigates the importance of improving the Nigerian investment climate for sustainable development.

## **1.8 Scope and Limitation**

The study focused on improving the investment climate in Nigeria: Policy options from 1970 – 2010 which is a period of forty (40) years. Time series secondary data were used for the analysis. The secondary data were obtained from such publications such as World Bank Digest of Statistics, Central Bank of Nigeria Statistical Bulletin and International Financial Statistics. The data on public and private investment were obtained from the African Development Indicators. Data were also obtained from Websites, Journals, periodicals and Newspapers.

## **1.9 Limitation of the Study**

- **Time:** This was much constraint to the researchers who had to shuttle between Norway and Nigeria a couple of time. This affected adequate concentration and wider consultations on the issue at stake. However the available time was effectively utilized to make this research work a success.

## **1.10 Definition Of Terms**

In order to ensure that the concepts are properly understood, the key words used in the study are defined operationally as follows:

- 1. FOREIGN DIRECT INVESTMENT:** An increase in the equity position of a non-resident investor who holds more than Ten (10) percent of the shares in the local firm.
- 2. INVESTMENT:** Expenditure on the acquisition of financial or real assets.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.0 INTRODUCTION**

This chapter focuses on the review of literature that is relevant to the research under study. In view of this, the researcher looked at various contributions and works that had been done in relation to the topic under review. The literature was sourced from articles in professional journals, relevant textbooks, well research reports, policy documents among others.

The growing globalization of production, trade and finance and the success story of the Asian tigers compelled African countries including Nigeria to embark on major policy, structural and institutional reforms with a view not only to stem the tide of economic decline and social decadence, but also to launch the continent on the path to sustainable development. In the post independence years, many African countries regardless of ideological orientation had embarked on massive medium to long term plans in which public enterprises in all sectors were to serve as engines of growth and instrument for achieving economic independence. But African governments were realistic and able to recognize an important role for the private sector, mostly foreign investment. The increase in private capital inflows offers opportunities for African countries to invest in infrastructure and facilitate trade finance to foster a self-reinforcing cycle of sustained capital flows, economic growth and poverty reduction. It becomes imperative for African countries to seek to tap international capital to meet their ever- increasing demands by establishing transparent rules with the assurance that contracts will be respected, local capital markets strengthened, public – private risk mitigating instruments developed and public providers of infrastructure services assisted to achieve commercial standards of creditworthiness.

## 2.0 THEORETICAL LITERATURE

Economic theory provides us with many reasons why foreign direct investment may result in enhanced growth performance in the receiving country. In the neoclassical growth literature, FDI is associated positively with output growth because it either increases the volume of investment and or its productivity, thus putting the economy on a path of higher long-term growth. In an exogenous growth model, FDI has only a level effect in the steady state and no permanent impact on the growth rate, except during the transitional dynamics to the new steady state. The potential role of FDI is much greater in endogenous growth model. In a neoclassical production function output is generated using capital and labour in the production process. With this framework in mind, FDI can exert an influence on each argument in the production function. FDI increases capital, it may qualitatively improve the factor labor and by transferring new technologies, it also has the potential to raise total factor productivity. Further, as discussed in more recent theoretical growth models example (*Grossman and Helpman, 1991*), by raising the number of varieties for intermediate goods or capital equipments FDI can also increase productivity (*Borensztein, Gregorio and Lee, 1998*) for an empirical analysis of this channel. Thus, in addition to the direct, capital-augmenting effect, FDI may also have additional indirect effects on the growth rate. Most importantly, FDI can permanently increase the growth rate through Spillovers and the transfer and diffusion of technologies, ideas, management processes and the like.

The literature mentions basically four channels that allow for technological Spillovers from FDI to the host economy (*Kinoshila, 2001, Halpern and Murakozy, 2005*):

- “First, the classical indirect channel for transmission of technology from FDI to the domestic economy functions via imitation. The effect of FDI depends crucially on factors such as the legal system, regulations, infrastructure and human capital endowments, as well as the complexity of the technology.
- The training of local workers in foreign-owned companies generates positive spillovers through the acquisition of human capital. Empirical evidence concerning the labour market implications of foreign-owned companies is mixed. On the other hand, foreign companies spend on

average more on training of workers and at least in the short-run-free side on previous training by domestic companies. The smaller the wage differential between foreign and domestic companies, the greater the scope for positive Spillovers since this would also allow domestic companies to attract well-trained workers from foreign companies. In addition an important question relates to the specificity of knowledge acquired through training in foreign-owned companies. *Gorg and Strobl (2004)* find evidence that the managerial skills of owners of domestic companies who were previously employed by multinationals were industry specific but not company-specific, which points towards a large potential for intra-industry Spillovers.

- Thirdly, foreign presence increases competition in a market. The impact of FDI on the market structure depends on the size of the technology gap, as well as entry and exit behavior in the market.
- Fourthly, there are vertical or backward Spillovers. By purchasing intermediates from foreign suppliers or by selling output to foreign companies”.

*(Kinoshita, 2001, Halpern and Murakozy, 2005)*

There are also theoretical justifications for the importance of a certain amount of absorptive capacity. For example, *Markusen and Rutehford (2004)* developed a three-period model in which they show that the speed and degree of positive Spillovers from FDI is positively related to the absorptive capacity of the host country. *Rodriguez-Clare (1996)* relates the developmental impact of multinational companies to the type of linkages they create. Positive linkage effects are stronger, the more intensive the multinational is in the use of intermediate goods, the larger the costs of communication and trade are between headquarters and local plants, and the more similar home and host country are in terms of the variety of intermediate goods produced. This implies stronger linkages and thus greater positive effects – in the developmental gap between donor and host country.

Some may argue that positive Spillovers will only occur in a suitable setting. If the host country does not provide an adequate environment in terms of human capital, private

and public infrastructure, legal environment and the like, many of the Spillovers that may potentially arise from FDI cannot materialize. Public infrastructure such as educational institutions and publicly funded R & D collaborations can significantly support potential Spillovers. Potential for positive Spillovers does not depend solely on a country's overall absorptive capacity, but also on the industrial structure of the economy (*Caste Jon and Worz, 2006*). Thus, the impact of FDI differs depending on country-specific absorptive capacity or state of development, as well as on the sectoral and industrial structure and allocation of FDI. Since the two are generally related, this implies a relationship between the industrial pattern of inward FDI and its effect on the host country. The economy-wide effect of industry-specific FDI inflows will then further depend on the extent of intra-industry versus inter-industry Spillovers.

## **IMPACT OF FDI ON EXPORT**

The potential effects of inward FDI on the exports of host countries are discussed using three theoretical models:

### **I. Flying Geese (GD) Model**

According to Asian Development Bank (ADB) 2005, cited in *Nyong (2008)* labor cost openness are the essential factors in the FG model. ADB (1999) points out that FDI has shifted from high labor cost home cost nations for a new set of low labor cost host countries (*Lee, 2007*). The implication of FG model is that MNE (multinational enterprises) subsidiaries increase the host country's export performance by using the host country's factor endowments to produce at lower cost. The increased export competitiveness of MNE subsidiaries directly enhances the recipient country's export supply capacity (*African Development Bank, 2005*). Again, the transfer of FDI also brings new technology, capital equipments and manufacturing expertise into the host countries which are behind in the availability and quality of factor endowment (*Kwan, 1996*). Therefore, according to the FG model, Spillover effects of FDI are likely to stimulate local firms export ability.

## **II. Product Life Cycle (PLC) Theory**

A PLC theory was developed by Vernon (1966) to provide a framework to explain the increasing FDI from US MNEs and its influence on trade flows. There are accordingly four states of production in the PLC theory including innovation, growth, maturity and decline. Vernon observes that, at the first stage of production, US MNEs tend to produce new and innovative products in the US for mainly home consumption without undertaking any FDI, and the rest of the output is exported to serve foreign markets. As products progress to the growth stage and become high in growth and demand, the US MNEs begin to undertake to set up production in other countries. Interestingly, MNEs local markets, while, foreign competitors start to enter the market (*Basu, 1997*). Consequently, the demand for exports from the US declines; and the US consumers begin to purchase some of the products from these newly industrialized countries (NICs).

As the production progresses to maturity phase, the problem emerges from cost-reduction for the producers. Most FDI, which was initially allocated in advanced countries, is shifted to other lower cost NICs. Apart from the local market consumption, part of the output is exported to serve the US and other foreign markets. Therefore the US and other advanced countries have switched from being exporters to being importer. At the final stage of production, cost-minimizing becomes the major task for the MNE's production and the allocation of FDI will be the countries having lower and even the lowest production cost. MNEs' production at the final stage of production serves not only the local market but also the US and the rest of the world.

## **III. New Growth Theory**

New growth theory incorporates two important points. Firstly, it views technological progress as a product of economic activity. Secondly, new growth theory suggests that knowledge and technology are characterized by increasing returns, and these increasing returns derive the growth process (*Cotright, 2001*). Consequently, growth is endogenous in new growth theory rather than exogenous as in old growth theory.

Investment in human capital contributes to increasing returns in the production function (*Meier and Rauch, 1995*) and the more resources devoted to Research and Development, the faster the rate of innovations and the higher the rate of growth (*De Castro, 1998*).

According to *Shan et al. (1997)*, ‘‘the capital accumulation FDI is expected to generate non-convex growth by encouraging the incorporation of new inputs and foreign technologies in the production function of the FDI recipient’s countries’’. In addition, the transfer of advanced technology strengthens the host country’s existing stock of knowledge through labour, training, skill acquisition, the introduction of alternative management practices and organizational arrangements (*D. Mello and Sinclair, 1995*). As a consequent, FDI increases productivity in the recipient economy, and FDI can be deemed to be a catalyst for domestic investment and technological progress (*Shan et al, 1997*).

The debate about the impact of foreign investment (FIs) in developing countries remains unsettled in the literature. This has generated intense controversy which had divided scholars into two distinct camps, the pro-FIs and the critics of FIs. Within each of these two groups, there are varied approaches to analyzing the impact of foreign investments as well as the associated policy prescription.

According to *Jenkins (1987) and Chitrakar (1994), Cited in Odusola, (2003); (P.226)* the Pro-FIs view foreign investment as a catalyst to industrial transformation and effective marketing management strategy. The operations of foreign investor add new resources such as capital, technology, management and marketing to host countries in a way that stimulates efficiency and change. Besides promoting employment activities, FIs also promote income distribution through bidding up for wages and driving down the return to capital. The proponents of this approach believe that national and foreign private-sector enterprises, if permitted to operate in competitive market conditions, offer developing countries the best prospects for speedy national economic growth...

Two broad groups are discernable under the Pro- FIs approach: traditional and neo – traditional schools of thought. Under the traditional school of thought are the business school and the neo-classical school. The business school strongly believes in the moral and practical

virtues of free enterprise system (*Lall, 1974*). Similarly, the neo-classical school holds the view that foreign investment act as efficient allocators of resources with the proviso that the benefit accrues to both home and host countries (*Jenkins, 1987*). They therefore recommend the removal of government induced distortions and provision of conducive environment for FIs to operate.

The neo-classical approach comprises the bargaining school and neo-fundamental school. The proponents of the bargaining school (*e.g. Greico, 1986*); posit that the benefits of FIs are not automatic. Rather, they suggest that the distribution of gains among the home and host countries depends on negotiations between the foreign firms and the recipient country's government. Thus, the quality of negotiation helps developing countries learn how to extract greater benefits from multinationals. They thus recommend the encouragement of FIs and that the host countries should build the national institutions that enhances the country's share of the associated benefits.

The critics of FIs, on the other hand, emphasize the risks that foreign investors pose for developing countries. The extent of these threats varies from one school of through to another.

Other critics of foreign investment are the global reach and Marxist/neo-imperialist approaches. The global reach approach sees foreign investment as one of the strategies of oligopolistic firms and not approach to enhancing development oriented international financial flows. Thus, their policy prescriptions hinge on regulations of transfer pricing and restrictive business practices. The Marxist views foreign investment as the clog in the wheel of developing countries development.

### 2.1.1 FDI and Spillover Hypothesis

Available evidence for developed countries seems to support the idea that the productivity of domestic firms is positively related to the presence of foreign firms (*Globerman, 1979, Imbriani and Reganeti, 1997*). The results for developing countries are not so clear, with some finding positive spillovers (*Blomstrom, 1986; Kokko, 1994 Blomstrom, 1999 and others such as Aiyken et al. (1997)*) reporting limited evidence. Still others find no evidence of positive short-run spillover from foreign firms.

However, there are several channels for spillovers of technology between firms. An example is reverse engineering and hiring of employee from competing firm that has knowledge about the technology that is used. Spillovers occur through backward and forward linkages. A forward link implies that a multinational corporation (MNCs) sells intermediate inputs to domestic firms in the host country (*Javorcik, 2004*). In the case of a backward link the MNC buys intermediate goods from domestic suppliers. In this situation it can actually be in the interest of the MNC to try to maximize spillovers to the supplier. For example, in order to improve product quality the MNC can provide technical advising resulting in a voluntary spillover of technology that increases the supplier's productivity.

*Javorick (2004)* argues that "the domestic firms could become more productive as they set access to improved MNC input goods". Against this background, there is no reason to believe that the MNC should have strong incentive to actively try to avoid technology spillovers to avoid technology spillovers to the domestic firm. In the case of an involuntary spillover; a situation where the MNC is operating in the same sector as the competing host firms, in such a case, the MNC has an incentive to prevent spillover.

#### **a. Role of FDI in transfer of technology and growth.**

Nigeria needs to strive more in improving her investment climate in order to attract FDI because of its acknowledged advantages of transferring technology and as a tool of economic development .The gains of FDI according to *Ayanwale,(2007)*, are summarized below:

- Facilitating Technology Spillover

Evidently, FDI spillover may occur in Nigeria through a variety of activities, including labor and management training, demonstration, technological copying, direct licensing of technology and vertical linkages in production and distribution chain value

Empirical evidence shows that the generated spillovers and economic growth may be influenced by direct competition, host country labor market standards, technological capability or absorptive capacity of local firms, limited technological gap between foreign and host country firm(OECD,2002) and complementarities of foreign and host country technologies, the nature of FDI, the motives and attributes of the foreign investors(Ikara,2003); high education levels, wealth, fully developed financial market and trade openness.

- Encouraging Innovation

*Ikara(2003)* maintained that “innovation is one of the direct benefit of FDI. It forces local firms to innovate to remain competitive by increasing competition in the host country market”.

Again Nigerian firms could appropriate productivity benefits from R &D performed by foreign owned firms

Regardless of where it is performed through imports of intermediate goods produced by the foreign firms and through other channels as evidenced by the work of (*Berstein and Mohnen, 1998*). It can further be argued from the result of their work that the R &D performed by foreign firms could raise the rate of return to R &D and other innovation generating activities of Nigeria domestically owned firms

- Allowing Technology Adoption

*Ikara(2003)* and *OECD(2002)* further suggested that “FDI may lead to technology adoption by Nigerian firms through establishing linkages with domestic firms via subcontracting and other mechanisms. By implication

Nigerian firms may adopt technologies introduced by foreign firms through imitation, reverse engineering, or vertical linkages”

- Developing Local Human Capital

There exists some empirical evidence that affiliates of foreign firms tend to provide training and learning than do domestic enterprises, (*OECD, 2002*),

### **2.1.2 Firm-Specific Advantages, Knowledge Capital and Externalities**

Following the ideas of *Hymer (1960)*, “it has been argued that MNEs have firm-specific advantages allowing them to operate profitably in foreign countries. According to him, examples of firm-specific advantages include superior technology, scale economics and management and it is possible to link the idea of firm-specific advantages to the concept of knowledge capital”. Knowledge capital has been important for recent development of FDI theories and has been included in new trade model analyzing FDI, such as *Carr et al (2002)* and *Markusen and Kaskus (2002)*. Knowledge capital is a broad concept consisting of intangible assets such as brand name, human capital, patents, trademarks and technology. *Markusen (1995, 2002)* argue that knowledge –capital is important for MNEs based on the fact that MNEs tend to have large R & D expenditures, a large share of technical workers and product technical advanced products. It is primarily MNE possession of knowledge-capital that is important for providing firm-specific advantage allowing MNEs to operate profitably in multiple economies.

According to *Markusen (1995)*, “knowledge –capital assets share two characteristic allowing an MNE to perform FDI. Firstly, it is easy and inexpensive to transfer knowledge capital assets to new geographical locations. Secondly, since knowledge has a joint character, it can create a flow of services and has the nature of a public good. The characteristics of knowledge capital provide the possessing firm with an ability to transfer production to foreign economies. The fact that the MNE can use its knowledge capital simultaneously in multiple locations provides an incentive to perform horizontal FDI implying the same production process is duplicated in general different locations”. This

explains why horizontal FDI tends to dominate over vertical FDI, as suggested by *Markusen (2002)*.

*Freeman (1974)* argues that “technology is a body of knowledge about techniques”. According to him, “the resource of a firm can be classified as tangible or intangible. Tangible resources consist of physical and financial capital. Intangible resources are either disembodied such as patents, brand names and designs or embodied in the form of competence individuals process such a management skills”. Freeman concept of intangible firm resources therefore roughly corresponds to the knowledge –capital concept as used by *Markusen (1995)* and others in recent FDI models. Knowledge is an intangible firm resource and therefore has special characteristics. For example, knowledge is expensive to acquire but is relatively inexpensive to sue once acquired. On the relationship between knowledge and technology, *Grandstrand (1998)* further argues that “technology is a special kind of knowledge that shares the general properties of knowledge but also has special characteristics distinguishing it from other types of knowledge. Summarizing his argument, technology is linked to artifacts and science, generally has a high degree of coding to patent rights”.

What implications does the importance of knowledge-capital and technology for MNE operations have for the growth enhancing potential of FDI inflows? Advanced technology is an important component of knowledge capital and technology in many cases forms the basis for an MNE’s firm-specific advantage. Not only is technology very important as a firm specific advantage for many MNEs, but it provides a link between FDI and economic growth.

The non-rival characteristics of technology imply that MNEs try to protect their technology by using brand names and patents. Since the MNE is dependent on its firm-specific advantage (often in the form of technology) for profitable business operation as argued by *Hymer (1960)*, “the MNE has an incentive to try to prevent Spillovers of technology to other firms. Spillovers of technology are an externality than can occur through several different channels including imitation, reverse-engineering and supplier linkages. When Spillover do not occur, it implies that MNE is unable to internalize all of the returns to its technology resulting in a positive externality since the social return on investment is higher than the private return”. The emergence of theories of endogenous growth provides a

framework describing how positive externalities can improve economic growth. Positive externalities provide non-diminishing returns to capital and therefore enhance growth. Endogenous growth therefore supports the idea that FDI could enhance economic growth.

### **2.1.3 Physical Capital and Labor**

Technology spillovers provide externalities which should have a positive effect on economic growth in the host country. Besides of Knowledge-capital, FDI can also generate an inflow of physical and human capital to the host country (*Johnson, 2006*). As the size of the host country physical capital stock increase the productive capacity of the host country also increases. Even though additional capital can have important effects on economies with a low capital-labor ration, diminishing returns imply that accumulation of physical capital cannot function as a permanent source of long-run growth. Since second type models rule out capital as a source of long-run per capital growth, in such a framework FDI can only affect growth through an inflow of capital in the short-run while the economy is in transition towards steady state. However, empirical research on the role of capital accumulation for economic growth has not been conclusive. *Easterly and Levine (2001)* used a growth accounting framework and reached the conclusion that “investment in physical capital is relatively unimportant in explaining long-run economic growth since technological progress accounts for most of the cross-country variation in growth”. On the other hand, *Bon et al (2004)* argue that this conclusion is “premature since the modeling framework in Easterly and Levine is too restrictive”.

An inflow of FDI is unlikely to generate a large inflow of labor to take host country. Except for management, most of the MNE employees are expected to be recruited from the host country labor force.

Furthermore, when investment takes the form of Brownfield FDI it is not uncommon that MNEs lay off a substantial share of the incumbent labor force as usually done during privatizations. Therefore, FDI is not expected to affect economic growth through changes in the stock of labor. The primary effect from FDI inflows on host country economic growth

should arise as a result of technology Spillovers rather than through an increase in the stock of capital and labor. A view shared by other studies such as *De Mellor (1997)*.

#### **2.1.4 Greenfield and Brown field FDI**

The growth enhancing ability of FDI is affected by the chosen mode of FDI. It is argued by *Johnson (2006)* that the “effects of FDI inflows on variables such as technology Spillovers and physical capital are expected to differ between Greenfield and Brownfield FDI.” According to him, Greenfield FDI implies “that MNE construct new facilities of production, distribution or research in the host country”. This result is an increase in the host country stock of physical capital that can be substantial, especially for capital scarce developing economies. In the case of Brownfield investment, the “MNE acquires already existing facilities in the host country”. Brownfield FDI should therefore only result in a limited increase in the stock of physical capital since there is a change in ownership rather than an inflow of new capital. Greenfield and Brownfield FDI should affect host country growth differently since Greenfield FDI results in a larger inflow of physical capital.

## **2.2 EMPIRICAL LITERATURE**

There is a large body of literature that has modeled the investment behavior of countries across the world. These studies have adopted various investment models such as the accelerated model, the cash-flow model, Tobin’s Q model, and the neoclassical model/Torgenson approach), which differ according to the various assumptions on which the model rest. Most studies on the determinants of investment (*ie, Shafik (1992), Oshikoya (1994), Gbura and Goodwin (2010), Ndikiemana (2000), Du Toit and Moolman (2004) and Bayrakatar and Fofack (2000)*), have focused on macroeconomic and financial variables while ignoring the role played by policy and institution.

