

Impact of Economic Reforms on Foreign Direct Investment (FDI) in Nigeria (1980-2012)

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Abstract

The central idea of this paper is to examine the effects of economic reforms on FDI by modeling the relationship between FDI and some economic indicators. The trend of FDI between 1980 and 2012 was examined and comparative analysis of the FDI before and after the reforms was undertaken. Multiple linear regression was employed for modeling the relationship and the test of significance revealed that interest rate, X_1 and consumer price index, X_2 were significant in their contributions to FDI. It was further observed that the trend of FDI over the period was nonlinear, with upward and downward shocks at certain period. The result of the t-test comparing the pre- and post- reform FDI showed that there was no significant difference between them. It was concluded that if policy measures were intensified around the two variables having significant contributions, there will be appreciable increase in FDI.

JEL classification numbers: E2

Keywords: Foreign Direct Investment, Economic indicators, Economic reforms.

1 Introduction

Nigerian authorities have been trying to attract FDI via various reforms. The reforms included the deregulation of the economy, the new industrial policy of 1989, the establishment of the Nigeria Investment Promotion Commission (NIPC) in early 1990s, and the signing of Bilateral Investment Treaties (BITs) in the late 1990s. Others were the establishment of the Economic and Financial Crimes Commission (EFCC) and the Independent Corrupt Practices Commission (ICPC). With the advent of democratic government in May 1999, the Nigerian government enthusiastically announced its desire

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to attract and embrace Foreign Direct Investments (FDI) into the country. This renewed interest emanated from the perceived opportunities derivable from utilizing this form of foreign capital injection into the economy (Adeseyoju 2001).

In the first instance, FDI is believed to be more stable and easier to service than commercial bank credit or portfolio investments. FDI is usually a long-term economic activity in which repatriation of profits only occur when the project generates enough returns. Secondly, Nigeria is expected to access modern technologies through FDI to upgrade the country's productive capacities through adaptation of such technologies to her local conditions. Thirdly, on account of its integrated network of activities across the globe, FDI is potent enough to integrate Nigeria into the global market (both for existing economic activities as well as new ones that are likely to emerge). Such penetration into international market engenders substantial capacity building and economies of scale, among others (Hood & Young 1979; Aremu, 2000).

Foreign Direct Investment (FDI) is an investment which gives foreign owners control over the behaviour of firms in which the investment is made. One of the key motives for FDI is to globalize production and competition. A second reason is to move some production to more profitable locations. Foreign direct investment provides developing countries (including Nigeria) with the much needed capital for investment, it also enhances job creation, managerial skills as well as transfer of technology, and these contribute to economic growth and development.

According to Montiel and Reinhart (2002), one important component of international capital flows is the Foreign Direct Investment (FDI) which refers to movement of financial and human capital from abroad for investment in another country. This type of capital can be owned by an individual, a corporate body or a government. Basically, the common denominator of FDI is that a foreign firm or individual must have controlling equity shares of such firm. Perceived from either the meaning or rationale for FDI as seen from the foregoing, there is little or no doubt that FDI directly augment the real resources available for production in the host country. Indeed, the opinions in literature is that FDI is "a good cholesterol" necessary for closing the existing investment – savings gap in developing economies.

The presence of market failures fortifies the Nigeria government intervention in internationalization of production, such intervention may equally be necessary to boost the economic effectiveness of FDI in most host economies. Based on this, attraction of FDI into Nigeria is usually premised on the implicit assumption that greater inflow of FDI will accelerate the level growth and development (measured by GDP) and mobilization of domestic capital as well as improvement in the balance of payments. Besides, FDI stimulates product diversification through investments into new businesses. It is in view of the foregoing reasoning that it becomes reasonable to say that Nigeria government is desirous of achieving rapid and sustainable economic growth by formulating and implementing appropriate policies and economic reforms that tend to facilitate the enthronement of investment-friendly environments. Oaikhenan and Ughulu (2006) persuasively argued that investors generally perceived an economic environment as investment friendly when there exists tax incentives, export promotion, correct macroeconomic policies and a polity in which the safety of lives and property is reasonably guaranteed (Iyoha, 2001 and 2009)

a. Objective of The Study

The central objective of this study is to examine the effect of economic reforms on FDI in

Nigeria. However, the following are the specific objectives of the study.

