FDI-Growth Nexus in Nigeria: A Co-Integration and Error Correction Tests

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Abstract: This study sets out to examine the impact of Foreign Direct Investment (FDI) on growth index in Nigeria. Data for the study were collected from secondary sources covering the research period (1981-2013). Data collected were analysed using multiple regression, co-integration and error correction techniques. The results revealed that foreign direct investment (FDI) positively related to growth index and statistically significant in the long-run though statistically insignificant in the short run. This means that economic growth in Nigeria adjusts slowly to the long-run equilibrium changes. The study therefore recommends that government should create an enabling environment through provision of infrastructure to reduce the cost of doing business in Nigeria, greater trade openness as well as reduction in the level of corruption and insecurity, to boost the level of foreign direct investment in Nigeria.

Keywords: Direct, foreign, growth, index, investment, nexus

I. INTRODUCTION

Foreign direct investment (FDI) has remained a major concern of developing economies. The enormous increase in foreign direct investment flows across countries is one of the clearest signs of globalization of the world economy. The issues in attracting foreign direct investment are complex. Actions are required at many levels. Such actions need to be well calibrated in term of policy instruments and well-articulated in strategic terms in order to turn the potential benefits of foreign direct investment inflows into tangible development outcomes in the host economy.

The need for foreign direct investment is particularly compelling in developing economies. Such economies generally require extensive enterprise restructuring and modernization because the extensive domestic resources base creates an environment for maximizing the potential benefits of foreign direct investment (Morriset 2000). Nigeria is well placed to benefit from foreign direct investment because it is relatively developed and possesses a highly educated labour force in line with the arguments of Borensztein et al (1998).

Nigeria being a mono-economy, highly dependent on oil resources and being vulnerable to external shocks, the importance of non-debt creating capital flows including foreign direct investment inflows for economic sustainability cannot be over-looked. It is argued that countries can only benefit from foreign direct investment inflows, if they formulate and implement sound economic policies.

Studies have shown poverty situation in Nigeria stemming from lack of capital, high level of unemployment, poor resources management, macroeconomic distortions leading to low investment, low income, poor infrastructure and as such there is the difficulty to escape from the vicious cycle of poverty (NBS 2010, Ozoh, 2010; Uma et al 2013, Nwakaet al 2015,)

Besides, there is evidence in literature that foreign direct investment leads to faster growth. The intuition is that openness enhances specialization, raising the level of income, which stimulates growth. In addition, there is increasing evidence that foreign direct investment fosters productivity growth within industries, forcing bad firms to exit and allowing good firms to expand. However, foreign direct investment can only induce growth when friendly business climate exists and when sound policies are formulated, implemented and directed towards correcting unsustainable macro-economic imbalances affecting foreign capital flows.

Foreign direct investment comprises not only merger and acquisition and new investments but also reinvested earnings and loans and similar capital transfers. One of the most noticeable features of today's globalization drive is conscious encouragement of cross-border investments, especially by transnational corporations. Many developing countries now see foreign direct investment as an important element in their strategy for driving economic growth. This appears most crucial following the inadequacy of resources to finance long-term investments as well as increasing poverty and unemployment levels,

Following the arguments of (Ngowi 2001), foreign direct investment is an engine of economic growth and development in Africa, since it creates employment, assists in technology transfer, provides superior skills, facilitates local firms' access to international markets and increases product diversity. One of the specific objectives

of launching new partnership for Africa's development (NEPAD) was to increase capital through a combination of reforms, resource mobilization and a conductive environment for foreign direct investment (Alfaco 2003).

Increasing the inflow of foreign direct investment has thus been the focus of policy in recent times and this has led to a considerable inflow of foreign direct investment over the last three decades in Nigeria. In the 1980s, this amount increased on a yearly basis from an aggregate of ₦735.8million in 1986, ₦75,940.6 million in 1995 to ₦1.27 billion in 2008, by 2011 Nigeria witnessed a remarkable inflow of foreign direct investment of ₦1.36 billion which however fell to ₦875.1 million in 2003 (CBN 2013).

However, inspiteof this tremendous inflow of resources from abroad, the trend of economic activities has been sluggish and worrisome. Available information from National Bureau of Statistics shows that the rate of unemployment in the country has been on the increase from 5.3 per cent in 2006 to a high rate of 23.9 per cent in December 2012. On the other hand poverty has been increasing with up to 84.5 per cent population caught in the web. According to World Bank Development Indicator (2014) the country is presently placed within the 47 poorest countries in the world.