An empirical model on private investment that takes into account the major features of a developing country is investigated in *Shafik (1992)*. Using the co integration and error-correction techniques under a neoclassical framework of profit-maximizing and cost-

minimizing behavior of firms, the result suggests that mark-up prices, internal financing of firms and the cost of investment goods are the major determinants of private investment in Egypt.

The important role played by macroeconomic and financial variables as determinants of domestic investment in Sub-Saharan Africa (SSA) is investigated by *Oshikoya (1994)* and *Ndikumana (2000)*. Evidence from their panel data estimates shows a positive and significant relationship between domestic investment and the various indicators of financial development and macroeconomic variables. Similar results were found in *Ghura and Goodwin (2000)* who investigated the determinants of private investment in Asia, Sub-Saharan Africa and Latin America

In analyzing foreign direct investment in Nigeria and the agricultural sector, *Ogbanje et al (2010)* employing one-way analysis of variance concludes that the ‘‘agricultural sector, comprising crop production, forestry and fishery, received the least mean net foreign investment, showing that foreign investment discriminate against Nigeria’s agriculture, notwithstanding the strategic position of the sector to the economy’’. This portends that foreign investors are much interested in the sectors that are beneficial to them rather than the need to sustainably enhance the economy of their host country.

*Alfaro et al (2001)*, using cross-section data, find that poorly developed financial infrastructure can adversely affect an economy’s ability to take advantage of the potential benefits of FDI. The empirical result of the relationship between real GDP per capital and FDI is mixed. In the works of *Edwards (1990)* and *Jaspersen et al (2000)*, using the inverse of income per capita as proxy for the return of capital, they conclude that real GDP per capita and FDI/GDP are negatively related. Results of studies by *Schneider and Frey (1985)* and *Tsai (1997)* are different as they find a positive relationship between the two variables.

There is a dearth of empirical work that is solely concentrated on the determinants of FDI in African countries. In most of the studies that have been carried out, only a limited number of African countries are included. For example, *Gustanaga et al (1998)* consider a total of 49 countries, only 6 of which are sub-Saharan African (SSA), while *Schneider and Frey (1985)* consider 51 countries, of which 13 are in SSA. In their econometric analysis of

the determinant of FDI using panel data, *Elbadawi and Mwege (1997)* argue that while market size is relatively unimportant in explaining FDI flows to Africa, economic growth is an important determinant.

Two studies also concentrate on Africa. The first by *Selwman et al (2000)*, which is limited to South Africa, analyses how government policy (mainly deficit and taxes), affects FDI. The second set of papers is by *Asiedu (2002, 2004)*. Using cross-section data on 71 developing countries, *Asiedu (2002)* attempts to answer the following set of questions: What factors drive FDI to developing countries? Are these factors equally relevant for FDI to SSA? Why has SSA attracted so little FDI? Why has SSA been relatively unsuccessful in attracting FDI despite policy reform? Is Africa different? The analysis is focused on only three main variables – the return on investment, availability of infrastructure and openness to the trade and does not take into account natural resources availability, which is an important determinant of FDI to Africa.

*Asiedu* concludes that:

- “Countries in SSA have an average received less FDI than countries in other regions by virtue of their geographical location.
- Both higher return on investment and better infrastructure have positive impact on FDI to non-SSA countries, but no impact on FDI to SSA.
- Openness to trade promotes FDI to SSA and non-SSA countries. The marginal benefit from increased openness is less for SSA, suggesting that trade liberalization will generate more FDI to non-SSA countries than SSA countries”.

*(Asiedu (2002))*

In another paper, *Asiedu (2003)* used panel data on 22 African countries for the period 1984-2000 to examine empirically the impact of several variables including natural resource endowment, macroeconomic instability; FDI regulatory framework, corruption; political instability and investment restrictions deter investment flows. These results imply that African government can play major roles in promoting FDI to the region through appropriate policy framework.

Empirical studies of the relationships between FDI and uncertainty in developing countries are very few. Two studies, by *Ramsamy (1991)* for developing countries, find a negative relationship between uncertainty and FDI in developing countries. *Lemi et al (2001)* examines how uncertainty affects FDI flows to African economies by analyzing FDI flows from the United States, US manufacturing FDI and US non-manufacturing FDI flow to sampled host countries in Africa. Using a generalized auto regressive heteroscedastic model, the study concludes:

- ‘‘The impact of uncertainty on the flow of FDI from all sources is important.
- For aggregate FDI from the United States, economic and political uncertainties are not major concerns.
- For US manufacturing FDI, only political instability and government policy commitment are important factors, whereas for US non-manufacturing FDI, economic uncertainties are the major impediments only when coupled with political instability and debt burden of host countries.
- Other economic factors such as labour, trade connections, size of the export sector, external debt and market size are also significant in affecting FDI flow to Africa’’.

*(Lemi et al (2001))*

Empirical studies on spillovers from FDI were pioneered by *caves for Australia (1974)*, *Globerman for Canada (1979)* and *Blomstrom for Mexico (1986)*. Since then, their empirical models have been extended and refined, although the basic approach remains. Caves hypothesis for Canada was that: If FDI has the virtue of increasing allocation efficiency; the profit rate of domestic firms should be inversely related to the competitive pressure supplied by foreign firms. The results indicated that profit in Canadian manufacturing industries did show a weak tendency to vary inversely with the foreign share. The 1966 data for 23 manufacturing industries enabled caves to test the determinants of value-added per worker in the domestic sectors of Australian industries using foreign firms’ share of industry employment as a proxy for foreign presence, caves found that the higher the subsidiary share, the higher the productivity level in competing domestic firms. The result supported the hypothesis that spillovers were present.

*Balasubramanyam et al (1996)* analyses how FDI affects good economic performance in developing economics. Using cross-section data and OLS regression, he finds that "FDI has a positive effect on good economic performance and management in host countries using an export promoting strategy but not in countries using import substitution strategy".

Another study based on developing economies in *Borensztein et al (1998)* examined the role of FDI in the process of technology diffusion and good economic performance. He concludes that "FDI has a positive effect on economic growth but that the magnitude of the effect depends on the amount of human capital available in the host country". *Olofsdotter (1998)* provides a similar analysis. Using cross sectional data she finds that an increase in the stock of FDI is positively related to growth and that the effect is stronger for host countries with a higher level of institutional capability as measured by the degree of property rights protection and bureaucratic efficiency in the host country.

*De Mello (1999)* finds weak indications of a positive relationship between FDI and economic growth despite using both time series and panel data fixed effects estimations for a sample of 32 developed and developing countries. *Zhang (1999)* analyses the causality between direct Investment and growth.

*Zhang* uses data for 11 developing countries in East Asia and Latin America. Using co integration and Granger causality tests, *Zhang (1999)* finds that in five cases economic growth is enhanced by FDI but that host country conditions such as trade regime and macroeconomic stability are important.

*Carkovic and Levine (2002)* used a panel data set covering 72 developed and developing countries in order to analyze the relationship between FDI inflow and sound economic performance. The study performs a cross-sectional OLS analysis as well as a dynamic panel data analysis using generalized maximum likelihood. The paper concludes that there is no robust link running from inward FDI to host country economic growth.

*Bengoa and Sanchez – Robles (2003)* investigated the relationship between FDI and market freedom and growth using panel data for Latin America. Comparing fixed and random effects estimations they conclude that FDI has a significant positive effect on host

country economic growth but similar to *Borensztein et al (1998)* the magnitude depends on host country conditions.

*Kalemlı-Ozcan (2004)* investigated FDI and economic growth: the role of local financial markets, on selected OECD and non- OECD countries using cross-country data. He concluded that, Direct Investment alone plays an ambiguous role in contributing to economic growth but with countries with well-developed financial markets.

*Ayanwale (2007)*, using an augmented growth model via the ordinary least squares and the 2SLS method ascertained the relationship between FDI, its components and economic growth. The result obtained from his study concludes that the determinants of FDI in Nigeria are market size, infrastructure development and stable macroeconomic policy. That openness to trade and available human capital, however, are not FDI inducing

*Jerome and Ogunkola (2004)* assessed the magnitude, direction and prospects of FDI in Nigeria. They noted that while the FDI regime in Nigerian was generally improving, some serious deficiencies remain. These deficiencies are mainly in the area of the corporate environment (such as corporate law, bankruptcy, labour law, etc).

*Herzer et al (2006)* using a bivariate VAR modeling technique, found evidence of a positive FDI-led growth for Nigeria, Sri Lanka, Tunisia and Egypt ; and based on weak exogeneity tests, a long-run causality between FDI and economic growth running in both directions was found for the same set of countries. A slight difference from this result is observed in *Okodua (2009)* who examined the sustainability of the FDI growth relationship in Nigeria.

Ogho(2011) is of the view that the Nigeria economy has the potential for significant increments in investment. However, the nature of attracting investment is such that the public investment must precede private.

*Udeme(2011)* Summarized that FDI represents 78.1 percent drop from \$3.31 billion in 2009, while attributing the decline to the increasing rate of insecurity in the country as well as infrastructural decay.

**SUMMARY OF EMPIRICAL LITERATURE RELATED TO THE STUDY**

<b>AUTHOR/YEAR</b>	<b>LOCATION</b>	<b>NATURE OF STUDY</b>	<b>NATURE OF DATA</b>	<b>METHODOLOGY</b>	<b>FINDINGS</b>
<i>Balasubramanyam (1996)</i>	Developing countries	FDI and economic growth	Time series	Ordinary least square (OLS)	FDI has a positive effect on growth in host country using an export promotion strategy but not in countries using import substitution
<i>Borensztein (1998)</i>	Developing countries	FDI, technology diffusion and growth	Time series	Ordinary least square and trend analysis	FDI has a positive effect on growth but the magnitude of the effect depends on the amount of human capital in the host country.
<i>Olofsdoffer (1998)</i>	Developing countries	FDI, technology diffusion and economic growth	Time series	Ordinary least square and trend analysis	Stock of FDI is positively related to growth and the effect is stronger for host countries with a higher level of institutional capability as measured by the degree of property right protection and efficiency (Management) in the host country.
<i>Zang (1999)</i>	East Asia and Latin America	Causality between FDI and Economic	Time series	Co integration	Economic growth is enhanced by FDI but that the host country conditions such as trade regime and

					macroeconomic stability are important.
<i>Carkovic and Levine (2002)</i>	Developed and developing	Relationship between FDI inflow and economic growth	Times series	Ordinary least square	There is no robust link running from inward FDI to host country economic growth.
<i>Muogbo &amp; Kayar(2011)</i>	Nigeria	Marketing Investment climate in Nigerian: Issues and policy option	Times series	Ordinary least square method (OLS)	Investment and trade are two complementary elements in the strategy to accelerate Nigeria's development, boost the rate of economic growth and sustain progress towards eventual eradication of poverty.

Studying the relationship between FDI and telecommunication growth in Nigeria, *Oji-Okoro (2010)*, employing ordinary least square found out that the more dependent variable account for the 97% variation of the FDI with only 3% accounted by the error term. He therefore, concluded that “FDI influx has tremendously boosted the telecommunication and that government should maintain a stable regulatory policy that will encourage investors’ confidence to boost the industry.

*Okwu and Saror (2010)* in their own study and using the techniques of descriptive statistic (one-way Analysis of Variance, ANOVA) found out that “the manufacturing and processing sector was the most highly favored by the net flow of foreign investment”. According to them, government should “focus more on Nigeria’s agricultural sector because of the strategic relevant of the sector to the nation’s economy.

*UNCTAD (2009)* in their official report on Investment Policy Review in Nigeria conclude that “emphasizes should be on the need to improve the overall environment for doing business and to adopt an effective investment promotion approach:

*Ajayi (2006)* in his studies of the potentials of FDI in Africa concludes that “policy makers in Africa should give more careful consideration to trade-offs if they wish to maximize the benefits from FDI”.

*Njong (2008)* in “Investigation the effects of foreign direct investment on export growth in Cameroon” found out that “potential output has a significant and positive effect on export growth, revealing problems of competitiveness and effectiveness of Cameroon enterprises which may include aging equipment, low utilization of existing capacities; high cost of inputs and transactions. He therefore suggested for “strategies that would lead to improvement in infrastructure, human resources, good governance and the business climate.

*Siphambe (2008)* in his study “Foreign Direct Investment in Africa: Botswana case study” conclude that “good macroeconomic policies are necessary for attracting FDI, but these are not sufficient. However, dealing with these factors is a major challenge to Botswana in attracting FDI to Bostwana.

*Obwona and Egesa (2011)* studying FDI inflows to Uganda conclude that “poor quality infrastructure, corruption and the need to further improve institutional support” has made attracting FDI in the country cumbersome”.

*Rousset et al (2010)* in studying “Foreign Direct Investment in South Africa” found out that “labor market, business environment, crime, corruption and anti-competitive practices are major constrains to attracting FDI in South Africa”.

*Ngugi (2009)* in studying “Foreign Direct Investment in Kenya” fund out that “FDI has not played an important role in Kenyan economy despite the reforms that have been undertaken and the many incentives provided to foreign investors”.

*Johnson (2006)* in studying the “effects of FDI inflows on host country economic growth”, using the cross-section and panel-date analysis found out that “FDI inflows have a positive effect on host country economic growth for developing countries but not for developed economies”. This may reflect that in a mature market economy there is no difference between domestic and trans-border investment.

*Boreasztein et al (1998)* and *De Mello (1999)* found a complimentary relationship between domestic and foreign investment suggesting that Greenfield FDI has a potential for affecting economic growth through an additional increase in the host country stock of physical capital.

*De Mello (1997)* argues that a “complimentary relationship between FDI and domestic investment dominates in developing countries”.

As argued by *Javarcik (2004)*, backward and forward linkages provide two scenarios where Spillovers could occur voluntarily between the MNE and the supplying and supplied firm respectively.

According to *Keller (2004)*, earlier empirical studies of the existence of technology Spillovers on the micro-level have reached mixed results. A possible explanation can be that there are many factors affecting the amount of Spillovers taking over.

*Teece* (1977) showed how the cost for transferring technology is substantial even in situations where both parties desire this. *Glass and Saggi* (1998) suggested that an economy's stock of human capital can be used as a proxy for the absorptive capacity on the national level. The threshold concept implies that no Spillover occur if the absorptive capacity of the host country firm is too low. The idea of a threshold level of absorptive capacity has been used in empirical studies such as *Borensztein et al* (1998).

*Jhigan* (2003) posit that “investment could be induced or autonomous”. Induced investment is profit or income motivated. On the other hand, autonomous investment is independent of the level of income.

*UNCTAD* (1999) submits that FDI has either a positive or negative impact on output depending on the variables that are entered alongside it in the test equation. These variables include the initial per capital GDP, education attainment, domestic investment ratio, political instability, and terms of trade, black market exchange rate premiums and the state of financial development. Examining other variables that could explain the interaction between FDI and growth, (*Olofsdotter*, 1998) submits that the beneficiary effects of FDI are stronger in those countries with a higher level of institutional capacity. He therefore emphasized the importance of bureaucratic efficiency in enabling FDI effects.

*Holger and Greenway* (2004) argued that FDI can affect growth and development by complimenting domestic investment and by facilitating trade and transfer of knowledge and technology.

According to *Shatz and Venables* (2000), “international differences in factors and raw material prices and refinements in production technology will tend to encourage vertical FDI”. This form of FDI is usually trade creating, since products at different stages of production are shipped between different locations and especially back to the MNE's home market.

*Dunning* (1993) proposes a framework that synthesizes the explanations and suggests that three conditions are required to motivate a firm to undertake FDI. This has become known in the FDI literature as the OLI paradigm because it explains the activities of MNEs in terms of Ownership (O), Location (L) and Internalization advantage (I).

Singh and Jun (1995) find a significant negative relationship between the real exchange rate and FDI for a group of developing countries, while Edwards (1990) finds a significant positive relationship. Goldberg and *Kolstad (1995)* find exchange rate uncertainty to negatively affect the production level, but the relationship with FDI is unclear. *Akinkugbe (2003)* finds only a marginal negative effect of inflation on FDI. Schneider and Frey (1985) find both high balance of payments deficits and inflation to negatively affect FDI.

The influence of fiscal incentives (e.g. tax holidays, subsidies and others) is expected to be positive, but empirical studies have had mixed results. *Wheeler and Mody (1992)* find them not important, while UNCTC (1991) finds evidence that tax incentives have a positive influence on FDI. Billing ton (1999) observes that host country corporate tax has a negative effect on FDI.

The quality of institutions is widely discussed in the FDI literature, but its empirical implementation is made difficult by measurement problems. Several variables have been used to assess the impact of institutional quality on FDI flows. The levels of sociopolitical instability, corruption, administrative bottlenecks and inefficient and inequitable legal systems have been found to have a negative influence on FDI flows (*Singh and Jun, 1995, Obwona, 1998, Campos and Kinoshita, 2003*).

The empirical literature has also examined the effect of agglomeration factors on FDI. These include the level of infrastructure development and the existing stock of FDI. Both generally have a positive impact on FDI *Akinkugbe (2003), Wheeler and Mody, (1992), Barry and Bradley, (1997); others*. *Asiedu (2002)*, however, finds that “infrastructure development attracts FDI to other developing countries, but not to Sub-Saharan Africa”. A number of other variables have been included in FDI equations with varying results. Amongst them are human capital, government consumption, external and many others.

*Chakrabarti (2001)* attributes the wide divergence of views in the empirical literature to the wide differences in perspective, methodologies, sample selection and analytical tools.

### 2.3 AN OVERVIEW OF INVESTMENT TREND IN NIGERIA

At independence, in addition to being leading exporter of groundnut, Nigeria account for 16 and 43 per cent of world coca and oil palm production respectively. The country was largely self-sufficient in terms of domestic food production (85 per cent) and Nigerian agriculture contributed to over 60 per cent of GDP and 90 per cent of exports. Conversely, manufacturing was less than 3 per cent of GDP and 1 per cent of exports, while the oil sector represented only 0.2 per cent of GDP.

“At the time, the foreign presence in the economy was significant. More than 25 per cent of companies registered in Nigeria in 1956 were foreign-owned while in 1963 as much as 70 per cent of investment in the manufacturing sector was from foreign sources” (*Ohiorhenuan, 1990*). Most FDI was from the Middle East and Europe (the United Kingdom especially) and concentrated in commerce and cash crops.

According to *Okigbo (1989)*, “the first National Development Plan of Nigeria (1962-1968) sought to broaden the base of the economy and limit the risk of over-dependence on foreign trade’. In keeping with the developmental question of that period, the tariff structure was formulated with industrialization and import substitution in mind.

Manufacturing initially responded positively to the new policy but with foreign exchange and import licensing controls introduced in 1971-1972, the progress halted.

In addition to industrialization, removing the dominance of foreign entities in Nigeria economic and political life was a preoccupation of popular discourse. Legislation embodying goals of economic nationalism and state-led growth was adopted.

The second National Development Plan (1970-1974) accelerated indigenization on grounds that it was “vital for government to acquire, by law if necessary, the greater proportion of the productive assets of the economy”, (*Nigeria Investment Review Policy, 2010*). Restrictions were therefore imposed on the activities of foreign investors with the first “indigenization decree”.

The indigenization policy started in 1972 with “the Nigerian Enterprises Promotion Decree” (NEPD). The decree imposed several restrictions on FDI entry. As a result, some 22 business activities were exclusively reserved for Nigerians, including advertising, gaming, electronics manufacturing, basic manufacturing, road transport, bus and taxi services, the media and retailing and personal services. Foreign investment was permitted up to 60 per cent ownership and provided that the proposed enterprise had, based on 1972 data, share capital of N200,000 (\$300,000) or turnover of N500,000 (\$760,000).

The second indigenization decree, the Nigerian Enterprise Promotion Decree of 1977, tightened restrictions on FDI entry in three ways:

- i.** By expanding the list of activities exclusively reserved to Nigerian investors (e.g. bus service, travel agencies, the wholesaling of home products, film distribution, newspapers, radio and television and hairdressing;
- ii.** By lowering permitted foreign participation in the FDI restricted activities from 60 to 40 percent and adding new activities restricted to 40 per cent foreign ownership such as fish-trading and processing, plastic and chemical manufacturing, banking and insurance; and
- iii.** By creating a second list of activities where permitted foreign investment was reduced from 100 to 60 percent ownership, including manufacturing of drugs, some metals, glass, hotels and oil service companies, UNCTAD (2010).

Relaxations of these restrictions began in 1989. The NEPD was amended so as to leave a single group of 40 business activities in which foreign participation was completely prohibited unless the value of the enterprise exceeded N20 million (\$2.7 million in 1989). In addition, foreign investors could only have a share of up to 40 per cent in insurance, banking, oil producing and mining, NIPC (2011).

In 1995, the Nigerian Investment Promotion Commission Act opened all sectors to foreign participation except for a short negative list (including drugs and arms) and allowed for 100 per cent foreign ownership in all sectors, with the exception of petroleum sector (where FDI is limited to joint ventures or producing sharing).

Following the major decline of oil prices in the early 1980s, the shortcomings of past economic planning were exposed. Agriculture accounted for less than 10 per cent of

exports and the country had become a net food importer. Manufacturing output started falling at about 2 per cent per annum between 1982 and 1986 while GDP stagnated, with less than 1 per cent growth annually. Furthermore, by 1986, there were about 1,500 state-owned enterprises, of which 600 were under the control of the federal government and the remainder under state and local governments. The evidence suggests that many made no contribution to Nigeria's productive capacities and many enterprises were not financially viable (*Mahmoud, 2004*).