- (i) to examine the relationship between FDI and other economic variables.
- (ii) to examine the trend inflow of FDI between 1980-2012
- (iii) to compare FDI at PRE and POST reform periods.

b. Research Hypothesis

- (i) Ho: There is no significant relationship between FDI and the economic indicators.
- (ii) Ho: there is no significant difference in the inflow of FDI at Pre reforms and Post reforms periods.

2 Theoretical Frame Work

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. He further reveals the negative effects of macroeconomic policies on FDI inflow before the structural adjustment programme (SAP) in Nigeria which led to the proliferation and growth of parallel markets and sustained capital flight in the country. *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. *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 pro-import and negatively related to gross domestic investment. *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. *Aremu (1997)* categorizes the various types of foreign investment in Nigeria into five: wholly foreign owned; joint ventures; special contract arrangements; technology management and marketing arrangements; and subcontract co-production and specialization. *Anyanwu (1998)* identifies change in domestic investment, change in domestic output or market size, indigenization policy, and change in openness of the economy as major determinants of FDI. He further notes that the abrogation of the indigenization policy in 1995 encourages FDI inflow into Nigeria.

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 *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. With respect to FDI determinants in Nigeria, Ekpo (1995) reports that political regime, real income per capita, rate of inflation, world interest rate, credit rating and debt service are the key explanatory factors.

Oke (2001) shows that host country market size, openness of the economy to foreign trade, and political stability, positively affect FDI inflow to Nigeria while exchange rate, attractiveness of host country's domestic policies, domestic inflation rate, and physical infrastructure negatively influence realized FDI in the country between 1970 and 2000. *Ogunkola 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.

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 capital 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.

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'. *Asiedu (2002)* is of the opinion that the determinants of FDI in one region may not be the same for other regions. In the same vein, the determinants of FDI in countries within a region may be different from one another and from one period to another. *Ekpo and Egwaikhide (1998)* observed that public investment directly influences private investment. As such the public (government) should invest in infrastructures which give an enabling environment for private investors, consequently it will help in attracting foreign direct investment to Nigeria.

a. Economic Reforms in Nigeria

The advent of democratic government in May 1999 in Nigeria has created the opportunity for economic reforms 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 stocks 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 reenergized, 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.

3 Research Methods

a. Methods of Data Collection

The data for the study is a secondary data transcribed from CBN Statistical Bulletin. The variables considered are FDI(dependent variable) and a set of Independent variables(namely GDP,EXCHRATE,DOMDEBT,IMPORT,EXPORT,INFRATE,CPI . Data transcribed on the variables covers 1980-2012.

b. Method of Data Analysis

The data was analysed using multiple regression analysis, ANOVA and independent t-test.

Hypothesis ONE:

H₀: There is no significant relationship between FDI and the economic indicators.

ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	55.446	7	7.921	3.835	.007 ^a
	Residual	47.501	23	2.065		
	Total	102.947	30			

Predictors: (Constant), CONSUMER PRICE INDEX, INFLATION RATE, DOMESTIC DEBT, IMPORT, EXCHANGE RATE, EXPORT, GROSS DOMESTIC PRODUCT

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.576	2.499		.631	.534
	GROSS DOMESTIC PRODUCT	-3.221E-6	.000	-.335	-.267	.792
	EXCHANGE RATE	-.034	.025	-1.115	-1.375	.182
	DOMESTIC DEBT	1.265E-7	.000	.097	.277	.785
	IMPORT	-1.047E-6	.000	-1.396	-2.054	.052
	EXPORT	-1.444E-7	.000	-.313	-.319	.752
	INFLATION RATE	.040	.017	.390	2.375	.026
	CONSUMER PRICE INDEX	.173	.066	3.305	2.624	.015

a. Dependent Variable: FOREIGN DIRECT INVESTMENT

b. Dependent Variable: FOREIGN DIRECT INVESTMENT

Interpretation**Hypothesis TWO:**

H₀: There is non- linear growth in the trend of FDI inflow over the period.