In view of the positive conception of FDI, the problem of 'growthlessness' in Nigeria, poor living standard, and advocate of trade openness views, this research becomes necessary to ascertain the extent to which FDI has played in Nigerian economy over the years. The objective of this research therefore is to ascertain the role of foreign direct investment (FDI) in stimulating economic growth in Nigeria as well as determine other factors that drive growth other than foreign direct investment. In this regard, the paper is streamlined thus: section two is the theoretical issue and the review of empirical literature, section three is the methodology and sources of data, data analysis and results presentation is the section four while the last section is summary of findings, recommendations and conclusion.

II. THEORETICAL ISSUE AND REVIEW OF EMPIRICAL LITERATURE

Undoubtedly, Less Developed Countries such as Nigeria needs capital for investment so as to increase productive capacity. Capital is needed for investment and investment creates new capital. But capital is deficient in developing economy due to low saving brought about by low income which is reflected by low productivity which in turns lead to low output, low income and low saving (Nurkse,1953). In view of low capacity to generate domestic savings, Nigeria's aspiration to grow depends greatly on increased inflow of foreign private finance. It is well-recognized that oil-related FDI has limited spillover benefits for the domestic business sector. Non-oil private investment in Nigeria is very small – less than one percent of gross domestic product (King and Meyer, 2002).

In order to break from existing state of inability to grow due to vicious circle of poverty, there must be development. Obviously, development is a continuous change that displaces the previously existing equilibrium state. It consists in carrying out new combinations for which possibilities exist in the stationary state and which came about in the form of innovations. And the role of innovation consists of: introduction of a new product; introduction of a new method of production; opening of a new market; conquest of a new source of supply of raw material or semi-manufactured goods. Schumpeter assigns the role of innovator not to the capitalist but to the entrepreneur in the economic development. He is the only one who introduces something entirely new. He does not provide funds but direct their uses. This is because of the entrepreneur's role of being motivated by the desire to fund a private commercial kingdom; the will to conquer and prove his superiority and has experienced the joy of creating things and getting them done. Foreign private investment usually involve experienced entrepreneur (Uma 2007; Schumpeter,1934).

Unequivocally, beside other factors, capital is the major basis for positive economic change. This is because of the role capital plays in acquiring necessary productive factors and capital overheads. Schumpeter (1934) is one of the earliest protagonists of the perception that finance is essential for economic progress. He has the conviction that the system for channeling capital has a considerable and momentous influence on economic growth.

Empirical literature on the relationship between foreign direct investment (FDI) and economic growth is characterized with mixed results. While some researchers find that foreign direct investment has a positive and significant impact on growth, others find a negative and insignificant impact on growth. For instance, Lumbila (2005) used a panel analysis to study the impact of foreign direct investment on economic growth in 47 African countries between 1980 and 2000. The findings revealed that foreign direct investment exerts a significant positive effect on economic growth. Similarly, Andeas (2006) employed both cross sectional and panel data on data set of 90 countries during the period of 1980-2002 and found that foreign direct investment inflow enhances economic growth in developing economies.

In a recent study on FDI, trade and economic growth in Bangladesh using time series data and vector error correction model, Hussain and Haque (2016) found a long-run relationship between FDI, trade and growth. He concluded that FDI is a very important growth variable in Bangladesh. In a related study Tang(2015) examines the

foreign capital flow effects on the European Union economic growth between 1987 to 2012. The study revealed amongst others that FDI has promoted growth in the European Union and encourage the sustainability of such investment in the region.

Bengoes and Sanchez-Robels (2003), opined that foreign direct investment is positively correlated with economic growth, and maintained that most countries require minimum human capital, economic stability and liberalized markets to benefit from long-term foreign direct investment inflows.

Banko and Lee (2012), a mixed fixed and random panel data estimation method to allow for cross country heterogeneity in the causal relationship, found some evidence that efficiency of foreign direct investment in raising future growth rate is higher for more open economies.

In a study of Busse and Groizard (2006), using a sample of 89 countries across region, found that countries need a sound business environment to enable it benefit from foreign direct investment inflows and achieve sustainable growth. Balasubramanyan (2010) opined that foreign direct investment could increase growth potentials if there is well developed human capital, and infrastructure.