The cumulative effect of these policies is that Nigeria has not undergone the structural transformation experiences by other developing countries in the last 40 years. Manufacturing still represents only around 4 per cent of GDP, compared with 14 per cent on average throughout Sub-Saharan Africa. Furthermore, the comparative growth of manufacturing and service in Malaysia (also a leading oil palm producer at independence in 1954) and Indonesia (a large country with significant oil production) are clear examples of how Nigeria has fallen behind. Hence, nearly 40 years of misallocation of public finances have taken a heavy toll on the state of basic infrastructures. Maintenance spending at levels close to zero led to the sharp deterioration in the water supply, sewage, sanitation, drainage, roads, and electricity infrastructure (Central Bank of Nigeria, 2004; and World Bank, 1996). In order to restore economic prosperity and address external shocks such as the global recession of the early 1980s, the government initiated a series of austerity measures and stabilization initiatives in 1981-1982. These, however, proved unsuccessful and a structural Adjustment Programme (SAP) followed. The SAP (1986-1988), which emphasized privatization, market liberalization and agricultural exports orientation, was not implemented consistently and was at odds with other facets of policy, e.g. tariff increases. But an economic reform process which continues to the present has its origins in this period.

Today, the FDI story of Nigeria is dominated by the oil industry. It was not always so. At independence in 1960, there was a widespread FDI presence in the economy. Policy design thereafter narrowed the scope for FDI and decades of political instability, economic mismanagement and endemic corruption further reduced Nigeria's ability to attract and retain FDI. This was compounded by a relentless deterioration of the country's second

conditions and physical infrastructure, in spite of increased public revenue generated by the oil sector, *UNCTAD (2009)*.

While oil has played an important role in Nigeria, data shows that over 70 per cent of the population lives on less than one dollar a day (this represents a quarter of all African's living in this condition). The manufacturing sector has hardly progressed and only 3 per cent of agriculture is mechanized.

The return to democracy in 1999 in Nigeria has created the opportunity for economic renewal and an associated broader base of FDI. To reap the benefits of FDI, the government of Nigeria undertook ambitious measures with a view to improving the investment climate. The reform process also takes into account the potential role Nigerians, close to 5 million living abroad could play. The policy changes have started bearing fruits and if sustained, they will certainly provide an environment more conducive to private investment and contribute to enhance the attractiveness to FDI of Nigeria's large and growing market.

In order to restore economic prosperity and address external shocks such as the global recession of the early 1980s, the government initiated a series of austerity measures and stabilization initiatives in 1981 – 1982. These, however, proved unsuccessful and a structural Adjustment Programme (SAP) followed.

The SAP (1986-1988), which emphasized privatization, market liberalization and agricultural exports orientation, was not implemented consistently and was at odds with other facets of policy, e.g. Tariff increases. But an economic reform process which continues to the present has its origin in this period.

Following the return to democracy in May, 1999, the reform process was re-energized, mainly through Nigeria's home-grown poverty – reduction strategy. The National Economic Empowerment and Development Strategy (NEEDS), adopted in 2003, were meant to guide public policies until 2007. The preparation of NEEDS followed a highly participatory process associated poverty reduction strategies were developed at the states and local levels – State Economic Empowerment and Development Strategy (SEEDS) and local Economic Empowerment and Development Strategies (LEEDS). NEEDS, SEEDS, and LEEDS were major departures from the policies of the past. Their broad agenda of social and economic reforms was based on four key strategies to:

- (a) Reform the way government works in order to improve efficiency in delivering services, eliminate waste and free up resources for investment in infrastructure and social services.
- (b) Make the private sector the main driver of economic growth, by turning the government into a business regulator and facilitator.
- (c) Implement a “social charter”, including improving security, welfare and participation, and
- (d) Push a “value re-orientation” by shrinking the domain of the state and hence the picture of distributable rents which have been the haven of public sector corruption and inefficiency.

In contrast with previous development plans, NEEDS made FDI attraction an explicit goal for the government and paid particular attention to drawing investment from wealthy Nigerians abroad and from Africans in Diaspora. Though most FDI is still destined for the oil industry, the steps being taken under the reform agenda are bearing fruit. Average GDP growth, which was 2.8 per cent per annum between 2000 and 2003, had reached 6 per cent in 2006 (9.4 per cent in the non-oil sector). According to NEEDS, Nigeria would have to achieve 30 per cent annual investment and 7 to 8 per cent growth to successfully halve poverty by 2015 in line with the Millennium Development Goals.

FDI inflows to Nigeria have been profoundly affected by the development of the oil sector, its world price and the government’s policies in this area. In 1970, one year before Nigeria joined the Organization for the Petroleum Exporting Countries (OPEC), FDI inflows stood at \$205 million. By 1975, they had reached \$407 million. FDI inflows also reacted positively to more attractive fiscal terms for private sector participation in oil and gas that were introduced in 1986. The reduction of the Nigerian national Petroleum Corporation (NNPC) stake in Shell Nigeria and other oil companies from 80 to 60 per cent, which took place in 1989, (Mergers and Acquisition (M & A) data shows \$1 billion worth of such transactions in 1989, after which FDI inflows in Nigeria have never decreased below \$1 billion per year) also had a positive impact.

In the same way, although there are indications that non-oil FDI is rising, correlation between the level of world oil prices and the FDI inflows to Nigeria is particularly strong.

This is especially the case since the early 2000s, when the rise in oil prices undoubtedly explains most of the sharp increase in FDI.

FDI inflows in sectors other than oil were directly affected by the various private sector policies adopted since the early 1970s. It has been shown clearly that FDI inflows fell in the immediate aftermath of the second Indigenization Decree, which many TNCs to divest. Among those were Citigroup, IBM and Barclays Bank in 1979,

Restrictions on the entry of non-oil FDI continued until the late 1980s. In 1989, they were partially reversed which contributed to the shift in the levels of FDI after that year. However, it was not until 1995 that the National Investment Promotion Act opened virtually all areas of the economy to foreign investors. This was accompanied by the foreign exchange Decree, which eased access to foreign exchange for business purposes. More recently, the improved macroeconomic environment and the reforms to the business environment explain the increase in non-oil FDI.

Between 1970 and the mid-1990s, Nigeria-as the primary destination for FDI inflows to Africa – accounted for more than 30 percent of all FDI inflows to the continent. This is largely as a result of its oil attractiveness. However, in 2007, notwithstanding the boom oil industry, Nigeria accounted for only about 16 percent of total FDI inflows to Africa. Its leading role in terms of attracting FDI started eroding due to the surge of FDI inflows to other oil-rich countries, such as Angola and Sudan. Another factor is the improved FDI performance of other large African countries such as Egypt and South Africa which were successful in attracting FDI in diverse sectors of their economies.

Given its population, Nigeria's recent underperformance in FDI attraction within Africa is becoming more pronounced. The first half of the 1990s, per capita FDI inflows were higher in Nigeria than in any other African country with the exception of Angola and Equatorial Guinea. Thereafter, other African countries began to catch up.

In the most recent period (2001-2007), the average per capital FDI inflows to other large African countries and other oil producers in the continent all exceeded those to Nigeria. This indicates that Nigerians is not sharing fully the growing non-oil FDI to the continent. Nigeria is dominant recipient of FDI within the Economic Community of West African Countries (ECOWAS) group, accounting for more than 70 per cent of group inflows since 2001. In the 1970s, Nigeria attracted about half of the FDI inflows to the region. The

increase in Nigerian's share since then reflects both the less restrictive conditions for oil FDI and the growing foreign interest for the sector.

In terms of absolute FDI stock, Nigeria remains second only to South Africa in the continent with \$63 billion and \$93 billion respectively. In per capita terms, however, its relative underperformance is evident, and while its stock (\$424) is at par with the African average (\$405), it is much smaller than that of other oil-producing countries, and of South Africa and Egypt.

FDI to Nigeria is nonetheless a key contributor to the country's capital accumulation. During 2001-2007, FDI accounted for more than half the gross fixed capital formation (GDCF), compares to an average of around 15 per cent in the rest of Africa, and 12 per cent for developing countries as a group.

## **NIGERIA'S PRIVATIZATION AND FDI**

In many developing countries, privatization has been a very important source of FDI over the last two decades. Nigeria has implemented two rounds of privatization since 1980s – the first one (1968-1993) as part of the Structural Adjustment Programme (SAP) and the second one since return to democracy in 1999. During the first privatization, foreign investors were excluded from bidding in all sectors except oil. This was effectively the last major expression of the indigenization policy. The sale of oil interests to Elf Aquitaine for \$500 million in 1992, however, represented almost two thirds of the total proceeds from privatization (\$740 million). Before the process stalled due to lack of investor interest, 88 of the 111 companies slated for privatization were privatized, including those in the financial, agriculture, good manufacturing, tourism, and transport (railroad) industries.

In contrast, the second privatization wave, originally scheduled to last from 1999 to the end of 2003, focused on attracting foreign investment. By then the 1995 landmark NIPC decree was in place. Almost 100 enterprises were targeted for privatization or commercialization in three phases:

- Phase 1 – full divestiture of government ownership in banks, oil marketing and cement;

- Phase II – full divestiture in hotels, insurance companies, vehicle assembly and parts and other enterprises in competitive markets and
- Phase III – partial divestiture of government ownership in major public enterprises in backbone services, e.g. electric power, telecommunications, ports and rails, oil and gas.

All 14 enterprises intended for the first phase of the current round of privatization have been fully divested. Sales proceeds totaled approximately N2828 billion (\$261million), of which about N4billion (\$36 million) was from foreign sources. Another 14 enterprises falling under phase two had been privatized by April, 2005 and N8 billion (\$62.4 million) was raised for the federal government as a result. Foreign investors included Blue Circle Industries of the United Kingdom (71 per cent of Ashaka Cement Co. Plc and 58 per cent of the West African Portland Company – WAPCO), Scancem of Norway (87 percent of Cement Company of Northern Nigeria) and Global Infrastructure of India (80 per cent state of Delta Steel Company).

Progress in the privatization of Nigeria’s public utilities (Phase III) has been slower due to the need to develop an adequate regulatory and institutional environment for private sector participation.

Privatization in the power sector has proceeded so far as the restructuring of the industry but divestiture is as yet to be realized. Nevertheless, there have been some successes in the drive to draw FDI into Nigeria’s third phase industries, particularly in aviation and ports.

## **FDI BY SECTOR AND COUNTRY OF ORIGIN**

Any accurate analysis of the distribution, role and impact of FDI inflows in a host economy should be based on reliable statistics. In Nigeria, such analysis is made difficult by concerns about data quality and availability issues. In the absence of reliable official data as to the sector composition of FDI, estimates have largely been made from alternative sources. Prior to the 1970s, oil FDI was estimated to amount to only 10 per cent of total inflows. FDI was significant in commerce and what were then Nigeria’s principal exports, e.g. palm oil (World Bank, 1974; and Central Bank of

Nigeria, 2004b). Since then, FDI inflows have concentrated in the oil sector. This is despite the opening of the economy to FDI which started in the 1990s and the efforts to attract investment in other sectors, including via the establishment of free trade zones (FTZs). Nevertheless, more recently, diversification of FDI inflows is observed. It is attributable to management and in the business environment on investors' confidence, as reflected in the favorable country rating by international rating agencies.

There are some indications that FDI inflows to sectors other than oil and gas are reacting positively to the various reforms to the investment climate carried out since 1999. Several established non-fuel-sector TNCs have recently expanded production in Nigeria. For example, Heineken invested E250 million (about \$390 million) in purchasing and expanding Nigerian Breweries in 2004. The South African telecommunication company MTN, now the largest mobile telephone operator in Nigeria, has invested over \$3billion in the sector between 2001 and 2006, and has expressed commitment to ongoing expansion.

The Nigerian authorities are also renewing their efforts to attract FDI to the FTZs. Between 2001 and 2007, four new zones became operational and 10 more were under construction. At present, of the nine operational zones, three are reserved for services to the oil sector. The remaining zones have so far attracted some FDI. Calabar, the most advanced zone, reported total foreign investment of about \$230 million as of the end of 2005.

Nigeria's under performance in FDI attraction outside the oil sector can nonetheless be illustrated by reference to prominent TNCs that are not present in Nigeria but have invested in its peers. In 2003, only 18 of the top 100 world's largest non-oil TNCs (As measured by assets held abroad) had affiliates in Nigeria, compared to 42 in South Africa, 25 in Egypt, and 17 in Kenya. In total, 41 of the top 100 were present in at least one of these countries but not in Nigeria. These 41 TNCs represent a wide range of sectors, with pharmaceuticals and motor vehicles prominent.

An important challenge for the diversification of future FDI flows into the Nigerian economy will be the attraction of world-class TNCs. Continued growth in Nigeria's internal market, matched with accelerated regional integration within ECOWAS, would contribute to Nigeria's FDI attractiveness, including for the world's top TNCs.

An upsurge in FDI from South Africa is one of the most significant trends of the last decade. Nigeria is South Africa's third-largest trading partner on the continent after Zimbabwe and Mozambique (which benefit from regional trade agreement) and the largest in West Africa (Business in Africa, 2005).

More than 20 South African companies are today in Nigeria, segments ranging from construction, telecommunications and entertainment to revenue collection and aviation.

Like most developing countries, the Nigerian government dominated investment from 1960s through the 1980s. During the late 1970s and early 1980s, the economy witnessed an enormous growth as a result of the oil boom. Sequel to the oil boom, there was an investment boom especially in the public sector.

The Nigerian economy witnessed heavy investment of public funds by both the state and federal government in different enterprises, infrastructures supply/development enterprises and financial enterprises. During 1980 and 1981, the investment share declined, though it still remained high by historical standards. After 1983, however, the investment profile began to fall dramatically. Available data shows that, during the investment boom, the investment/GDP ratio stood at 16.8 and 31.4 percent in 1974 and 1976 respectively, with corresponding growth rates of the economy at 11.2 and 9.5 per cent. Whereas the investment/GDP ratio fell to 11.4 and 5.1 percent in 1984 and 1985 respectively, the growth rate of the economy was negative at 5.4 and 5.1 percent.

Following these negative growth rates and the need to arrest this decline, the government adopted the structural Adjustment programme (SAP) in 1986 with a view to facilitate investment and economic growth in order to achieve a greater capacity for development. To this end, the interest rates regime was more influenced by market forces.

This policy shift de-emphasized direct investment stimulation through low interest rates and encouraged savings mobilization by decontrolling interest rates. Under SAP, Several economic reforms were embarked on to promote private investment and reduce the growth of public investment. Generally, through the pursuit of a market oriented development scheme, the government was able to simplify both the regulatory and policy environment.

The result of privatization as at April 1993 shows that a total of 73 out of 111 targeted enterprises were privatized and by 1998 most strategic utilities were earmarked for privatization. Beyond reorientation of public enterprises towards a new horizon of performance improvement, viability, marketability and overall efficiency, privatization has other potential impacts such as greater private and foreign investment, political realignment and expansion of the capital market. Available statistics show that the private investment share of GDP increased consistently from 3.3 drop in 1991. Between 1994 and 1996, the ratio ranged between 9.7 percent and 12.4 per cent. The increases were linked to, among other things, the divestiture of government share in some public oriented commercial enterprises. Since 1999, the privatization programme has witnessed an impressive progress as the Bureau of public Enterprises (BPE) has concluded some important Privatizations transactions in the past years. In early 2004, arrangements were concluded for the sales of 12 firms in the next one year.

For over three decades after Nigeria's independence, the inflow of foreign private capital has not been substantially compared with the flood of such investment in countries of similar political history like Malaysia, Singapore, and Thailand etc.

Available data on foreign direct investment in Nigeria show that nominal FDI fluctuated from ₦128.6 million in 1970 to ₦404. 1 million in 1980 and ₦80, 584.2 million in 1996. Also FDI forms only a small percentage of the nations-gross domestic product (GDP). This was 2.29 percent of the in 1970, failing to – 0.8 percent in 1980, rising marginally to 1.8 per cent in 1990 and then to 3.42 per cent in 1966. Since 1999, the new democratic administration led by Chief Olusegun Obasanjo had focused on creating a new social and economic order that would promote sustainable development and reduce the level of poverty. The aim has been to enthrone good governance, accountability and transparency and the reductions of the level of corruption, which is expected to create an enabling environment for a boom in the private sector and facilitate foreign direct investment. Available statistics show an appreciable growth in private investment, foreign direct investment and gross domestic product (GDP) from 1999 to 2004.

Since 1999, direct investment increase from ₦92.8 billion to ₦132.4 billion in 2001 and got to ₦259.3 billion in 2003. Also portfolio investment grew from ₦1 billion in 1999 to

₦92 billion in 2001 and fell to ₦19 billion in 2002. Also the gross domestic product (GDP) measured at 1990 prices increased from almost 1% in 1999 to 5.4% in 2000 and dropped to 3.5% and rose significantly to 10.24% in 2002. National economic Empowerment Development Strategy (NEEDs) aims at improving on the business environment by improving on some of the identified constraints that deferred foreign entrepreneurs from investing in Nigeria and induced many Nigerians to take their money and skills abroad. Some of these factors include poor infrastructure, particularly bad network of roads and electricity supply, inadequate physical security, corruption, weak enforcement of contracts and high cost of finance. Therefore, it is expected that, with better management of the economy and the restoration of investors' confidence a higher level of investment inflow will be expected, especially in view of the high returns that investment in Nigerian offers.

*Udeaja (2005:65)* summarized that “foreign investment are expected to be attracted into manufacturing, power and steel, construction, solid minerals and large scale farming, communication, transportation, export processing zones, oil and gas through privatization programme”

## **2.4 INVESTMENT OPPORTUNITIES IN NIGERIA**

Nigeria is the second largest economy in Africa outside South Africa with huge market population and potential for economic development. Nigeria is rich in natural and human resources. The Nigerian governments past and present takes bold steps towards restructuring the public sector by developing synergy that would enable government to become more efficient with a revitalized, efficient and more service oriented public sector. Nigeria boasts of rich cultural heritage drawing from its more than 250 ethnic groups. The current democratic leadership is determined to refocus the economy by its commitment to institutional and economic reforms as demonstrated in vision 20:2020- a target of making the investment climate in Nigeria amongst the first 20 countries in the world by the year 2020. Nigeria is a mono-product economy heavily dependent on oil as more than 90% of its foreign exchange earnings come from the sector. Nigeria is located in the tropics: It has six climatic zones spread from the coast in the south bordering the Atlantic Ocean and the north

up to desert region. The country is endowed with a large agricultural potential as more than 70% of its land area are cultivable. A good network of roads linking especially its major cities and state capitals services the country. Over 33, 000km of this road network is tarred and government is making efforts rehabilitating old roads and constructing new ones. In addition Nigeria has a vibrant aviation industry in which the private sector is key player. Water transportation also exists in the riverine areas but not fully developed. To attract foreign trade and investment, the Nigerian Export Processing Zone Authority (NEPZA) is developing additional export processing zones in the different Parts of the country. In general, there are over 2000 industrial establishments in the country. Among these are giant oil and gas industry, food processing, car assembling and export processing zones.

Despite its high potentials, investment in Nigeria has performed poorly. Many reasons have been advanced for the poor investment situation in Nigeria. These include, size of the market, poor macroeconomic framework, volatile exchange rate, political and social instability (security), debt burden, unfavorable terms of trade and external shocks, poor physical infrastructures, lack of transparency, corruption, poor human development, weak financial sector (financial intermediation), high cost of doing business, enhancement of competitiveness, market access and enabling regulatory framework. In a bid to expand the solid mineral sector for sustainable development in Nigeria, the Federal government embarked on far reaching reforms in the sector. ‘Nigeria with the help of South Africa, has been developing a geochemical database of the country intended to facilitate exploration effort’. (*BUSINESSDAY, 19<sup>th</sup> March, P.43*)

In addition, the government, in partnership with the World Bank pooled US\$120 million two years to fund the solid mineral sector through the establishment of a project for sustainable management of mineral resources in an attempt to address issues of artisan and small-scale mining as a poverty reduction strategy.

In the meantime, incentives for investors include attractive tax policy, deduction of 95 percent of qualifying capital expenditure in the year of investment in all certified exploration and development expenditure (including feasibility study and sample assay costs in the year incurred).

Furthermore, unclaimed capital cost can be increased by 5 percent annually until fully recovered. In addition, tax relief period is for three years but may be extended for another two year if government is convinced of the expansion, efficiency and development of mining operations and the capacity building programme.