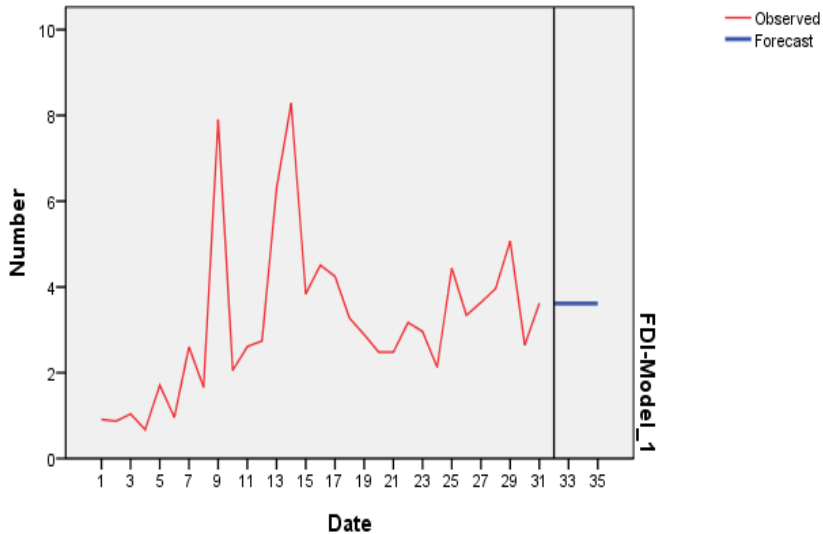
3.1.1 Trend of FDI inflows in Nigeria

Year	1980	1981	1982	1983	1990	1995	1996	1999	2001	2003	2004	2006
FDI	786.4	2,193.4	1,423.5	6,236.7	10,450	55,999.3	5,672.9	4,035.5	4,937	13,531	20,064	41,734.

Source: CBN Statistical Bulletin

It can be seen from table I that Nigeria has travelled from a Foreign Investment level #786.40m in 1980 to 10,450.0m in the year 1990 registering a growth rate of multiply

increase inflows. On the contrary, the share and increase of inflows since 1990s have been astounding of the FDI inflows into the African economics in Nigeria's share stood at 46.5% in the year 2009 with an investment of #41,734.0m as against its share of FDI inflows in 1990 was just 1.61%. The impressive surge in FDI flows in to Nigeria during the post reform period has given a unique position in the map of MNC'S strategic investment locations. Moreover, Nigeria has also been ranked second recipient in African FDI investment in 2010 and likely continues to remain among the top five attractive destinations for international investor during 2010-12 (UNCTAD)



Trend of FDI inflows in Nigeria

Hypothesis THREE:

Ho: there is no significant difference in the inflow Of FDI at Pre reforms and Post reforms periods.

	Levene's Test for Equality of Variances		t-test for Equality of Means						
	F	Sig.	T	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference	
								Lower	Upper
Equal variances assumed	6.166	.019	-.316	29	.754	-.21939	.69354	-1.63784	1.19907
Equal variances not assumed			-.377	25.050	.709	-.21939	.58207	-1.41806	.97929

4 Interpretation

Table 3 shows the student t - test for comparing FDI at Pre and Post reforms periods .From the result P value(0.754) is less than 0.05 level of significance which revealed that there exists no significant difference in the FDI values at the two periods.

Discussion of result

The regression equation for relationship between FDI and the indicators is- $Y = 1.576 - 3.221E-6X_1 + 0.034X_2 + 1.265E-7X_3 - 1.047E-6X_4 - 1.444E-7X_5 + 0.040X_6 + 0.73X_7$. The test of significance revealed that Interest Rate(X_6) and Consumer Price Index (X_7) are statistically significant in terms of their contribution to FDI. Furthermore, it was observed that the trend of FDI over the period (1980-2012) was non- linear with upward and downward shocks at certain period. The independent t-test performed to compare FDI at Pre and Post reforms period revealed that there was no significant difference between Pre-reforms and Post-reforms FDI.

5 Conclusions and Recommendations

5.1 Conclusion

The above results have important policy implications, since the Interest Rate and Consumer Price Index are statistically significant because the values (0.26 and 0.15) are less than the level of significance ($\alpha=0.05$) it implies that both are having significant effect on FDI, the Government must continue to increase the level of Gross Domestic Product and reduce the cost of capital which has direct influence over the Interest Rate. The domestic investors and foreign investors will be encourage and attracted when it is certain that the host country are consistent in their reform programmes that involves measures easier set-up and creation of enabling environment.

Government should strengthened the political institutions and embrace a democratic principles that will ensure stability in the reforms processes.

5.2 Recommendations

This study thus recommend that to sustain increase FDI, the economic reforms in the country should be tailored towards the acceleration of economic growth, strengthening domestic institutions, increasing the quality of social sector spending, maintaining infrastructure investment and embark on technology-driven economy which are expected to impact positively on some other economic indicators which will in turn contribute to the growth of FDI. Having formulated policies that are expected to have positive impact on the nation economy, the implementation should be observed keenly, assess from time- to -time and constant review of the policy is equally necessary.

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