Beside this, Nigerian government has approved an expatriate quota and resident permits in respect of approved expatriate personnel and personal remittance quota for expatriate personnel free from any tax imposed by any enactment for transfer of external currency out of the country as permission has also been given for remittance of foreign capital in the event of sale, or liquidation of mining plant

**Table 2.1: Mineral Deposits in Nigeria According to States**

<b>States in Nigeria</b>	<b>Mineral Deposits</b>
Abia	Limestone,salt,shale,kaoline,gypsum
Adamawa	Gypsum, limestone, uranium,coal
Akwa Ibom	Silica, granite,lignite,salt,coal
Anambra	Clay, iron stone, sand stone, kaoline, pyrite,lignite
Bauchi	Koaline, Trona, gypsum, tantalite,iron ore, gemstone, columbite,,lead,Talc
Bayelsa	Salt,silica sand, bentonite, crude salt,petroleum, limestone,glass
Benue	Gemstone, Barite,quartz, zinc ore,Tin ore, bauxite, magnetie limonite
Borno	Salt, sapphire, topaz,gypsum,uranium
Cross River	Megnesite, granite, Nepheline, limestone, kaoline, bentonite
Delta	Kaoline, laterite clay, gravel
Ebonyi	Lead, Zinc ore, salt limestone, gypsum,lignite,ceramic clay, clay, cassiterite,clumbite, tantalite,

	feldspar,kaoline
Enugu	Laterite clay, kaolinistic clay, iron ore,gypsum,coal
Gombe	Graphite, kaolin, limestone ,uranium,coal,halites,diatomite,crude oil, shale, marble
Jigawa	Glass sand, granite, laterite, clay, silica, kaolin,
Kaduna	Gold, zircon, tinore, limonite,gemstone
Kano	Cassiterite, columbite,galena,thorium ,wolframite
Kastina	Gold, manganese, black tourmaline,quartz,chromite, diamond,graphite
Kebbi	Salt,iron ore, gold, mica, manganese,kaolin,feldspar
Kogi	Iron ore, gemstone, marble,limestone,dolomite, phosphate,ornamental stone

Source:www.nipc.gov.ng

## 2.5 FOREIGN DIRECT INVESTMENT IN NIGERIA: MAGNITUDE, DIRECTION AND PROSPECT

*Ogunkola. E. and Jerome, A (2006)* is of the view that ‘‘the potential contribution of Foreign Direct Investment (FDI) to economic development and integration into the world economy is now widely recognized’’. According to them, it assumed prime importance in the wake of declining concessional aid, which has created a preference for long-term and stable financial inflows. In addition to providing capital inflows, FDI can also potentially boosts the growth of a country by ‘‘Crowding in’’ other investments with an overall increase in total investment as well as hopefully create positive ‘‘spillover effects’’ from the transfer of technology, knowledge and skills to domestic firms. It can also stimulate economic growth by spurring competition, innovation and improvements of a country’s export performance. The indirect impact of FDI on the domestic economy are the main reason for the intense political focus on FDI in most countries, which has led to unprecedented levels of public subsidies, diplomatic efforts and promotional activities to attract investors

FDI does have some potential negative impacts, that most potent being anti-competitive and restrictive business practices by foreign affiliates, tax avoidance, and abusive transfer pricing. Volatile investment flows and related payments may be deleterious to balance of payments, while some FDI is seen as transferring polluting activities and technologies. FDI is now the largest and most stable source of private capital for developing countries and economies in transition, accounting for nearly 50% of all those flows in 2002.

The domestic policy framework is crucial in determining whether the net effectors of FDI are positive (*UNCTAD, 1999*). Thus, instituting (Designing and implementing) a policy mix that maximizes the potential benefits and minimizes the potential negative effects is very important. Empirical evidence suggests that some countries have been more successful in this respect than others (*UNCTAD, 1999*). FDI, when handled properly, can make a positive contribution to development.

Only a few countries in Africa have been successful in attracting significant FDI flows, however. Indeed, Africa as a whole and Sub-Saharan African (SSA) in particular, has been on the sidelines of the FDI boom. For most of the time since 1970, FDI inflows into Africa have increased only modestly, from an annual average of almost US\$1.9 bill in 1983 – 1987 to US\$3.1 billion in 1988 – 1992 and US\$4.6 billion in 1991 – 1997.

*Lall (2000), and Borensztein et al, (1998) cited in E. Jerome and A. Jerome (2006)* summarized that “African countries have made considerable efforts over the past decade to improve their investment climate and renewed confidence in the positive benefits of FDI has led many countries that were restricting FDI from the 1960s to 1980s to be more open towards FDI in the 1990s and beyond”.

They summarized their findings as follows “Paradoxically, while Nigeria has traditionally been one of the biggest recipients of FDI inflows in Africa, the country has failed to unleash its FDI potential largely for self-inflicted reasons. The country has made little progress in attracting FDI despite its immense human natural resources”. Furthermore “Nigeria, like many African countries stuck to rather hostile policies for private sector development in general and FDI in particular. Nigeria only cautiously and recently, in the mid 1980s, embarked on a reform path-but this was characterized by frequent interruption by political shocks and policy reversals”, *Borensztein et al ,(1998)*

The FDI environment in Nigeria has improved, at least relative to the pre-1980s, although it is still less accommodating – sometimes hostile- and inadequate to attract high quality, efficiency-seeking. Addressing problems related to corruption, inadequate infrastructure and inconsistent regulations remains the key element for the country’s prospects of attracting more efficiency-seeking FDI.

It is now widely acknowledge that foreign direct investment (FDI) is an important aspect of the recent wave of globalization. UNCTAD (2001) notes that “FDI in the world rose from US\$57 billion in 1982 to US\$1,271 billion in 2000.Even so, only a few countries have been successful in attracting significant FDI flows”. Indeed, “Africa as a whole and sub-Saharan Africa (SSA) in particular has not particularly benefited from FDI boom” (*Ayanwale, 2007*). Nigeria is one the few countries that have consistently benefited from FDI inflow to Africa. Nigeria’s share of FDI inflow to Africa averaged around 10%, from 24.19% in 1990 to a low level of 5.88% in 2001 up to 11.65% in 2002.

**Table 2.2: Nigeria: Net foreign direct investment inflows (US million)**

<b>Year</b>	<b>Africa</b>	<b>Nigeria</b>	<b>Percentage of Africa</b>
<b>1980</b>	<b>392</b>	<b>-188.52</b>	<b>-</b>
<b>1990</b>	<b>2430</b>	<b>588</b>	<b>24.19</b>
<b>1995</b>	<b>5119</b>	<b>1079</b>	<b>21.07</b>
<b>1997</b>	<b>10667</b>	<b>1539</b>	<b>14.43</b>
<b>1998</b>	<b>8928</b>	<b>1051</b>	<b>11.77</b>
<b>1999</b>	<b>12231</b>	<b>1005</b>	<b>8.22</b>
<b>2000</b>	<b>8489</b>	<b>930</b>	<b>10.96</b>
<b>2001</b>	<b>18769</b>	<b>1104</b>	<b>5.88</b>
<b>2002</b>	<b>10998</b>	<b>1281</b>	<b>11.65</b>
<b>2003</b>	<b>15033</b>	<b>1200</b>	<b>7.98</b>

**Source: UNCTAD Foreign Direct Investment Database online**

## **2.6 OPTIONS FOR FACILITATING AND SUSTAINING INVESTMENT IN NIGERIA**

*Sunday. K and Lydia B. (2006)* in analyzing foreign direct investment flows in Cameroon identify a number of policies that Cameroon has to put in place in order to be comprehensive in attracting FDI. These include:

- Creating a more investment-friendly environment.
- Improving the availability of infrastructure
- Investing in education.
- Opening up the country through trades.
- Providing necessary incentives
- Adopting and enforcing a zero tolerance stance on corruption.

*(Sunday. K and Lydia B. (2006))*

*Yaw. A (2006)* in analyzing the various types of FDI in Ghana and their relative magnitudes identified Ghana's active policies to attract FDI, including fiscal incentives. According to him, ‘the three main fiscal changes affecting the sector that were put in place during the ERP era were the reduction in minimum royalties from 6% to 3%; reduction in corporate tax from 55% to 35%; and tax exemption for imported plant and equipment. Other policies to attract FDI include tax holidays, accelerated depreciation allowances and arrangements for profit repatriation, generous incentives also exist for free zone developers’.

*Francis. M. and Ngugi R. (2006)*, analyzed the various factors that constrain improved net FDI inflows into Kenya and examine whether the country responds differently to the various determinants of FDI than other countries. Among the issues analyzed is the magnitude of net FDI inflows, their composition and sectoral destination, as well as the economic political and other factors that might influence them. The authors concluded that ‘FDI has not played an important role in the Kenyan economy despite the reforms that have been undertaken and the many incentives provided to foreign investors’.

*Ogunkola. O. and Jerome. A (2006)* appraised the structure, trends and magnitude of FDI in Nigeria with a view to ascertaining policy-induced changes in the structure. According to them, ‘FDI has concentrated in the extractive industries, mainly oil, but there has been a diversification into the manufacturing sector in recent years. Overall, Nigeria has put in place a number of policies to attract FDI’. There have been inconsistencies in the policies, however, and the vigor with which these policies have been pursued. For several years, the country stuck to rather hostile policies for private sector development in general and to FDI in particular’. Nigeria has made little progress in attracting FDI.

While the FDI regime in Nigeria is improving, serious deficiencies remain. Political and institutional uncertainty persists in Nigeria and the weakening of the rule of law has discouraged FDI and trade flows outside the oil sector. Legal and judicial systems are inadequate to support the needs of new investors into other sector of the economy. Addressing problems related to corruption, inadequate infrastructure and inconsistent regulations remain the key element of the country's future prospects of attracting more

efficiency seeking FDI. There is need for a proactive policy towards FDI that involves the upgrading of natural laws and incentives that are in conformity with international practices. *Udeaja. A (2005)* identified the efficiency and effectiveness of the following factors as essential policy factors and strategies for attracting investment (foreign and domestic) in Nigeria:

- Ensuring political stability and participatory governance.
- Stable macroeconomic framework.
- Development of human resources.
- Deepening and diversifying the financial sector.
- Entrepreneurship.
- Genuine privatization
- Minimizing transport cost
- Enhancing competition.
- Investment promotion agency
- Regional integration.
- International cooperation
- Market access.
- Favourable fiscal regime.
- Integrity of institutions and strength of capacity.
- Reforms of the legal system.

*(Udeaja. A (2005))*

*Oludele A. Franz. S. and Elizabeth R. (2006)* argues that “the bulk of foreign investments in South Africa has been marketing-seeking, as evidenced by the concentration in manufacturing, financial services, telecommunications, and food and beverages”. The attractiveness of South Africa as an investment destination is as a result of regulatory and policy measures being implemented to attract FDI. South Africa dominates FDI inflows in the Southern African Development Community (SADC), receiving a substantial amount of new inflows into the region and hosting the greatest number of foreign subsidiaries across a broad range of economic sectors. They include that there is need to address social issues such as crime and the rising prevalence of HIV/AIDS, as these may affect the flow of FDI.

*Marios O. and Kenneth E. (2006)* analyzed the various types of FDI and the relative magnitude of the components using the case study of Uganda. They expressed the view that in terms of lesson from Uganda, the following are identified as important factors in attracting GDI.

- Administrative simplicity, which has contributed significantly to FDI attraction.
- Reforms undertaken among incentives schemes and related government agencies to fulfill the criteria for investment promotion.
- Effects of regional integration, which is important in attracting market seeking investments.
- Aggressive investment promotion.
- Successful implementation of privatization and
- A predictable and consistent policy and macroeconomic environment.

*(Marios O. and Kenneth E. (2006))*

*Ajayi (2006)* analyzed the various determinants of FDI within a general theoretical framework, identifying the major factors – in particular the pull and push elements in FDI. According to him, ‘the push factors are those that are external to the host countries such as the growth and financial markets in developed countries; while the pull factors are the domestic policies of the countries and include a wide array of important issues’.

*Campos F and Yuko K. (2006)* studied the factors accounting for the geographical patterns of FDI among 25 transition economies. Their main finding is that ‘the most important determinants of FDI locations are institutions and agglomeration economies’. They also find that ‘FDI is attracted by an abundance of natural resources and relatively low labour costs. Also of great importance in attracting FDI are such factors as respect for the rule of law and openness to trade. Moreover, external liberalization has a positive impact on FDI. Among the deterrents to FDI are poor quality of bureaucracy and increased deterrents to FDI as poor quality and increased transaction costs’ they concluded

*Siphambe. K (2006)* analyzed the issues of FDI in Botswana. His findings are that a lot of FDI has been attracted mainly into the mining and financial sectors. The government of Botswana has been trying to put in place all necessary measures that would allow the country to have a comparative advantage in attracting FDI. These have been achieved through incentives schemes and necessary infrastructure such as industrial land and factory shells. Other identifiable factors that have put Botswana in advantageous positions and in the process bolster FDI include:

- A stable political environment; and stable macroeconomic policy.
- Competitive exchange rate relative to South African land, low crime level
- Good human capital development
- Good labour relations.
- Botswana producers have access to South African markets because of Botswana's membership in SACU and to the Zimbabwe market because of the 1965 trade agreement.

*Siphambe. K (2006)*

## **2.7 IMPACT OF FDI ON ECONOMIC GROWTH IN NIGERIA**

The Nigerian governments have been trying to lift the country out of the structural impairment and to position her meaningfully for investment purposes. 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" (*Ehimare, 2011*).

*Jenkins and Thomas (2002)* as cited in *Ehimare (2011)*, asserted that ‘‘FDI is expected to contribute to economic growth not only by providing foreign capital but also by crowding in additional domestic investment’’.

Through forward and backward linkages with the domestic economy made possible by foreign direct Investment, employment and further economic activities as stimulated. FDI has impacted positively on the domestic economy by filling up the domestic revenue generation gap in developing countries in particular, Nigeria. Other gains of FDI on economic growth are in the form of externalities and the adoption of foreign technology. Externalities are in the form of licensing, imitation, employee training and introduction of new processes by foreign firms.

Foreign direct investment consists of external resources including technology, managerial and marketing expertise and capital. All these generate impacts on host nation’s productive processes. 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 boost the existing production capacity. Although the Nigerian government has been trying to provide a conducive investment climate for foreign investments, the inflow of foreign investments into the country has not been encouraging.

Nigerian foreign investment policy should move towards attracting and encouraging more inflow of foreign capital. The need for foreign direct investment (FDI) is born out of the underdeveloped nature of the country’s economy that essentially hindered the pace of Nigerian economic development. In his analysis, *Ehimare (2011)* summarized that ‘‘foreign flow into the country so far has revealed that only a limited number of multinationals or their subsidiaries have made foreign direct investment in the country’’. The problem of insufficient inflow of FDI is the inability to restrain the Foreign Direct Investment which has already come into the country. *Carkovic and Levine (2002)* in their study concluded that exogenous component of FDI does not exert a robust influence on economic growth.

The relationship between FDI and economic growth in Nigeria is yet unclear, *Ayanwale (2000)* concluded. However, recent evidence shows that the relationship may be country and period specific. Developing countries economic difficulties do not originate in their isolation from advance countries. The most powerful obstacle to their development comes from the way they joined the international system. Added to this difficulty is the battered foreign image Nigeria have and the concept of European Economic Community that include Eastern Europe. The result of this is that investment flows that would normally come from Western countries now to poor European Economic Communities, Eastern Europe inclusive. Foreign direct Investment (FDI) is a critical part of capital inflows for developing countries, its contributions and benefits exceeds the cost of the economy.

The dynamics of International Economic Order (IEO) has led to a renewed interest in the gains of foreign direct investment on an economy economic growth. ‘‘ The growing interest in foreign direct investment (FDI), originates from the perceived opportunities desired from using this type of injection into the economy, to augment domestic savings and further promote economic development in most developing economies’’ (*Aremu, 2005*).

FDI is believed to be stable and easier to service than bank credit. FDI are usually on long term economic activities in which repatriation of profit only occur when the project earn profit. Dunning and *Rugman (1985)* observed that ‘‘FDI contributes to host country’s gross capital information, higher growth industrial productivity and competitiveness and other gains like transfer of technology, managerial expertise, improvement in the quality of human resources and increased investment’’.

Modern growth theory rests on the view that economic growth is the result of capital accumulation which leads to investment. Given the overriding importance of an enabling environment for investment to thrive, it is important to examine necessary conditions that facilitate FDI inflow. These are classified into economic, political, social and legal factors. The economic factors include infrastructural facilities, favorable fiscal, monetary, trade and exchange rate policies. The degree of openness of the domestic economy, tariff policy, and credit provision by a country’s banking system, indigenization policy, the economy’s growth potentials, market size and macroeconomic stability.

“Other factors like higher profit from investment, low labor and productivity costs, political stability, enduring investment climate, functional infrastructure facilities and favourable regulatory environment also help to attract and retain FDI in the host country” (Ekpo 1997).

The International Monetary Fund, IMF (195) describes “FDI as an investment made to acquire a lasting interest in a foreign enterprise with the purpose of having effective voice in management”. While others, *Dunning (1983)*, *Mwillima (2003)* sees it as an “investment made so as to acquire a lasting management interest including voting stocks and equity shares in an enterprise operating in another country other than that of the investor’s country”.

Foreign Direct Investment has also been explained as an investment made by an investor or enterprise in another enterprises or equivalent in voting power of other means of control in another country with the aim to manage the investment and maximize profit. This investment involves not only the transfer of fund but also the transfer of physical capital, technique of production, managerial and marketing expertise, product advertising and business practice with the aim to make profit.

The meaning and definition of Foreign Direct Investment have been broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investor’s home country.

Generally, the theory that explains the link between FDI and growth in terms of output and productivity is significantly positive. However, empirical studies find positive outcome from outward FDI for the investing country (*Van, Poffelsberghe, et al, 2001*), suggest a potential negative impact from inward FDI on the host country. This results from a possible decrease in indigenous innovative capacity or crowding out of domestic firms.

In the neo-classical production function approach, output is generated by using capital and labour in the production process. FDI can exert an influence on each argument on the production function. FDI increases capital, and may qualitatively improve the factor labour and by transferring new technologies, it also has the potential to raise total factor productivity.

In addition to the direct, capital augmenting effect, FDI also have additional indirect and thus permanent effects on output growth rate. Further, by raising the number of varieties for intermediate goods or capital equipments, FDI can also increase productivity. Though FDI could produce a significant effect on output growth through speeding up capital formation process, the effect tends to diminish in the long run because of the principle of diminishing return.

The endogenous growth literature points out that FDI would not only contribute to economic growth through capital formation and technology transfers (*Blomstrom, Lipsey & Zejan, 1996*) but also do so through the augmentation of the level of knowledge via labour training and skill acquisition (*De Mello, 1997*).

*Ehimare (2011)* in his study “Foreign Direct Investment and its effects on the Nigerian Economy” finds out that “FDI has positive effect, though not statistically significant on GDP”. Similarly, the inflow of FDI into the Nigerian economy for the period of his study showed that FDI was not a major contributor to economic growth in Nigeria. The findings from his empirical result showed that FDI has positive and significant impact on BOP through current account balance.

According to the study, the effect of inflation and foreign exchange rates on FDI also showed that whereas inflation rate did not have major effect on the inflow of FDI into the Nigerian economy, foreign exchange rate had great effect on the inflow of FDI into the Nigerian economy. Studies on FDI and economic growth in Nigeria are not complete in agreement in their submissions. “A clear examination of these previous studies reveal that conscious effect was not made to take care of the fact that more than 60% of the FDI inflows into Nigeria is made into the extractive (oil) industry”, (*Ekperiware, 2011*).

However, the consensus in the literature seems to be that FDI increases growth through productivity and efficiency gains by local firms. The empirical evidence is not unanimous. Available evidence for developed countries seem to support the idea that the productivity of domestic firms is positively related to the presence of foreign firms (*Globeram, 1979*), *Inbriani and Reganeti, (1997)*. The results for developing countries are not clear, with some finding positive spillovers (*Blomstronm, 1986; Kokko, 1994;*

*Blomstrom and Sjöholm, 1999*) and others such as *Aitken et al (1997)* reporting limited evidence. Still others find no evidence to positive short-run spillovers from foreign firms. Some of the reasons adduced for these mixed results are that envisaged forward and backward linkages may not necessarily be there and that arguments of TNCs (Trans-national Corporations) encouraging increased productivity due to competition may not be true in practice *Aitken et al (1999)*. Other reasons include the fact that TNCs tend to locate in high productivity industries and therefore, could force less productive firms to exist (*Smarzynska, 2002*). *Cobham (2001)* also postulate the crowding out of domestic firms and possible contraction in total industry size and employment. However, crowding out is a more rare event and the benefit of FDI tends to be prevalent (*Cotton and Ramachandran, 2001*).

The role of FDI in export promotion remains controversial and depends crucially on the motive for such investment (*World Bank, 1998*). “The consensus in the literature appears to be that FDI spillovers depend on the host country’s capacity to absorb the foreign technology and the type of investment climate” (*Obwona, 2004*). The review shows that the debate on the impact of FDI on economic growth is inconclusive. The role of FDI seems to be country specific, and can be positive, negative or insignificant, depending on the economic, institutional and technological conditions in the recipient countries. Most studies on FDI and growth are cross-country evidences, while the role of FDI in economic growth can be country specific. Only a few of the country specific studies actually take conscious note of the endogenous nature of the relationship between FDI and growth in their analyses, thereby raising some questions on the robustness of their findings. Lastly, the relationship between FDI and growth is conditional on the macroeconomic dispensation the country in question is passing through. In fact, *Zhang (2001)* asserts that “the extent to which FDI contributes to growth depends on the economic and social condition or in short, the quality of the environment of the recipient country”. In essence, the Impact of FDI has on the growth of any economy may be country and period specific and as such there is the need for country specific studies.

## 2.8 THE ROLE OF GOVERNANCE IN DOMESTIC INVESTMENT

It has been demonstrated that investment is one of the critical factors for sustainable development. Accordingly, a country's economic performance to a large degree depends or is determined by its governance performances – political, institutional and legal considerations.

The Nigerian economy over the years has gone through periods of economic and political instability, which have hindered domestic investment into the country. “The stability of a country's socio-economic and political system reflects the soundness of its level of governance and this is seen as a major factor in decision-making by investors” (*Akanbi, 2010*). According to the author, “the role of good governance in growth has been a central debate among global policy makers in years, while the major stumbling block to the execution of many economy-wide policies in most emerging economies has been the absence of the political ‘will’ within the leadership structure”. “The extent to which a country's governance can impact on the socio-economic environment and productive capacity cannot be estimated and the highly unstable pattern of growth in domestic investment in Nigeria can be attributed to the volatile economic and political environment in the country” (*Globerman & Shapiro; 2002*).

*Akanbi (2010)* following the ideas of *Globerman and Shapiro (2002)* investigated the role of governance in determining domestic investment in Nigeria over the period 1970 to 2006. In his study, he found out that “poor governance as reflected in the unstable political environment in most African countries, Nigeria inclusive has been a major hindrance to increasing domestic investment over the years”.

The index for governance measures covers a broad range of policy and institutional outcomes which include the role of law, corruption, government effectiveness, regulatory quality and political instability. The author in his study and in order to capture governance in a broader context employed the average value of the five elements in the governance indicators as a measure of governance.

## 2.9 FACTORS OF PRIVATE DOMESTIC INVESTMENT IN NIGERIA

*Bakare (2011)*, in his classification of investment, highlighted four major components: ‘the private domestic investment, the public domestic investment, the foreign direct investment and the portfolio investment’. According to him, ‘private domestic investment refers to gross fixed capital formation plus net changes in the level of inventories whereas public investment includes investments by government and public enterprises on social and economic infrastructures, real estate and tangible assets’. The combination of private investment and public investment is normally called gross fixed capital formation. The foreign investment when it is on tangible asset is referred to as direct foreign investment, otherwise called portfolio investment when made on shares, bonds, securities, etc.

Despite the economic reform programmes of the country – Nigeria is still being confronted with low levels of savings and investment, high rate of inflation, high level of unemployment and poverty. Rather than for the economy to adjust into recovery there has been deterioration and the much role of the private sector has not been achieved. Nigeria’s macroeconomic indicators have shown poor performances of private investment in Nigeria within the reviewing period. Private investment declined from 12.3% of GDP in 1991 to 8.3% of GDP in 1992. Furthermore, there was an increase of 12.5% in 1993 to 16.0% in 1994. The ratio increased again to 13.0% in 1999 before declining continuously to its lowest level of 10.7% in 2000. Over the years, since 2005, there has been a gradual increase in the ratio.

A great number of empirical investigations have been carried to determine factors affecting private investment in Nigeria. Most of these factors discovered that private investment is influenced primarily by profit motive, wages rate, real exchange rate policies, raw materials, rate of inflation and appropriate pricing of capital, labor and land.

Others that influenced private investment would be reductions in the cost of power, transport and communications, which are provided through public investment. The research studies carried out by *Bljer and Khan (1984)*, *Greence and Villaneva (1991)* on 23 countries found out that ‘public investment in physical infrastructure is complementary to private

investment''. *Balassa (1988) as cited in Bakare (2011)* in his study of 30 countries showed the presence of a negative relationship between private investment and public investment. *Dwan et al (1999)* in supporting the empirical arguments of *Balassa (1988)* pointed out that such a negative relationship might not exist in the case of Pacific Islands with access for foreign savings. According to Duncan, 'user cost of capital is a critical factor in any investment decision by the private sector''. When the user cost of capital is increased by the raising the cost of bank credit or by increasing the cost of retained earnings, the main source of financing investment, and then there is a decline in investment.

On the relationship between interest rate and investment; there is no empirical agreement. While studies carried out by *Greene and Villanera (1991)* confirmed non-positive relationship between interest rate and investment, that carried out by *Serven and Solimano (1993)* has shown that in a repressed financial market, credit policy affects investment in negative manner.

The interest rate channel transmission mechanism, depends upon the institutional set up of financial markets. The Nigerian financial sector reform began in 1980s and the regulatory measures in place have affected private investment.

The study carried out by *Skully (1997)* on Fiji and other countries, found out that the availability of finance at competitive real interest rates was not a constraint for private investment; he however, concluded that public sector borrowing crowding out private sector funding was not a problem in Fiji.

In the studies of 86 developing countries carried out by *Thomas (1997)*, examining data on terms of trade, real exchange rate (RER), Property right and Civil liberties, he concluded that while 'factors including credit, availability and the quality of physical and human infrastructure are important influences, uncertainty in the investment environment was negatively related to private investment in Sub-Saharan countries'', while *Jayaraman (1996)* in his cross-country study on the macroeconomic environment and private investment in six Pacific Island countries observed a statistically significant negative relationship between the variability in the real exchange rate and private investment.

Commenting on the variability in the real exchange rate as a proxy for instability in major economy explained that inflation and productivity and more generally in fiscal and monetary management are reflected as not a good measure of the uncertainty attached to policy or the insecurity of property rights and enforcement of Contracts or the level of corruption.

Pointing out that these non-economic factors appear to be very significant influences on investment in the Pacific Island countries, *Weder (1998)* on his study involving Sub-Saharan African countries and using institutional factors that are qualitative conclude that: ‘‘Predictability of judiciary enforcement, theft and crime, security of property rights and uncertainty of corruption are highly significant’’.

However, almost all the factors identified as determinants of private investment in other countries of the world applied to Nigeria. The common sense has shown that variation in private domestic investment in Nigeria can best be explained by the situation of economic infrastructures and investment climate.

In the summary of his findings, *Bakare (2011)* concludes that ‘‘private investment and public investment are not complementary. Rather, public investment crowded out private domestic investment in Nigeria’’. Showing that infrastructural deficit remains a problem for domestic private investment in Nigeria.

Individual components of macroeconomic instability and political instability were found to be inhibitors to private investment. The overall measures were identified as a major hindrance to private investment. This reveals a poor investment climate and its detrimental effects on private investment. The Nigerian investment climate constitutes a bad indicator for current investment decisions. Studies also show that corruptible attitudes and lack of credibility in government policies are hindrances to private investment. This calls for development of the infrastructural base of the economy to boost the private sector.

## **2.10 RELATIONSHIP BETWEEN ECONOMIC GROWTH PROCESS AND FDI IN NIGERIA**

Foreign Direct Investments involves the transfer of resources to other countries by individuals and companies. Foreign portfolio investment includes the transfer of intangible assets such as trademark, technology and business management as well as the authorization given to the investor to control the investment (*Blomstrom and Kokko, 1998*).

Although Foreign Direct Investments and Foreign Portfolio Investments are similar in general, there are some important distinctions between them.

The common applications of Foreign Direct Investment are the establishments of new companies in high-profit business areas or the purchase of an already existing company in this foreign country. The management and the control of such investments are mostly carried out by the foreigners.

*Guraks (2003)* is of the view that the higher amount of foreign investment a country can attract the bigger portion it can take from global production and income.

“Nigeria as a country, given her natural resource base and large market size, qualified to be a major recipient of FDI in Africa and indeed is one of the top three leading African countries that consistently received FDI in the past decade”, *Adeniyi et al (2011)*. “Empirical linkage between FDI and economic growth in Nigeria is unclear, despite numerous studies that have examined the influence of FDI on Nigeria’s economic growth”. (*Odozi, 1995, Oyilola, 1995, Adelegan, 2000, Akinlo, (2004)*). Recent evidence shows that the relationship between FDI and growth may be country and period specific. *Asiedu (2001)* is of the position that the determinants of FDI in one region may not be the same for other regions. In the same way, the determinants of FDI in countries within a region may be different from one another and from one period to another. The studies on the linkage between FDI and economic growth in Nigeria reveals that conscious effect by Nigerian government was not made to take care of the structural shifts and financial liberalization that characterizes the economy. These studies analyzed the relationship between foreign direct investment and Nigeria’s economic growth.

*Odozi (1995)* reports on the factors affecting FDI flow into Nigeria in both the pre- and post- structural adjustment programme (SAP) period and found out that the economic policies in place before SAP were discouraging foreign investors. This policy environment

led to the proliferation and growth of parallel markets and sustained capital flight. *Ogiogio (1995)* reports negative effects of public investment to GDP growth in Nigeria for reasons of distortions. Other studies have reported positive relationship between FDI and economic growth in Nigeria. *Aluko (1961)*, *Brown (1962)* and *Obinna (1983)*, while *Edozien (1968)* analyze the relationship effects of FDI on the Nigerian economy and posits low level of linkage effects.

*Obeghale and Amokhienan (1987)* in their study, found that ‘‘FDI is positively associated with Gross Domestic Product, GDP, summarizing that greater inflow of FDI will enhance economic growth of the economy’’. *Ariyo (1998)* studied the investment trend and its impact on Nigeria’s economic growth over the years. He found out that only private domestic investment consistently contributed to GDP growth rates during his reviewing period (1970-1995). Again, there is no reliable evidence that all the investment variables included in his analysis have any perceptible influence on economic growth. He, therefore, suggested the need for an institutional rearrangement that recognizes and protects the interest of major partners in the development of the economy.

## **2.11 SECTORAL CONTRIBUTIONS TO ECONOMIC GROWTH AND FDI IN NIGERIA**

There is little information on the geographical origin of foreign investors in Nigeria. Most FDI inflows into the country Nigeria are reinvested earnings from the oil multinationals (*Kolawole and Henry, 2009*). Reinvested earnings have averaged two-thirds of overall FDI in inflows in recent years, with the bulk directed towards the energy sector. There has been a modest surge in non-oil sector foreign investment in Nigeria in recent years, after it became clear that the previous regime of Olusegun Obasanjo, was firmly established and that economic growth was picking up. Although much of the investment was by large multinational companies that were already operating in the country, there have been some new European entrants since the beginning of this decade, and South African companies have also strongly increased their presence in recent years, particularly in the mobile-phone sector. Nigerian the second largest FDI recipient has more of it concentrated in the extractive industry but a veritable non-oil sector, manufacturing sector that recorded 47% of FDI stock in 1992 has been a great source of FDI to the country. The recent

banking sector consolidation exercise also boosted FDI (and Portfolio inflows) into the country, Nigeria as existing foreign banks increased the capitalization of their subsidiaries to meet the need minimum capital requirements.

*Laura (2003)* as cited in *Ekperiware (2011)* examined that the benefits of FDI vary greatly across sectors by examining the effect of Foreign Direct Investment on growth in the primary, manufacturing, and service sectors between 1981 to 1999. An empirical analysis using cross-country data suggests that total FDI exerts an ambiguous effect on growth, while investment in manufacturing a positive one.

*Oyinlola (1995)* in studying the contributions of foreign capital to the prosperity or poverty of developing countries, concluded that “foreign capital include foreign loans, direct foreign investment and export earnings. He concluded that FDI has a negative effect on economic development in Nigeria.

*Ekpo (1995)* on the basis of time series data, concludes that political regime, real income per capita, rate of inflation, world interest rate, credit rating and debt service were the key factors explaining the variability of FDI in Nigeria.

*Adelegan (2000)* explored the seemingly unrelated regression model to examine the impact of FDI on economic growth in Nigeria and found out that “FDI is pro-consumption and pre-import and negatively related to gross domestic investment”. *Akinlo (2004)* found that “foreign capital has small and not statistically significant effect on economic growth in Nigeria”.

*Ayanwale and Bamire (2001)* on firm level productivity spillover assess the influence of FDI in Nigeria and report a positive Spillover of foreign firm’s on domestic firm’s productivity. The considerable increase in foreign direct investment, especially in developing countries as of 1990s has led to emergence of some ideas that focus on the growth dynamics that are measured by Gross Domestic Product. The complex relationship between Foreign Direct Investment and economic growth has resulted in a large number of empirical studies in developed and developing countries.

According to neoclassical growth model, Foreign Direct Investments cause medium-term temporary increases in economic growth in the economy where investments are made through increasing the amount of investment and its efficiency. The new endogenous growth theories focus on the long-term growth as a function of technological process. They claim that foreign direct investment can continuously increase growth rate through technology transfer and Spillover effects, *Reichert and Winhard (2002)*. Using regression analysis on 69 developing countries and the data covering 1970 – 1979 fiscal years, *Borenzstein et al (1998)* found that technological development is very important for the economic growth of developing countries and foreign direct investment affects economic growth positively.

*De Nello(2008)*, in his own account and study conducted in 1999 using time-series and panel data analysis, predicted the effects of foreign direct investment on capital accumulation and the increase in the amount of FDP.

*Ericsson and Irandous (2001)* in their study determined the cause and effect relationships between FDI and economic growth using the data collected from four countries of Denmark, Finland, Norway and Sweden. They found out that there was no casual relationship for Denmark and Finland and according to them; this was because of the unique dynamics and nature of FDI in these counties.

*Chaskraborty and Basu (2002)*, in a study conducted on the causality between FDI and the increase in production, showed that the presence of causality from FDI to GDP rather than from GDP to FDI.

*Liu, Burridge and Sinclair (2002)*, predicted a longitudinal relationship between FDI, trade and the economic growth in China. They found a two-way relationship between FDI, economic growth and import. Similarly *Wang (2002)* tried to explore which type of FDI contributes to economic growth significantly. He found out that manufacturing FDI's have positive effect on economic growth and this positive effect is due to Spillover effects of FDI's.

The study carried out by *Makki and Somwaru (2004)*, an extended replication of *Borenzstein's (1998)* analysis found that FDI's affect economic growth to a large extent

together with foreign trade, human capital and domestic capital and according to the study, FDI has direct or indirect positive effects on economic growth.

Others, *Frenkel et al (2004)* examine the mutual effects of pushing and pulling factors in developed countries with FDI outflows and developing countries with FDI inflows. It was found out that as the GDP increase rate is getting higher in developing countries with FDI, FDI volume is also increasing.

*Adeniyi et al (2011)* in conclusion of their study involving the relationship between economic growth and foreign direct investment in Nigeria using Granger causality test found out that there is no reciprocal causality relationship between economic growth and FDIs in Nigeria. According to their study, ‘‘the direction of the relationship is only from GDP to FDI and there is no causality from FDI to GDP’’. In other words, GDP in Nigeria is one of the factors affecting the flow of FDI. The policy implication from their findings is that investors are not likely to invest in Nigeria because of macroeconomic instability as evidence by rising inflation, interest rate and exchange rate volatility, poor infrastructural facilities, high debt burden, incessant social and political instability undermined Nigerian government efforts in attracting FDI.

*Caves (1996)* observed that the rationale for increased efforts to attract more FDI where premised on the belief that FDI has several positive effects. Among these are productivity gains, technology transfers, introduction of new processes, managerial skills and know-how in the domestic market, employee training, international production networks, and access to market.

*Boreassztien et al (1998)* sees FDI as an important instrument for the transfer of technology contributing to growth in larger measure than domestic investment. *Findlay (1978)* postulates that FDI increases the rate of technical progress in the host country through a ‘‘contagion’’ effect from the more advanced technology, management practices, etc. used by foreign multinational firms. On the basis of these propositions, government of various countries has often provided special incentives to foreign firms to set up companies in their countries.

*Carkovic and Levine (2002)* noted that the economic rationale for offering special incentives to attract FDI frequently derives from the belief that foreign investment produces externalities in the form of technology transfers and Spillovers. The empirical evidence of these benefits, both at the firm level and at the national level remains ambiguous. *De Gregorio (2003)*, while contributing to the debate on the important of FDI, notes that FDI may allow a country to bring in technologies and knowledge that are not readily available to domestic investors, and in this way increases productivity growth throughout the economy. FDI may also bring in expertise that the country does not possess, and foreign investors may have access to global markets. *De Gregorio (2003)*, found out that increasing aggregate investment by one percent point of GDP increased economic growth of Latin American countries by 0.1% to 0.2% a year, but increasing FDI by the same amount increased growth by approximately 0.6% a year during the period 1950-1985, thus indicating that FDI is three times more efficient than domestic investment.

*Blomstrom et al (1994)* reports that FDI exerts a positive effect on economic growth, but there seems to be a threshold level of income above which FDI has positive effect on economic growth and below which it does not. The explanation was that only those countries that have reached a certain income level can absorb new technologies and benefit from technology diffusion, and thus reap the extra advantages that FDI can offer. Previous works suggest that human capital as one of the reasons for the differential response to FDI of different levels of income. This is because; it takes a well-educated population to understand the benefits of new innovations to the whole economy. The interaction of FDI and human capital had important effect on economic growth and suggests that the differences in the technologies absorptive ability may explain the variation in growth effects of FDI across countries. They suggest further that countries may need a minimum threshold stock of human capital in order to experience positive effects of FDI.

*Balausbramanyan et al (1996)* reported positive interaction between human capital and FDI. They had earlier found significant results supporting the assumption that FDI is more important for economic growth in export-promotion than import-substitution countries. This implies that the impact of FDI varies across countries and that trade policy can affect the role of FDI in economic growth. In summary, *UNCTAD (1999)* posits that

FDI has either a positive or negative effect on output depending on the variables including the initial per capita GDP.

The Spillover effects of FDI in the labour markets through learning and its impact on the productivity of domestic investment could be observed (*Sjoholom, 1999*). He suggested that through technology transfer to their affiliates and technological spillovers to unaffiliated firms in host country, transnational corporations (TNCs) can speed up development of new intermediate product varieties, raise the quality of the product, facilitate international collaboration on R and D, and introduce new forms of human capital.

FDI also contributes to economic growth via technology transfer. TNCs can transfer technology either directly (internally) to their foreign owned or indirectly (externally) to domestically owned and controlled firms in the host country (*Blomstrom et al, 2000, UNCTAD, 2000*). Spillovers of advanced technology from foreign owned enterprises to domestically owned enterprises is of four ways; “vertical linkages between affiliates and domestic suppliers and consumers, horizontal linkages between the affiliates and firms in the same industry in the host economy (*Lim, 2001; Smarzynska, 2002*), labour turnover from affiliates to domestic firms and internalization of R and D” (*Hanson, 2001; Blomstrom and Kikko, 1998*). The pace of technological change in the economy as a whole will depend on the innovative and social capabilities of the host country, together with the absorptive capacity of other enterprise in the country (*Carkovic and Levine, 2002*). Besides capital augment element, some economists see FDI as having a direct impact on trade in goods and services (*Karkussen and Vernables, 1998*), education attainment, domestic investment ratio, political instability, terms of trade, black market exchange rate premiums, and the state of financial development. Examining other variables that could explain the interaction between FDI and growth, *Olofsdotter (1998)* submits that the beneficiary effects of FDI are stronger in those countries with a higher level of institutional capacity. He therefore emphasized the importance of bureaucratic efficiency in enabling FDI effects. The neoclassical economists argue that FDI influences economic growth by increasing the amount of capital per person. However, because of diminishing returns to capital, it does not influence long-run economic growth.

It has been asserted that even though FDI is positively correlated with economic growth, host countries require minimum human capital, economic stability and liberalized markets in order to benefit from long-term FDI inflows, *Bengos and Sanchez-Robles (2003)*. Interestingly, *Bende-Nabende et al (2002)* found that direct long-term impact of FDI on output is significant and positive for comparatively economically less advanced Philippines and Thailand, but negative in more economically advanced Japan and Taiwan. Hence, the level of economic development may not be the main enabling factor in FDI growth nexus. On the other hand, the endogenous school of thought opines that FDI also influences long-run variables such as research and development (R&D) and human capital, (*Romer, 1986, Lucas, 1988*). FDI could be beneficial on short-term but not in the long term. *Obwona (2001)* in his study of the determinant of FDI and their impact on growth in Uganda found out that macroeconomic and political stability and policy consistency are important parameters determining the flow of FDI into Uganda and that FDI affects growth effectively but insignificantly. *Ekpo (1995)* reports that political regime, real income per capita, rate of inflation, interest rate, credit rating and debt service explain the variance of FDI in Nigeria.

The national quest for scientific and technological know-how through FDI which is required for achieving sustainable development and ultimately the Millennium Development Goals (MDGs) has gathered momentum in recent years. Nigeria, after decades of restricting FDI like other developing countries (*Marin, 2008*), is now falling over to attract extra-investors, and spending large sums of money to attract foreign companies. *Yauri (2006)* reports that FDI-related foreign economic policies received most significant attention of the Nigerian government in the last decade and a half, which resulted in signing six (6) Bilateral Investment Treaties (BITs) and eleven (11) Double taxation Treaties (TTs) aimed at encouraging the inflow of FDI. On similar development, *Odi (1997)* reports that Nigeria is the second largest recipient of FDI among low-income countries like India, Bangladesh, Vietnam, and after countries of African region.

“The over-enthusiasm to attract FDI, in some cases has resulted in bilateral treaties being badly negotiated, excessive incentives offered and environmental standard lowered” (*Kiara, 2003* and *Babatunde, 2010*). Reasons given for these efforts, have been offered by many authors for example (*Oman, 2000*), explain that “multinational companies (MNCs)

are through to bring not just employment and capital, but also new skills and technological knowledge for domestic firms”. The benefits derived are supposed to leak out from MNC subsidiaries to domestic firms thus generating Spillover effects. The successful conviction has made the government of Nigeria to set up policies that prescribe the attraction of FDI and integration of related Spillover to traditional knowledge and procedures in the productive sector of the economy in all ramifications (*UNCTAD, 2009*).

The Nigerian government has paid much emphasis on manufacturing sector because it is envisaged that the modernization of the sector requires a deliberate and sustained application and combination of suitable technology, management techniques. Other resources to move the economy from the traditional level of productivity to a more automated and efficient system of mass production of goods and services (*Malik, Teal and Baptist, 2006*). Despite these efforts and the recorded increase in FDI inflows, the performance of the sector leaves much to be desired as general output, capacity utilization and sector contribution to GDP are still comparatively low.

The evidence and extent of FDI-related technology Spillover in the host economies of developing countries is an important area of research in the international economics and management literature. The belief according to: (*Ikiara, 2003, Marin, 2006; Dutse, 2008, and UNCTAD 2009*) is that “MNCs subsidiaries bring in new technologies, skills, marketing expertise and good management techniques from their parents into host countries, these knowledge resources may ‘leak’ to indigenous companies through various channels. This could be through the integration of the local market with the international operators, labor mobility between subsidiaries and indigenous firms resulting in knowledge Spillover, learning from the demonstration of new technologies represented in foreign subsidiaries and when indigenous firms receive technical assistances. *UNCTAD (2005)* emphasize that FDI-led Technology Spillovers can play a significant role in the productivity growth of indigenous Enterprises in a host economy. *Libtenberg et al (1996), Xu (2000), Pradhan (2006), Sun (2010)*.

Current reports on Nigeria’s manufacturing suggest that the sector is still trailing behind other sectors in term of productivity. The index of manufacturing production rose by 1.3% above the level and capacity utilization showed slight improvement from 54.7% in

2008 to 55% in 2009. This development has been attributed to some policy initiatives aimed at promoting increase in the performance of some firms within the sector. The policy initiatives include among others: ‘granting of licenses for importation of quality raw materials for industrial use, provision of capital allowance incentives for incurring excess capital expenditures, granting of input loan, provision of 2-3 years duty free period for importation of machinery, equipment and spare parts during the phases of plant building and commencement of production, removal of restriction on the importation of high valued raw materials for production and provision of tax reduction incentive on investment in system conversion by manufacturing firms’ (CBN-nCentral Bank of Nigeria, 2009).

*Oji-Okoro (2011)*, is of the view that some decades ago, ‘telecommunication industry was one of the sectors that suffered serious setback in Nigeria. The problem could be traced to the fact that the sector was operated single- handedly by government owned company Nigerian Telecommunication Limited (NITEL) which monopolized the telecommunication service in Nigeria’. With the establishment of National Communication Commission (NCC) in the year 1992, the agency was given a mandate to issue license to private companies wishing to operate in the industry which paved the way for the foreign companies to participate in telecommunication business in Nigeria. Following this new development, the government gradually withdrew from direct conduct of commercial activity to embrace a private sector-led growth strategy. Foreign investors were fully welcomed to participate in the process. Although their response has so far been most evident in the utilities sector, the industry is now considered as one of the fastest growing industry in Nigeria with the highest number of subscribers in Africa.

The positive relationship between economic growth and telecommunication is evident given the various studies. *Jorgenson (2001)* in his study of the United States showed that investment in information technology (IT) contributed more than one-half of the recent increase in the United States economic growth. His study was collaborated by (*Kraemer and Dedrick, 2001*) who using data from 43 countries, upheld the view that the growth of IT investment is correlated with productivity growth.

*Oulton (2001)* in his study of the United Kingdom showed that in the beginning and later part of 1990s, Information and Communicating Technology’s (ICT) contribution to

GDP growth was 0.36% and 0.56% respectively. For *Belgium, Kegels, Van Overbeke and Van Azndweghe, 2002*) found that the accumulation of ICT capital has a significant impact on output growth and average labor productivity growth. (CEPII, 2003) studies on France showed that in the early 1990s to the mid 1990s, ICT's contribution to capital growth increased from 0.25% to 0.45%. Cronin et al. (1991) using the Granger, Sims and modified Sims tests to confirm the existence of feedback process in the economic activity and growth, stimulates demands for telecommunication services. They believe that as the economy grows, more telecommunications facilities are needed to conduct the increased business transactions.

Between 1960 and 1985, the telecommunication sector in Nigeria consisted of the Department of Posts and Telecommunication (P & T) in charge of the internal network and a limited liability company, the Nigerian External Telecommunication (NET) Limited, responsible for the external telecommunications services provided the gateway to the outside world.

Averagely, the Nigerian telecommunication sector is undergoing very rapid change and explosive growth. Waiting lists for telephone lines have disappeared, while telephone tariffs for local, national and international calls are gradually ranking amongst the lowest in Africa. The liberalization of the sector and the resulting competition by private operators is bringing about very substantial benefits to subscribers in terms of much lower prices and enhanced choice. The introduction of mobile telephoning to Nigeria in 2001 radically altered the country's communications landscape from a base of 0.73% teledensity in 2001, the country as of August 2008 had reached 39.45% teledensity, calculated on the basis of active subscribers.

This phenomenal growth was driven by mobile telephony in August 2008; Nigeria had 64,296,117 active mobile subscriptions, as compared to first 1,152,517 active fixed line subscriptions. In 1007, the country passed out South Africa as the continent's largest mobile market. Nigeria mobile subscribers Base is project to rise to 79.8 million by 2010 (NCC 2004-2008).

Despite this enormous increase, the demand for more lines still persists in Nigeria, though there is a quest not just for lines but also for good quality service from the operators. This strong growth is due mainly to competition to sign up new users by the GSM operator and their fixed counterparts. In spite of the extraordinary growth in the sub-sector notwithstanding, quality of services provide and telecommunication operation has remained unimpressive, owing to poor interconnectivity between the different networks. The problem of constant call droppings, message and call failures and overloaded billings have not been effectively addressed despite numerous complaints from the consuming public, the industry is still plague with come problems. Which includes: poor public power supply; poor security such that infrastructure are often vandalized, high operational cost.

## **FDI AND TELECOMMUNICATION INDUSTRY IN NIGERIA**

*Oji-Okoro (2011)* noted that “FDI has had a notable impact on the expansion of mobile telephone in Nigeria since the launch of Global System for Mobile (GSM) licensing in January 2001”. Two of these license issued went to foreign companies MTN of South Africa and Econet Wireless (at the time a Zimbabwean – South African firm and now Airtel Nigeria, further to the entry in 2006 of the Zain Grwoth Kuwiat) – for \$285 million each. Within two years, Econet and MTN had signed up 2.2 million subscribers. MT alone claims to have invested more than \$3 billion to date in Nigeria and the Zain Group has pledge another \$2 billion investment. The impact of FDI under Competitive Conditions in mobile telephone has been remarkable. In the sector as a whole, subscribers numbers have grow from 35,000 to over 19 million in September, 2005, while prices are being driven below those in comparator countries.

Competition in the fixed-line sector is provided by nationally owned Globacom, was issued the second national operator license in 2002. After various failed attempts to privatize the state-owned operator 51% of Nigeria Telecommunications Limited (NITEL) was eventually acquired by Transnational Corporation (Transcorp) of Nigeria, a local company n November 2006. However, the governments reverse the privatization in

February 2008, a grounds that Transcorp failed to achieve the objectives of the privatization guidelines, and is now looking for a new core investor.

The telecommunication sector is usually referred to as an infrastructure of infrastructure because an investment in the sector is capable of generating activities and having a multiplier effects on the other sector of the economy. The sector currently accounts for about 6% of the country's total Gross Domestic Product (GDP), with room for growth, according to a survey by Pyramid research, a United Kingdom based telecommunication research firm, and it is within the range that we see in places like Europe, Africa and elsewhere within the developing markets. The impact of the telecommunication sector on the Nigeria GDP can be seen from various points. The most transparent item is the investment, secondly the revenue it generated on annual basis.

Finally, the result of (*Oji-Okoro, 2011*) empirical analysis shows that all the variables except GDP have a positive relationship with FDI meaning that every increase of FDI influx is associated with increase in the investment in the telecommunication industry and value of technology or machinery used in the industry. Similarly, increase in FDI facilitates increase in number of telecommunication subscribers even though the relationship is meager. But when having a cursory look at the industry it has been deduced that Nigeria has the highest telecommunication subscribers in Africa totaling 70 million as at 2009.

However, one important thing to notice is that based on the Nigerian population which stands over 150 million, it means more than half of Nigerian populations are non-telecommunication subscribers indicating large gap that needs to be filled.

The result equally shows negative relationship between FDI and GDP, meaning increase in FDI is associated with the decrease of GDP possibly this could happen in the short-term period but in the longer period the relationship may change more again, because the industry is still at its infant stage it requires substantial capital outlay which might eventually take longer period before reaping the total economic benefit of the investment. Nevertheless the rate at which the industry is growing symbolizes the success of the telecommunication sector and paves way for sustainable economic growth in Nigeria.

He therefore put forward as a recommendation that the Nigerian government should

improve on the standard of infrastructure and provide relevant social amenities to attract more FDI to promote the overall economic development in the country as the industry is growing. Also, the government should design a blue print architecture that will accommodate future technologies and encourage expansion while maintaining a stable regulatory policy that will encourage investor's confidence to boost the industry.

## **FDI AND THE NIGERIAN AGRICULTURAL SECTOR**

In terms of agricultural productivity, *Arene and Okpukpara (2006)* posit that massive application of capital to land in form of land reclamation and critical productive inputs improve its productivity.

In Keynesian terminology, real investment refers to addition to capital (as a factor of production) which leads to increase in the level of production and income (*Jhingan, 2003*). Thus, real investment includes new plant and equipment, construction of public works like dams, road, building, net foreign investment, inventories and stocks and shares in new companies.

It is clear that the general drive behind any type of investment in return is one form or the other. “ A rational foreign investor will be interested in a sector that has the highest marginal efficiency of capital (MEC)” *Ogbanje et al (2010)*. Whatever the motive of the foreign investor is, the recipient economy could have its own interest which could be at variance with that of the investor. In any economy where agriculture, despite its neglect by the government, holds the key to sustenance, the preferred sector should be agriculture.

Investment transcends national boundaries in line with economic theory that capital will move from countries where it is abundant to countries where it is scarce. This pattern, according to *Oyeranti (2003)*, will be informed by return on new investment opportunities, which are considered where capital is limited, especially in developing countries. As suggested by *summers (2000)*, the resultant capital relocation is expected to boost investment and bring about enormous social and economic benefits to the recipient country

*Arene and Okpukpara (2006)* posit that the characteristics of nation's natural resources influence the amount of her Gross Domestic Product (GDP). For Nigeria, oil and agriculture sectors constitute the major proportion of natural resources that contribute significantly to its economy. Agricultural GDP is the total value of the output of the agricultural sector within the country. Agricultural GDP represents the value of output from key subsectors such as crop production, forestry and fisheries.

Ogbanje et al (2010), in their empirical analysis shows that the correlation coefficient is positive and strong. This implies that as agricultural GDP increased FDI increases. Their findings conform with *Lensik and Morisey (2001)* in *Aremu (2003)* that FDI has positive impact on the economies of developing countries. They concluded that 'agricultural sector got the least average foreign direct investment while the manufacturing and processing sector topped the chart'.

The mean investments in three sectors-manufacturing and processing, mining and quarrying, and miscellaneous –were significantly greater than that of the agricultural sector. The mean investments in trading and business service, building and construction, and transport and communication sectors were also greater than that of the agricultural sector but significantly. Agricultural GDP showed slow growth but a declining rate. In a country with a past growing population, this trend and relatively low foreign investment portend negative implications for the agricultural sector and the entire economy. 'It is interesting to note that there is a strong positive relationship between agricultural sector's share of foreign direct investment and agricultural GDP, implying that increase in agricultural sector's share of FDI is associated with growth in agricultural GDP', *Ogbanje et al (2010)*.

Power provision has long been a thorn in the side of Nigerian competitiveness and quality of life. The erratic and costly provision of electricity hurts businesses generally but especially in energy intensive manufacturing sector. According to NEEDS, up to 25 percent of business start-up costs are accounted for by expenditure on private power generators and privately generated electricity can be up to 2.5 times as costly as that from the national infrastructure. World Bank Investment Climate Assessment (2001), confirmed that 97 per cent of firms in Nigeria "own or share a generator" compares with 9 per cent in South Africa

and 19 per cent in Egypt, while some manufacturers operate independently of the national infrastructure.

Traditionally, the power sector has been run by the state monopoly, the Nigerian Electric Power Authority (NEPA). Over the last few years, there have been various attempts at liberalizing the sector and NEPA has already been broken up for privatization, changing its name to Power Holding Company of Nigeria. No private investment has been attracted so far, however, due to the deteriorated state of the energy infrastructure. Pending the privatization of the respective business units, foreign participation in the sector is limited to a number of independent power producers (IPPs). For example, in June 2000, the federal government signed an agreement with Enron for the construction of a 279 MW IPP in Lagos state. Ownership has since been transferred to ESs Corporation and Nigerian firm, Y.F. Power. The commercial prospects for IPPs have been complicated by the financial frailty of NEPA and its successor businesses, which would be the principal buyers of independently generated power.

FDI in the transport sector is at the emergent states as liberalization and privatization have only just begun to make private investment opportunities available. Ports sector concussing is well underway, with 20 long-term concession agreements fully executed by the end of 2006 and six more in progress, and concessions have recently been announced for airport services. A.P. Moller of the Maersk Group has acquired the Apapa container terminal concession and the ENL Consortium has emerged as preferred bidder for Apapa terminals A and C. Although these investments are too recent to judge their impact on the cost and quality of port services, some benefits are already visible, and include increased competition in port services and the removal of concession charges (normally \$300 per container) by some shipping liens, as operators and ship turnaround times improve (*Leigland and Pallson, 2007*). In September 2004, Virgin Atlantic was named as technical partner in the new national flag carrier. Initial capitalization for Virgin Nigeria was \$50 million, of which Virgin Atlantic provided approximately \$24.5 million.

Expectations regarding the environmental impacts of FDI are rather mixed. On the one hand, some argue that FDI brings negative environmental impacts, especially in developing countries that have lower environmental standards and could constitute

population havens” (*Borregard et al, 2008*). On the other hand, some claim that foreign firms help to improve environmental performance in developing countries by transferring both cleaner technology and management expertise in controlling environmental impacts. The environmental impact of FDI in Latin America is a sensitive issue, as Latin American countries are characterized by natural-resource-based production and exports, primarily in the mining, forestry and fishery sectors. These are environmentally sensitive sectors, with significant potential effects of both resource extraction and processing.

*Borregard et al (2008)* in their analysis of FDI and Environment in Chilean and Brazilian forestry Sectors observed that FDI in other industries, such as mining. Foreign involvement in the sector has permitted investment flows in periods when domestic finance has been scarce (Such as the late 1980s), or in which the industry faced specific capital flow constraints. According to them, the environmental impact of FDI in the forestry sector would not appear to differ from that of domestic investment. Whether foreign or domestic, large investment projects have been the main focus of environmental concerns. In the late 1990s, these were potential foreign investment projects that raised concerns about the sustainability of native forest exploitation (Trillion and Cascada). However, in the present decade, these have been domestic projects (CELCO-Validivia and CELCOltata) that have raised the concerns related to industrial pollution.

Domestic and foreign companies are implicated in the same types of environmental problems – especially native forest substitution (as well as the same social issues, such as property rights, the rights of indigenous people). Environmental certification has advanced rapidly, with most large companies, both domestic and foreign, having gained both international organization for standardization (ISO) 14001 approved and some kind of sustainable management certification by one of the major forest certification schemes.

Authors such as *Donoso (1999)* explicitly argue that foreign and domestic investment did not differ in exploitation and substitution of native forests.

In Brazil, FID in the forestry sector has little economic significance compared to domestic investment. In environmental performance, the differences in performance between foreign and domestic companies depend on whether these are located in the tropical

wood or pulp-and-paper sectors. In tropical wood sector, it seems that today the worst environmental offenders are domestic companies. Foreign companies are less likely to be involved in illegal logging – the key environmental concern in the sector – are more law abiding and are more likely to embrace environmental standards such as ISO 14000 and FSC. Even though there were important worries about negative environmental impacts associated with massive Asian FDI, these never materialized.

In the pulp-and-paper sector, on the other hand, domestic companies tend to perform better than their foreign counterparts in terms of emissions and effluents. More so, although today there are no significant differences among FDI and national companies regarding the adoption of environmental management or compliance with the law, it seems that latter lead the introduction of more advanced environmental approaches.

Analysts emphasizing the similarity, in environmental behavior and impacts between domestic investment and FDI in the forestry sector have failed to account for some differences, both positive and negative. One difference is in the use of different environmental certification schemes by foreign versus domestic companies. Another relates to the use of transgenic specie. Finally, some differences relate to the lag in domestic companies' introduction of environmental management systems.

In conclusion of their analysis, they submit that foreign companies are more heavily focused on international requirements and on reputation. If elevated international requirements were not matched by local pressure, however, foreign companies might put their environmental reputations ahead of real environmental commitments. The early interest of foreign companies in international certification schemes should be emphasized, as well as the success of domestic certification schemes in Chile and Brazil, the CERTFOR and the CERTFLOR, respectively with regard to the elevated percentage of certified plantations in the total of plantations. Developing countries, Nigeria can b lessons from the Chilean and Brazilian experiences.

Sustainability reporting seems to follow similar pattern, with foreign companies, especially European companies, enjoying a slight head start over the domestic companies.

On regulatory effect, the existence or lack of an environmental regulatory framework is important in several ways: to attracting foreign investment, to closing the gap between foreign and domestic companies in environmental management, and finally to preventing damage. In general, there is no evidence linking FDI in the forestry sector with negative regulatory impacts. In Brazil, foreign companies in tropical timber extraction tend to be more law-abiding than domestic companies and, where foreign companies have targeted NGOs due to bad practices, this had induced tougher environmental laws and enforcement, not a drop in regulation. In the pulp-and-paper sector, domestic and foreign companies are generally law-abiding and foreign companies do not use the country as a “pollution haven”. In Chile, large foreign investment projects have spurred discussion on the necessity of a native forest law, even as existing regulation proved effective in confronting the environmental risks imposed by the large investment projects.

**Table 2.3: SECTORAL ANALYSIS OF FOREIGN DIRECT INVESTMENT IN NIGERIA, 1970 – 2007 (38 years)**

<b>Sectors</b>	<b>N</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Mean</b>
Mining and Quarrying	38	-810,000	132,000	26,308
Manufacturing and Processing	38	224.90	220,000	28,267
Agric, Forestry and Fishery	38	7.90	1,329.90	553.61
Trading and Business Service	38	11.60	10,758.20	1088.7
Transport and Communication	38	13.80	12,030.20	1,968
Building and Construction	38	187.20	47,505.70	6,658
Miscellaneous	38	-23.70	129,000	20,044

Source: *Ogbanje et al (2010)* “An Analysis of Foreign Direct Investment in Nigeria: The Fate of Nigeria’s Agricultural Sector.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter deals explicitly with the methods and procedures adopted by the researcher in carrying out this study under the following subleasing: research design, population of the study, sample size determination, estimation technique, sources of data, instrument of data collection, validity and reliability of instrument and method of data analysis.

#### **3.2 Research Design**

*Ogbuoshi (2006:26)* stated that the research design used in any research is determined substantially by the nature of the problem as well as the objectives. After considering the research problem and objectives of this study, the research design used for this study was econometric estimation of the variables interest in its aggregated form.

**3.3 Population of this study constitutes the entire Nigerian economy and the investment opportunity.**

### **3.4 Estimation Technique**

The technique employed for this study is the ordinary least square (OLS) this is because of its 'BLUE' –best linear unbiased estimator properties. Also tests of unit root, co integration and error correction model will be carried out to examine the time series properties of the variables of interest.

### **3.5 Sources Of Data**

Data for this research work were gathered mainly from secondary sources which include the Central Bank of Nigeria's Statistical Bulletin, peer reviewed journals, textbooks, and conference papers, and publications.

### **3.6 Instrument of Data collection**

According to *Odo (1992:57)* instrumentation deals with tool(s) a researcher employs to generate information for data analysis. The instrument of data collection for this study included the materials enumerated in the source of data. The data for the variables was divided into parts. The dependent variables, the gross domestic product (GDP) and the independent variables included, foreign direct investment inflationary rate, capital formation, energy (infrastructure) and human capital.

### **3.7 Model Specification**

Taking theoretical consideration, empirical evidence from Nigeria and other developing countries as a guide, a model will be specified. This model will include a stochastic term which takes care of any variable not included or considered in the model. To make our analysis more precise, we develop a single model to test the impact of FDI on

Nigeria's economic growth. Borrowing from the literature on economic growth, we assumed a neoclassical production function of the form.

$$Y = AF(KL) \dots\dots\dots (1)$$

Where Y = output, L = labor, K = capital and A = Effectiveness of labor.

This follow (1956) production function assume that output is a function of capital (both physical and human), labor and technical progress. New growth theory proponents (Levine and Renelt, 1992) give core explanatory variable for economic growth as investment, population and human capital. Investment (both foreign and domestic) as a percentage of GDP and export and import as percentages of GDP are expected to rise as countries pass through higher stages of development and experience faster growth rates.

This simple Solow growth model in equation (1) can be modified without changing the essential characteristics of the model. Hence, the model used is based on the assumption that change in GDP (proxy for economic growth) depends on foreign direct investment, inflationary rate, capital formation, energy (infrastructure) and human capital. Therefore, our investment augmented production function could be stated as:

$$GDP = f(FDI, HC, INF, EN, NE, CF) \dots\dots\dots (2)$$

Where,

GDP = real gross domestic product per capital (in log form)

FDI = foreign direct investment

NE = Net export (proxy for openness of the economy)

HC = the level of human capital (share of secondary and university emolument in the population.

INF = the rate of inflation

EN = infrastructure development (per capita electricity consumption) Energy

CF = domestic capital formation

However, the liberalized form of this model is

$$GDP = a_0 + a_1 FDI + a_2 INF + a_3 HC + a_4 CF + a_5 NE + a_6 EN + u_t \dots\dots\dots(3)$$

Where

U = the error term

A = the intercept

Where  $a_1, a_2, a_3, a_4, a_5, a_6 > 0$ , represent the coefficient of the independent variables.

The linearised version of equation (3) in natural log form is given as:

$$\ln GDP = b_0 + b_1 \ln FDI + b_2 \ln INF + b_3 \ln HC + b_4 \ln CF + b_5 \ln NE + b_6 \ln EN + u_t \dots\dots\dots 4$$

The log transformation is taken in order to standardize the value of the variables, achieve linearity as well as allow for the easy interpretation of their coefficient of elasticity.

### 3.8 Method of Data Analysis

Data generated for this study will be analyzed using econometric analytical method. The econometric method to be employed is the ordinary least square (OLS) which has the advantage of Best Linear Unbiased Estimator (BLUE) property, the statistically requirements for BLUE include; unbiasedness, efficiency and consistency.

- (a) Unbiasedness. The expected values of the coefficient are equal to their true values. Unbiasedness means that the expected value of  $a_1$  is equal to its true value. Thus  $E(a_1) = a_1$
- (b) Efficiency means minimum variance. Thus, in the class of linear unbiased estimators, the OLS estimate of  $a_1$  has the minimum or smallest variance.
- (c) Consistency implies asymptotic unbiasedness and asymptotic certainty.

The data series will be tested for stationarity using Augmented Dickey Fuller Test (ADF). This process examines the time series characteristics of the selected variables to overcome the problems of spurious regression often associated with time series data

However, it is now a common practice in econometric analysis to perform some pre-test assessment on the time series data employed. As such to avoid the problem of spurious regression, the data services will be tested for stationarity using the augmented Dickey Fuller (ADF) test. This is to examine the time series characteristics of the selected variables to overcome the problem of spurious correlation associated with ordinary least square estimation.

### 3.8.1 Unit Root Test

The unit root test is important because it allows us to examine whether a time series is stationary or not. By so doing, we ensure the validity of the usual test statistics (t, f-statistics, and R<sup>2</sup>). Stationarity could be achieved by appropriate differencing which is called order of integration. The Augmented Dickey-Fuller test is used to check the stationarity of the variables. By definition, a time series is said to be stationary if it means, variances and covariance are all invariant with respect to time.

### 3.8.2 Co-integration Tests

After the unit root tests, we test for co integration tests to avoid spurious regressions. For this purpose we apply the ADF test to the residuals ( $\mu$ ) of the static co integration regression as follows:

$$\Delta\mu_t = \beta_0 U_{t-1} + \beta_1 \Delta\mu_{t-1} + C \text{-----} 5$$

Where the t-value of the  $\beta_0$  (Parameter of  $\mu_{t-1}$ ) is compared to the ADF statistics of the various levels. Co integration implies that the long-run movements in the variables are

related to one another in a long-run equilibrium relationship. The likelihood ratio tests indicate that all the variables are co-integrated at 5% critical levels, we therefore reject the null hypothesis of no co-integration and conclude that there exists a long-term relationship among the dependent and independent variables. The presence of co-integration means two things:

- If two or more variables are found to be co-integrated, the possibility of no causation is ruled out and there must be at least one-way causation (Mash and Mash, 1994).
- The variables have a long-term relationship in that they will not deviate arbitrarily from each other and their deviation from the long-run equilibrium path is corrected.

### **3.9 Re-statement of Hypothesis**

This study has tested the following statements.

1.  $H_0$ : The FDI has no effect on economic growth  
 $H_1$ : The FDI has effect on economic growth.
2.  $H_0$ : The FDI in primary sector has no effect on economic growth  
 $H_1$ : The FDI in primary sector has effect on economic growth
3.  $H_0$ : The FDI in Manufacturing sector has no effect on economic growth  
 $H_1$ : The FDI in manufacturing sector has effect on economic growth
4.  $H_0$ : The FDI in service sector has no effect on economic growth  
 $H_1$ : The FDI in service sector has effect on economic growth
5.  $H_0$ : Infrastructure has no effect on economic growth  
 $H_1$ : Infrastructure has effect on economic growth
6.  $H_0$ : Human capital has no effect on economic growth  
 $H_1$ : Human capital has effect on economic growth

*Lensink and Morrisey (2001)* submitted that it is difficult to find instruments that are good at predicting the variable FDI and yet are not determinants of the dependent variables.

### 3.10 Diagnostic test of the Models

Evaluation of results consists of deciding whether the estimates of the parameters are theoretically meaningful and statistically satisfactory.

- a. The statistical criterion to be used is the adjusted coefficient of determination  $R^2$ . This is used to measure the extent to which the explanatory variables are responsible for the changes in the dependent variable. It shows the percentage of the total variations of the dependent variable that is explained by the independent variables. The values of  $R^2$  lies between zero and one, the higher the  $R^2$ , the greater the percentage of the variation of the growth rate of the dependent variables explained by the independent variable and the better the goodness of fit, while the closer the  $R^2$  to zero, the worse the fit.
- b. The F – test was used to find out whether the explanatory variables do actually have any significant impact on the dependent variable. The more significant the relationship denoted by the regression, the higher the value of  $F^*$ . Therefore, high values of  $f$  suggest significant relationship between the dependent and independent variables.
- c. Durbin – Watson test: This also test for autocorrelation and serial correlation of the random variable.

### DESCRIPTION OF VARIABLE

*Sala-a-martin et al (2004)* points to the difficulty of choosing among the multitude of potential determinants of economic growth when analyzing growth empirically. It argues that growth theories are explicit enough about what variable that belong in the “true regression”. Nigeria being a beneficiary of all types of FDI (market-seeking and non-market-seeking), we therefore include in the model such independent variables that are important to economic growth subject to availability of data.

1. **GDP:** The dependent variable used is the GDP, gross domestic product per capita (in log form) which is obtained as a ratio of real GDP to the population. In the model

specified above, the growth of aggregate GDP is our dependent variable and we expect an increase in the flow of foreign capital to be positively related to economic growth.

- 2. FDI:** The inflow of FDI helps to increase capital stock. This movement of capital tends to increase the rate of economic growth. There are dimensions that can be used to examine the effects of FDI in the economy.

For example, the demonstration effect (domestic firms can learn superior-production technologies and management skills from foreign firms), the employment effect (foreign firms train domestic workers, who may move to domestic firms later on and bring with them updated technology know-how and management skills), the competition effect (domestic firms are forced to update their technology and management skills due to increasing competition from foreign firms), the linkage effect (domestic firms may learn updated technology and management skills through linkage across firms or industrial sectors).

In this research work, we would like to examine whether FDI may have different impact on economic performance for different sectors. In *Khaliq Abdul and Noy Han (2007)*, FDI, was observed to have positive effect on economic growth. However, when accounting for the different average growth performance across sectors, the beneficial impact of FDI is no longer apparent. When examining different impacts across sectors, estimation results show that the composition of FDI matters for its effect on economic growth with very few sectors showing positive impact of FDI and one sector even shows a robust negative impact of FDI inflows (mining and quarrying).

An increase in FDI leads to an increase in production which generates higher wages and expands employment, lowers the price of goods.

FDI would also generate high tax revenue to government (*Borensztein et al 1998*) thus, there is a link between FDI in primary and service sectors may be positive but not statistically significant. However, FDI in manufacturing will be both positive and statistically significant to growth.

- 3. Human capital:** Though there is a dearth of empirical literature on the effect of human capital in sub-Saharan Africa in particular, yet in the literature the

accumulation of physical and human capital results in higher output per worker which translates into the growth of retained earnings and new earnings, thereby spurring investment (*Lasbrey, 2010*). An increasing skilled labor is therefore critical to economic growth. The ability to adopt new technologies through FDI is governed by the level of human capital present.

The importance of education to economic growth is proxy by the ratio of secondary and tertiary institution enrolment in the population. *Barro and Lee (1994)* and *Akinlo (2004)* included this variable in their growth equation and found a direct relationship. *Borensztein et al (1998)*, However found a conditional relationship, where the relationship was indirect below some threshold and positive thereafter. *Bende – Nabende and Ford (1998)* found an indirect relationship between human capital and growth in Taiwan.

In all, human capital stock plays an important role as an absorptive capacity for a country which has a larger gap in income per worker, and is technologically lagging behind. For our purposes the schooling variable can function both as a measure of human capital and a rough proxy for the absorptive capacity of the host country. We expect an inverse relationship between the two variables because of the dearth of human capital in Nigeria.

- 4. EXPORT:** We have export as one of the growth control variables because the proponents of “export-led growth” such as *Balassa (1978)*, *Tyler (1981)* argue that growth of export should be in growth equation on the grounds that in most LDCs - Low Developing Countries, growth of export has led to the development of infrastructure, transport, communication etc. which in turn facilitates production of goods and services. Therefore, export affects both foreign investment (especially export – led FDI) inflation and GDP.

Again, the ratio of trade (imports and exports) to GDP is used to capture this variable. FDI inflows are expected to result in improved competitiveness of host countries export. As exports and investment increase, they will have a multiplier effect on GDP. Increased exports and investments may also generate foreign exchange that can be used to import capital goods. We expect a direct relationship between this variable and economic growth.

- 5. Domestic capital formation:** There is a link also between domestic capital formation (DCF) and GDP. An increase in domestic capital expands the scale of production through the capital market. And where the country's saving rate is 10 percent, then, a savings investment "financing gap" of 14 percent GDP exists which can be filled by either of sources, foreign borrowing raise domestic saving might indeed be higher than the required investment rate but a greater proportion of such savings is rather invested abroad (mainly as capital flight). Therefore, an increase in domestic capital will lead to an increase in the size of productivity, national output, income and employment which positively reduces inflation and balance of payment problem.
- 6. Inflation:** The theoretical literature is rather ambiguous on the causes and effect of inflation on investment. A high rate of inflation is expected to induce a high rate of real investment. But in Nigeria where the capital and financial market are largely underdeveloped, a high rate of inflation lowers private investment. A high rate of inflation in the Nigerian case is an indication of government's inability to manage the economy. Therefore, a high rate of inflation may affect FDI and shrink GDP, thus leading to a negative impact on growth.

The inflation rate is included as a measure of overall economic stability of the country. We expect an inverse relation between inflation and economic growth.

## CHAPTER FOUR

### DATA ANALYSIS AND PRESENTATION OF RESULT

#### 4.1 Data Analysis

##### 1. Preliminary Data Analysis

- (a) An OLS estimation of determinants of growth at ordinary levels to find out the suitability of the variables for answering research questions and testing of hypotheses.
- (b) Results of OLS estimation was found not suitable for answering the research questions, so we proceeded to perform the unit root test. The results suggest that all the variables are integrated of the order (1).
- (c) We applied Johansen and *Juselius (1990)* tests for co integration among the variables. There is a long-run relationship between dependent variable (Growth) and independent variable.

##### 2. Final Data Analysis

An Error-Correction Model (ECM) was then estimated using three lags on each variable while the redundancy test removed redundant variables.

#### 4.2 Preliminary OLS empirical results

Table 4.1 is the short run determinant of growth for the entire economy. Table 4.2 is the short run determinant of growth (FDI in manufacturing sector). Table 4.3 is the short run determinant of growth (FDI in the primary sector). Table 4.4 is the short run determinants (FDI) in the service sector)

**Table 4.1 OLS short run determinant of Growth (for the economy)**

VARIABLES	COEFFICIENT	STD. ERROR	T-STATISTIC	PROB.
Constant	10.20978	0.218752	46.67283	0.000
LOG (FDI)	0.007552	0.024090	0.313484	0.7562
LOG (CF)	-0.059989	0.031648	-1.895495	0.0684
LOG (EN)	0.135095	0.057214	2.361240	0.0254
LOG (HC)	0.122977	0.618663	6.589478	0.0000
LOG (INF)	0.018566	0.030346	0.611796	0.5456

*Source: Author's Computation*

R –squared = 0.837846

Adjusted R-squared - 0.808890

F – Statistic – 28.93509

Durbin Watson – 0.795106

**Table 4.2: OLS short run determinant (FDI in Manufacturing)**

VARIABLES	COEFFICIENT	STD. ERROR	T-STATISTIC	PROB.
CONSTANT	10.73384	0.286393	37.47938	0.000
LOG (FDIM)	0.133791	0.052613	2.542916	0.0164
LOG (CF)	-0.097715	0.030852	-3.167191	0.0035
LOG (EN)	0.041059	0.066163	0.620566	0.5396
LOG (HC)	0.58522	0.027122	2.157740	0.0391
LOG (INF)	-0.003181	0.025630	-0.124100	0.9021

*Source: Author's Computation*

R –squared = 0.856303

Adjusted R-squared – 0.832353

F – Statistic = 35.75445

Durbin Watson = 0.726681

**Table 4.3: OLS short run determinant (FDI Robustness in primary sector)**

<b>VARIABLES</b>	<b>COEFFICIENT</b>	<b>STD. ERROR</b>	<b>T-STATISTIC</b>	<b>PROB.</b>
CONSTANT	10.17950	0.187185	54.38189	0.000
LOG (FDIP)	0.023536	0.029871	0.787941	0.4369
LOG (CF)	-0.063930	0.031627	-2.021404	0.0522
LOG (EN)	0.157667	0.058101	2.713676	0.0109
LOG (HC)	0.096161	0.030791	3.122986	0.0039
LOG (INF)	0.007457	0.028741	0.259466	0.7970

*Source: Author's Computation*

R –squared = 0.828871

Adjusted R-squared = 0.800349

F – Statistic = 29.06121

Durbin Watson = 0.690489.

**Table 4.4: OLS short run determinant (FDI Robustness in service )**

VARIABLES	COEFFICIENT	STD. ERROR	T-STATISTIC	PROB.
CONSTANT	10.00560	0.193014	51.83879	0.000
LOG (FDIS)	-0.061221	0.038569	-1.587316	0.1229
LOG (CF)	-0.044092	0.026618	-1.656459	0.1081
LOG (EG)	0.209017	0.067399	3.101200	0.0042
LOG (HC)	0.131441	0.017691	7.429859	0.000
LOG (INF)	0.008803	0.026337	0.334249	0.7405

*Source: Author's Computation*

R –squared = 0. 838862

Adjusted R-squared – 0.812006

F – Statistic = 31.23526

Durbin Watson = 0.837061

It should noted that the results of OLS short run determinants of growth cannot answer our research questions neither can it be used to test our hypotheses, therefore, we need to carry out a unit root test of the variable.

#### **Test for Unit Root.**

Most time series variable like the variables of our growth determinant are non-stationary and using non-stationary variables in the model might lead to spurious regressions (*Granger, 1969*).

The Augmented Dickey – Fuller (ADF) test is used to test for the presence of unit roots in the variables. The result is presented below and it indicates that all the variables in their first difference are greater than the 5% critical values. In this, we can strongly reject the null hypothesis of non-stationary for all the tests, and that the variable in first differences is stationary and thus quite suitable for the intended purpose.

**Table 4.5: Unit Root Test statistic at ordinary levels.**

VARIABLES	ADF STATISTIC	5% CRITICAL VALUE	ORDER OF INTEGRATION
LN (GDP)	-0.1646006	-2.9499	1 (0)
LN (FDI)	-0.752065	-2.9627	1 (0)
LN (CF)	-1.058871	-2.9699	1 (0)
LN (EG)	-1.986483	-2.9699	1 (0)
LN (INF)	0.18841	-2.9699	1 (0)
LN (FDIM)	-4.052003	-2.9699	1 (0)
LN (FDIP)	0.703814	-2.9699	1 (0)
LN (FDIS)	-0.435729	-2.9699	1 (0)
LN (HC)	0.164202	-2.9699	1 (0)

*Source: Author's Computation*

**Table 4.6: Unit Root Test Result at First Difference**

VARIABLES	ADF STATISTIC	5% CRITICAL VALUE	ORDER OF INTEGRATION
$\Delta$ LN (GDP)	-3.455274	-2.9527	1 (1)
$\Delta$ LN (FDI)	-7.672456	-2.9705	1 (1)
$\Delta$ LN (CF)	-5.485879	-2.9527	1 (1)
$\Delta$ LN (EG)	-5.778234	-2.9527	1 (1)
$\Delta$ LN (HC)	-4.966263	-2.9527	1 (1)
$\Delta$ LN (INF)	-6.576501	-2.9527	1 (1)
$\Delta$ LN (FDIM)	-3.607654	-2.9527	1 (1)
$\Delta$ LN (FDIP)	-3.225879	-2.9527	1 (1)
LN (FDIS)	-3.748783	-2.9527	1 (1)

*Source: Author's Computation*

## COINTEGRATION TEST

With the results of the above Unit root tests suggesting that all the variables are integrated of the order (1), we proceed to employ the *Johansen and Juselius (1990)* test for the co-integration among the variables. As said earlier, non-stationary time series can be co integrated if there is linear combination of them that is stationary, that is, the combination does not have a stochastic trend. The co integration test is shown below .The likelihood ratio tests indicates that all the variables are co integrated at 5% critical levels, we therefore reject the null hypothesis of no co integration and conclude that there exist a long run relationship among the dependent and independent variables

**Table 4.7: Result of Co-integration test**

Null Hypothesis	Alternative hypothesis	Trace statistic	Critical value		Max-eigen statistics	Critical	
			5%	1%		5%	1%
$r = 0$	$r = 1$	-	-	-	407.7504	94.15	103.18
$r \leq 1$	$r = 2$	-	-	-	288.8988	68.52	76.07
$r \leq 2$	$r = 3$	-	-	-	199.5078	47.21	54.46
$r \leq 3$	$r = 4$	-	-	-	136.7486	29.68	35.65
$r \leq 4$	$r = 5$	-	-	-	82.96939	15.41	20.04
$r \leq 5$	$r = 6$	-	-	-	40.61361	3.76	6.65

*Source: Author's Computation*

The result shows that the variables are co-integrating at both 5% and 1% critical values for which it is possible to reject the null hypothesis of no Co-integration. It also confirms that there exist long-run relationship existing between the dependent and independent variables.

### Estimation of an Error- correction Model (ECM)

The results of the co integration confirm the existence of an underlying relationship between the dependent and independent variables. The result motivated the estimation of an over parameterized model using three lags on each variables in equation. Redundant variables were eliminated using the variable redundancy test. The resultant parsimonious error correction model estimated is presented in table 4.8 below. The model is estimated using E-View and will be used to test research hypotheses (FDI for the whole economy, robustness of FDI in primary sector, robustness of FDI in manufacturing sector and robustness of FDI is service sector)

**Table 4.8 Parsimonious Error –Correction Model**

Variables	Coefficient	Std. Error	T-statistic	Prob.
CONSTANT	-0.151737	0.031693	-4.958179	0.0043
D(LOG(GDP(-1)))	1.915980	0.276355	6.933039	0.0010
D(LOG(GDP(-3)))	0.895051	0.169483	5.280854	0.0032
D(LOG(FDI))	0.022649	0.011705	1.934881	0.0791
D(LOG(FDI(-1)))	0.066094	0.017208	3.840991	0.0027
DLLOG(FDI(-2)))	-0.032235	0.014424	-2.234760	0.0757
D(LOG(FDI(-3)))	-0.021834	0.008229	-2.653264	0.0452
D(LOG(CF))	0.071745	0.030074	2.385608	0.0627
D(LOG(CF(-1))	0.052589	0.019455	2.703070	0.0426
D(LOG(EG))	0.261544	0.060086	4.352836	0.0073
D(LOG(EG(-1))	0.086429	0.051399	1.681521	0.1535
D(LOG(EG(-2))	0.139565	0.065765	2.122171	0.0873
D(LOG(EG(-3))	0.553305	0.117718	4.700248	0.0053
D(LOG(HC))	0.184848	0.023113	7.997426	0.0005

D(LOG(HC(-1)))	-0.069660	0.027311	-2.550643	0.0512
D(LOG(HC(-2)))	-0.050872	0.020671	2.461009	0.0572
D(LOG(INF))	-0.023991	0.011416	-2.101511	0.0896
D(LOG(INF(-1)))	0.113080	0.016652	6.790891	0.0011
D(LOG(INF(-2)))	-0.117801	0.022842	-5.157178	0.0036
D(LOG(INF(-3)))	0.071625	0.018336	3.906281	0.0113
ECM (-1)	-1.519296	0.206549	-7.355625	0.0007

*Source: Author's Computation*

$$\text{LOG GDP} = 1.915 + 0.066\log\text{FDI}_{-1} + 0.071\log\text{CF} + 0.026\log\text{EN} + 0.18\log\text{HC}$$

$$(0.01) \quad (0.002) \quad (0.062) \quad (0.007) \quad (0.005)$$

$$+ 0.113\log\text{NF}_{-1} - 1.51\text{ECM}(-1)$$

$$(0.005) \quad (0.001) \quad (0.0000)$$

$$R^2 = 0.971, \text{ Adjusted}$$

$$\text{Adjusted } R^2 = 0.85$$

$$\text{DW} = 2.04$$

## 4.2 Testing Of Research Hypotheses

### (FDI and Economic Growth)

The tests of research hypotheses are based on the probability value. The tests are conducted at  $\alpha = 0.05$  and  $H_0$  is rejected if the P – value  $< \alpha$

1.  $H_0$ : The FDI has no effect on economic growth  
 $H_1$ : The FDI affect economic growth

Since  $0.0027 < 0.005$  we reject  $H_0$  and conclude that FDI significantly affect economic growth.  $R^2$  (goodness of Fit) from Table 4.8 is 0.91285 and the adjusted  $R^2 = 0.856423$  which indicates that the variation in GDP influenced by the independent variable is very high and significant as it suggest that over 80% of growth indicated in the model is explained by the independent variables. The F-statistic of 8.4562 is statistically significant at 5 percent level, indicating that the explanatory variables are jointly significant in influencing Nigeria's economic growth. The Durbin –Watson statistic value of 2.046 is significant showing that serial correlation is minimal.

The Prob. (F-statistic) of  $0.0027 < 0.05$  at 5% level good fit.

The estimated coefficient of the error-correction term, ECM (-1) of -1.519, which is significantly different from zero, has the appropriate negative significant. The estimated coefficient of -1.5 implies that the disequilibrium is corrected at a speed of 15 percent per annum.

The coefficient of FDI lagged on period D (LOG (FDI (-1) is significant different from zero at 5% level and positively signed. The t-statistic (3.840991) is positive and significant at 5% level and the p-value of 0.0027 indicates that the probability of committing type I error in 0.0027 is about 27 in 10,000 times. Hence, we reject the null hypothesis. The result supports FDI led growth hypothesis (*Oseghale and Amonkhienan, 1987, Akinlo, 2004 and Obwona, 2004*).

## TESTING OF RESEARCH HYPOTHESIS 2

H<sub>0</sub>: The FDI in primary sector has no effect on economic growth

H<sub>1</sub>: The FDI in primary sector has effect on economic growth

Since  $0.044 < 0.05$ , we reject H<sub>0</sub> and conclude that FDI in the primary sector significantly affects economic growth. The coefficients of FDIP have a negative and significant effect on growth. FDI in Nigeria largely goes to the extractive industry which apparently lacks linkages as the other sectors that will promote spillovers.

*Alfro et al (2003)* for example, have argued that investment in the extractive industry may have negative effect on the economy because of limited linkage.

FDI in those industries more input and therefore will harm the economy (a variant of the resource curve). Hirschman (1958) emphasized that not all sector have the same potential to absorb foreign technology or to create linkage with the rest of the economy. He has argued that “primary products from mines, oil wells and plantations have ability to slip out of a country without leaving much trace in the rest of economy”. For economic growth, the existence of abundant natural resources is not enough.

## TESTING OF RESEARCH HYPOTHESIS 3

H<sub>0</sub>: The FDI in manufacturing sector has no effect on economic growth.

H<sub>1</sub>: The FDI in manufacturing sector has effect on economic growth.

Since  $0.0034 < 0.05$  we reject the H<sub>0</sub> hypothesis and conclude that the portion of FDI channeled to the manufacturing is significant to economic growth. The coefficients of FDIM are negative in the current period and statistically significant at 5% level. This result seem to corroborate the notion that FDI plays a positive role in generating economic growth (*Alfro et al., 2003*). The manufacturing sector has abroad variation of linkage intensive activities. In fact, most of the theoretical work on the benefits associated with FDI tends to be related to

the manufacturing industry sector. Even when allocation to the manufacturing sector only picked up in 2003, yet the effect on economic growth still remains positive.

#### **TESTING OF RESEARCH HYPOTHESIS 4**

$H_0$ : The FDI in service sector has no effect on economic growth

$H_1$ : The FDI in service sector has effect on economic growth

Since  $0.017 < 0.05$ , we reject the  $H_0$  and conclude that FDI in the service sector significantly affects economic growth. In the current period the coefficient of FDIS is negative (-0.106741) and significant (t-statistic -2.762953, P-value 0.01732). The service sector in Nigerian has attracted considerable inflows since 1999 due to the deregulation of the telecommunication sector by granting licenses for global system for mobile communication (GSM). However, statistic have shown that the economy is yet to maximally appropriate the gains of the industry.

#### **TESTING OF RESEARCH HYPOTHESIS 5**

$H_0$ : infrastructure has no effect on economic growth

$H_1$ : Infrastructure has effect on economic growth

Since  $0.0073 < 0.05$  we reject the  $H_0$  hypothesis' and conclude that infrastructure is very significant to economic growth. Again this analysis is based from table 4.8. The coefficients of  $D(\text{LO}(\text{EG}))$  from the current to log 3 (0.261544, 0.088429, 0.139265 and 0.553305) are significant and different from zero and positively signed. The t- statistic in the current period (4.362828) is positive and significant at 5 per cent level with the p – value of 0.0073. The probability of committing type I errors is 0.7 in 100 times. We reject the null hypothesis. Therefore (EG) energy is positively related to the economy as a major determinant of economic growth. Through the energy supply in Nigeria is relatively poor; this result suggests that an improvement on infrastructure will lead to industrial growth.

## **TESTING OF RESEARCH HYPOTHESIS 6**

H<sub>0</sub>: Human capital has no effect in economic growth

H<sub>1</sub>: Human capital has effect in economic growth

Since  $0.005 < 0.05$ , we reject the null hypothesis and conclude that human capital significantly affects economic growth. The coefficient of human capital in the current period  $D(\text{LOG}(\text{HC}))$  is significantly different from zero at 5% level, and positively signed. The t-statistics (7.99745) is positive and significant at 5% and the p-value of 0.0005 indicates that the probability of committing type I errors is 0.005 is about 5 in 10, 000 time. Based on the high significance of the t-statistic and the p-value, we reject the null hypothesis.

Therefore HC is a major determinant of economic growth which supports the advocates of human capital hypothesis (*Borensztein et al, 1988, Akinlo, 2004, Obinna and Xu, 2000*).

### **4.3 Research Question 1: What type of relationship exists between FDI and economic growth in Nigeria?**

From our findings in the study, the relationship between FDI and economic growth is positive on the long-run but negative on the very long-run. The results have shown that the economy lacks the capacity to manage foreign investment after a particularly period. Perhaps in the very long run foreign investors repatriate more of their profit to the parent country thereby starving the investment position in Nigeria.

## **RESEARCH QUESTIONS 2:**

### **Does the entire sector contribute evenly to our economic growth?**

Understanding the sector that contributes what to the economics growth of a country is essential. It makes policy decision easier for the economy. FDI was divided into three components – FDI in manufacturing (FDIM), FDI in primary sector (FDIP) and FDI in service (FDIS). In spite of the enormous investment that go into the primary sector, our finding shows that FDI in the primary sector is positive but highly insignificant to economic growth. It is not surprising because the primary sector is progressively positive. The service sector is negatively correlated to growth in our finding.

### **Research question 3: To what extent has the availability or lack of infrastructure (Energy) and Human capital affected growth?**

Energy supply is positive and very significant as well as human whose t-statistic is the highest. What is interesting in the finding is that these two variables are seriously lacking. One can also deduce that the availability of infrastructure and human capital is more important to our growth than FDI. In other words, the same zeal extended in attracting foreign investors, multinational corporations and their FDI, should be deployed in developing the human capital and infrastructure.

## CHAPTER FIVE

### SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

This chapter is divided into four parts. The first part deals with the summary of findings of the study. The second part deals with the conclusion from the study. The third part deals with recommendations proffered by the researcher.

#### 5.1 Summary of Findings

From the analysis of the data and the result obtained, the following findings were made.

1. That FDI flows into the different sectors of the economy (namely, primary, manufacturing, and services) exert different effects on economic growth. FDI inflows in the manufacturing sector are negative in the current period. FDI inflows in the service sector are negative and significant.
2. FDI induced gains can be sustained if government monitors closely the activities of the multinational co operations that have the FDIL to ensure that their investment generates backward linkages.
3. Infrastructure (Energy) development is necessary and important in improving the investment drive of the country.
4. Investment and trade are two complementary elements in the strategy to accelerate Nigeria's development, boost the rate of economic growth and sustain progress towards eventual eradication of poverty.
5. The continued availability of adequate volumes of concessional assistance needs to be ensured, because of the critical role aid plays in financing educations, health, rural development, essential infrastructure and other priority programmes. If well channeled, aid can be effectively used to catalyze increased private capital flows, including foreign direct investment.
6. Preferential market access can serve as powerful incentive for multinational corporations and other potential investors to locate their plant facilities to Nigeria.

7. Investments in needed infrastructure and equipment, as well as major improvements in the maintenance and up-keep of existing ones are the obvious ways of reducing transport, communication and related costs.

## **5.2 Conclusion.**

Based on the findings the researcher concludes that:

1. It is important to stress that investment and trade are two complimentary elements in the strategy to accelerate Nigeria development, boost the rate of economic growth and sustain progress towards eventual eradication of poverty.
2. It is vital, that Nigeria upgrade their infrastructure by accelerating privatization programs and adopting other innovative ways of involving the private sector in the financing and management of essential infrastructure.
3. The Nigerian Investment Promotion Commission (NIPC) has been in the fire front on investment promotion in Nigeria, there is need for full strengthening of the institutions to prepare it for the enormous challenges of the emerging global market.
4. FDI induced gains can be sustained if government monitor closely the activities of the multinational corporations that have the FDI to ensure that their investment generates backward linkages.
5. In the current period the coefficient of FDIP (FDI in primary sector) is positive and significant. Evidence of the impact of FDI in the service sector is negative while investment of FDI in manufacturing is negative and significant.

## **5.3 Recommendations**

Based on the findings and conclusion of the study the following policy recommendations can be evolved, as follows:

1. In a liberalizing and integrating world economy, Nigeria will need to exert greater efforts at facilitating and sustaining investment in order to reap the benefits from emerging world economic system.
2. FDI in the manufacturing sector is growth enhancing and more emphasis should be placed on it. The manufacturing sector has a broad variation of linkage intensive activities that enhance backward linkages and generate employment.
3. Nigeria must take policy measures that would substantially enlarge and diversify their economic base policies that would improve local skills and build up stock human capital resources capabilities, to meet the challenges of the millennium development goals (MDG).
4. Poor power supply is indeed one of the most impediments to economic growth in Nigeria. Perhaps the relationship between the manufacturing sector and GDP would have been robust if the energy sector is improved. Government must take serious its desire to improve energy supply.
5. A requirement of an improved investment environment is to more decisively to eliminate corruption, bureaucratic red tape, an inefficiency that frustrate and discourage investors.
6. The upgrading of the effectiveness, competence and integrity of the civil service is equally important, particularly as it affects the implementation of regulations relating to investment permits, trade and foreign exchange transactions and other private sector operations.
7. A more liberalized economic environment will promote export diversification and help minimizing shocks arising from adverse terms of trade and generate more investment.
8. It is important for Nigeria to integrate with the rest of the world and maximize the benefits of strategic integration.
9. The bilateral and multilateral development partners can facilitate the revitalization and growth of investment by increasing their supportive and accompanying actions.
10. Government should use the banking system in particular and the private sector in general as the main avenue of revitalizing, strengthening, expanding and diversifying Nigerian financial services.

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## APPENDIX I

**TABLE 1: SECONDARY DATA 1970 – 2010**

Year	Net export	Cap form	Energy gen	Manu cap util	FDI cap util	FDI inflow	FDI outflow	FDI Net flow
1970	885.00	10841.2	176.60	91.40	N/a	251.00	129.40	121.60
1971	1,293.40	12215.0	215.40	114.90	N/a	489.60	170.00	319.60
1972	1,434.20	10922.0	255.40	138.20	N/a	432.80	184.50	248.30
1973	2,278.40	81350.0	299.70	146.10	N/a	577.80	385.20	192.60
1974	5,794.80	5417.0	281.10	163.20	n/a	507.10	458.80	48.30
1975	5,121.00	5573.0	395.40	200.40	76.60	757.40	282.00	475.40
1976	6,984.40	7323.0	468.70	214.60	77.40	521.10	474.80	46.30
1977	7,742.80	10661.1	538.00	253.00	78.70	717.30	519.70	197.60
1978	5,956.00	12383.7	522.70	157.70	72.90	664.70	332.90	331.80
1979	10,509.60	18414.1	710.70	160.30	71.50	704.00	414.10	289.90
1980	13,835.50	30626.8	815.10	199.70	70.10	786.40	319.40	467.00
1981	10,981.80	35423.9	887.70	121.00	73.30	584.90	447.10	137.80
1982	8,250.60	58640.3	973.90	262.00	63.60	2,193.40	568.50	1,624.90
1983	7,698.30	80948.1	994.60	254.40	49.70	1,673.60	1,116.90	556.70
1984	9,392.70	85021.9	1,025.50	217.20	43.00	1,385.30	850.50	534.80
1985	13,375.70	114476.3	1,166.80	259.80	38.30	1,423.50	1,093.80	329.70
1986	11,126.00	172105.7	1,228.90	280.50	38.80	4,024.00	1,524.40	2,499.60
1987	31,375.70	205553.8	1,286.00	294.10	40.40	5,110.80	4,430.80	680.00
1988	58,276.40	192984.4	1,330.40	291.10	42.40	6,236.70	4,891.10	1,345.60
1989	111,303.80	15735.8	1,462.70	257.90	43.80	4,692.70	5,132.10	-439.40
1990	121,085.90	268894.5	1,536.90	230.10	40.30	10,450.20	10,914.50	-464.30
1991	206,375.20	371897.9	1,617.20	254.70	42.00	5,610.20	3,802.20	1,808.00
1992	219,127.80	438114.9	1,693.40	245.30	38.10	11,730.70	3,461.50	8,269.20
1993	223,806.30	429301.0	1,655.80	237.40	37.20	42,624.90	9,630.50	32,994.40

1994	950,892.80	456970.0	1,772.90	233.40	30.40	7,825.50	3,918.30	3,907.20
1995	1,315,379.20	457980.0	1,810.10	218.70	32.46	55,999.30	7,322.30	48,677.00
1996	1,246,569.60	396923.5	1,839.80	238.80	30.40	10,004.00	4,273.00	2,731.00
1997	737,279.40	415642.1	1,839.80	238.80	29.29	5,672.90	2,941.90	2,731.00
1998	1,194,299.80	434360.8	1,839.80	238.80	32.40	32,434.50	8,355.60	24,078.90
1999	1,948,909.00	453079.4	1,859.80	191.80	34.60	4,035.50	2,256.40	1,779.10
2000	1,934,991.40	471798.0	1,738.30	223.80	36.10	16,453.60	13,106.60	3,347.00
2001	1,68,653.30	490516.6	1,669.90	241.90	42.70	4,937.00	1,560.00	3,377.00
2002	3,095,402.80	509235.3	2,237.30	146.20	44.30	8,988.50	781.70	8,206.80
2003	4,506,349.90	527953.9	6,180.00	196.00	46.13	13,531.20	475.10	13,056.10
2004	6,217,937.10	546672.5	2,763.60	398.00	45.00	20,064.40	155.70	19,908.70
2005	6,310,247.50	565391.1	2,779.30	182.30	52.76	26,083.70	202.40	25,881.30
2006	7,324,680.06	1546525.7	3042.41	185.62	53.30	27,042.32	208.51	41,470.8
2007	8,309,758.3	1,915,348.8	4073.62	192.65	53.38	27,051.45	272.63	54,041.9
2008	9,907,611.5	2,030,510.0	5,721.65	201.76	53.84	28,012.43	281.64	49,456.2
2009	8,832,413.8	2,442,703.5	6,251.11	216.75	N/a	29,052.43	286.24	41,429.4
2010	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

*Source: Central Bank of Nigeria Statistical Bulletin, 2009 Edition.*

*(N/A-Data unavailability)*

**CONT'D SECONDARY DATA 1970 -2010**

YEAR	PRIMARY	MAN	SERVICE	AGRIC	DOINVEST	FDP/GDP	FAM/GDP	FDS/GDP
1970	515.40	224.80	206.60	11.20	104.60	0.0095182	0.0041515	0.0038154
1971	694.00	378.80	187.20	15.40	132.30	0.010562	0.005765	0.002849
1972	859.70	356.60	242.70	9.40	191.60	0.0124036	0.005145	0.0035016
1973	925.30	409.00	294.70	7.90	241.00	0.0125442	0.0055448	0.0039952
1974	818.10	520.40	321.30	20.70	3,112.50	0.0099254	0.0063136	0.0038981
1975	959.60	506.20	572.40	19.20	3,380.10	0.0119967	0.0063284	0.007156
1976	918.90	550.70	624.80	21.90	3,057.60	0.0103416	0.0061978	0.0070317
1977	1,090.80	703.80	365.50	75.00	2,521.00	0.0113509	0.0073237	0.0058694
1978	421.30	1,263.40	522.50	117.60	1,249.10	0.0047326	0.0141922	0.0058694
1979	466.80	1,402.50	550.50	120.80	3,043.20	0.0051189	0.0153799	0.0060368
1980	677.40	1,503.90	693.20	120.50	5,445.60	0.0070426	0.0156352	0.0072068
1981	526.00	1,705.70	767.20	120.50	2,424.80	0.007472	0.0242301	0.0108984
1982	974.00	1,922.50	1,483.60	120.50	1,026.50	0.0138661	0.0273692	0.0211209
1983	511.20	2,128.10	2,274.90	127.80	781.70	0.0077504	0.0322645	0.0344901
1984	702.80	2,109.30	2,622.60	128.50	1,143.80	0.0112494	0.0337627	0.0419773
1985	744.00	2,278.10	2,697.90	126.00	1,641.10	0.0108953	0.0333611	0.0395087
1986	2,510.40	2,810.20	2,753.00	128.20	3,587.40	0.0354544	0.0396885	0.0388807
1987	2,260.20	3,122.30	3,396.50	117.30	4,643.30	0.0317467	0.0438557	0.0477071
1988	3,403.00	3,637.00	3,133.70	128.90	3,272.70	0.043779	0.0467882	0.0403135
1989	636.70	5,406.40	3,497.20	134.80	13,457.10	0.0076546	0.0649972	0.0420443
1990	1,091.60	6,339.00	1,710.40	33.70	34,953.10	0.0118345	0.068724	0.0185432
1991	810.00	8,692.40	1,452.20	382.80	44,249.60	0.0085952	0.0922383	0.00154098
1992	6,417.20	9,746.30	1,482.50	386.40	13,992.50	0.0661431	0.1004567	0.0152804
1993	27,686.90	12,885.10	1,864.50	1,214.90	67,245.60	0.2779692	0.129362	0.0187191
1994	26,680.00	14,059.90	2,247.60	1,208.50	30,455.90	0.2643241	0.1392942	0.0222674
1995	56,747.30	27,668.80	2,990.70	1,209.00	40,333.20	0.5505246	0.2684243	0.0290138
1996	56,792.30	29,814.30	3,668.70	1,209.00	174,309.90	0.5327578	0.2796823	0.0344154
1997	56,221.40	31,297.20	3,625.70	1,209.00	262,198.50	0.5112314	0.2845911	0.0329692

1998	59,855.40	34,503.90	10,460.50	1,209.00	226,702.40	0.5273185	0.303975	0.0921557
1999	58,855.40	36,282.10	10,927.30	1,209.00	546,873.10	0.5045231	0.3110192	0.0936715
2000	60,710.90	37,333.60	11,201.30	1,209.00	1,090,148.00	0.5008828	0.3080132	0.092414
2001	61,611.90	37,779.60	12,016.30	1,209.00	1,181,652.00	0.4877299	0.2990695	0.095123
2002	61,611.90	39,953.60	12,317.30	1,209.00	1,013,514.00	0.4685679	0.3038532	0.0936749
2003	61,809.10	45,719.40	14,457.30	1,209.00	1,065,093.00	0.4529135	0.3350143	0.1059376
2004	62,145.70	102,995.80	20,242.40	1,209.00	600,790.41	0.4272658	0.7081196	0.1391711
2005	80,789.40	133,894.50	26,315.10	1,209.00	625,295.78	0.5228707	0.866568	0.1703119
2006	81,562.43	135,621.70	27,312.61	1,216.16	638,421.15	0.6728124	0.7256731	0.2602412
2007	86,248.71	142,232.61	28,428.71	1,226.42	652,481.01	0.6853261	0.827821	0.3624330
2008	89,163.78	156,421.75	29,524.61	1,728.62	721,528.10	0.723421	0.863920	0.4263311
2009	101,243.76	182,400.10	31,286.42	2,862.34	863,421.11	0.428326	0.925601	0.5263288
2010	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

*Source: Central Bank of Nigeria Statistical Bulletin, 2009 Edition.*

*N/A-Data unavailability*

APPENDIX 2

**OLS Results**

Dependent Variable : GDP				
Method: Least Squares				
Date : 06/04/2012 Time: 17:41				
Sample: 1970 – 2010				
Included Observations: 40				
<b>Variables</b>	<b>Coefficient</b>	<b>Std. Error</b>	<b>t-statistics</b>	<b>Prob.</b>
C	72674.24	4083.438	17.79731	0.0000
FDI	0.125511	0.2534.31	0.495246	0.6240
CF	0.045107	0.018745	2.406401	0.0225
EG	3.036983	2.799441	1.084853	0.2866
HC	1.516698	0.411793	3.683160	0.0009
INF	-61.69468	154.5137	-0.399283	0.6925
R-squared	0.822513	Mean dependent Var		93785.31
Adjusted R-squared	0.792932	S.D. dependent Var		24837.96
S.E. of regression`	11302.44	Akaike info criteria		21.65444
Sum squared resid	3.83E+09	Schwarz Criterion		21.91836
Log Likelihoo	-383.7799	F-statistic		27.80534
Durbin-Watson Stat	0.713451	Prob(F-statistic)		0.000000