Borensztein, De Gregorio and Lee (1998) found that the growth effect of foreign direct investment is significantly positive only when the host has greater financial debt. Bolkaky and Freund (2004), in the study of growth effect of foreign direct investment, and trade openness, using cross-country regressions in levels and changes of percapitagross domestic product (GDP), found that foreign direct investment promotes economic growth only in countries with sound macroeconomic policy fundamentals with less-regulations. They argued that in countries with high regulations, poor and inconsistent policy framework, signaling macro-economic instability, growth does not accompany foreign direct investment because resources are prevented from flowing to the most productive sectors.

Hebbel (2004), using volume of trade/GDP as a measure of openness to trade in a panel growth regression, found that the growth effect of foreign direct investment is nearly zero for countries with high trade restrictions and low levels of per capita GDP. He opined that growth effect of foreign direct investment depends on the host country specific characteristics economic fundamentals, extent of trade openness, economic policy reforms among others.

In a cross sectional regression framework, Ram and Zhang (2000) found some evidence that foreign direct investment boosts economic growth rate only when the host macroeconomic factors such as price, and exchange rates are stable. Kokko and Blomstrom (2002) found a clear linkage between foreign direct investment and growth rates using panel data for the 1970-1990 for countries with relative price stability and narrow exchange rate premium.

Globlerman and Shapiro (2001) used a panel data and found robust results for positive growth effects of foreign direct investment inflows in their sample of 42 countries for the period 1960-1995. They noted that foreign direct investment growth effect is positive for countries with low inflation rates, stable exchange rates, and friendly business environment.

Akinlo (2004) found that the effects of foreign direct investment on Nigeria economy were not significant. Anyawale (2007), found that foreign direct investment had a negative growth effect in non- OECD countries which he attributed to the fact that foreign direct investment reduces total factor productivity growth.

Alfaro (2003) used cross country data for the period 1981-1999 and examined the impact of foreign direct investment on growth in primary manufacturing and services sectors and found that the value of foreign direct investment varied greatly across sectors. Also in a study of sub-saharan Africa countries, Habiyaremye and Ziesemer (2006) found that the overall level of capital investment does not seem to significantly affect the level of economic growth because most of the capital was in the primary sector.

Blamtol (2014) found that foreign direct investment exerts a positive effect on economic growth, but that there seems to be a threshold level of income above which foreign direct investment has positive effect on economic growth and below which foreign direct investment does not. The reason being that only countries that have attained certain level of income can absorb technologies and benefit from technology diffusion and therefore reap advantages and benefits which foreign direct investment offers.

Anyawale (2007) opined that the insignificant impact of foreign direct investment on economic growth was due to low level of human capacity development in the developing economies. Therefore there is need to build absorptive capacity and promote foreign direct investment through government policy.

Adeolu (2007) examined empirically the relationship between non-extractive foreign direct investment and economic growth. The finding revealed that foreign direct investment in Nigeria contributes significantly and positively to economic growth. UNCTAD (1999) submits that foreign direct investment has either a positive or negative impact on growth depending on the variables that are entered in foreign direct investment equation test. Such variables include the per capita GDP; education attainment, domestic investment ratio, political risk, terms of trade, black market exchange rate premium and the state of financial development.

From the empirical literature above, it is clear that most studies carried out on this subject were based on cross-country data analysis which may likely lead to generalized research outcomes which may turn out to be untrue when disaggregated under a single-country dynamic regression data. This paper therefore intends to isolate country specific data with Nigeria as reference point to test the impact of foreign direct investment on growth. This study is unique in comparison with most other studies

III. METHODOLOGY AND SOURCE OF DATA

The research design adopted for this study is the ex-post-facto design in which secondary information were obtained and analysed. The data for this research were collected from Central Bank of Nigeria statistical bulletin, and National Bureau of Statistics. The study employed multiple regression analysis, unit root test, co-integration and error correction technique.

Testing for stationarity in economic time series is crucial since standard econometric methodologies assume stationarity in the time series while they are in actual sense non-stationary. This actually assists to avoid the problem of spurious regression. Here the ADF (Augmented Dickey Fuller) unit root test is adopted. This would assist in determining the order of integration of the variables as well as the long-run Foreign Direct Investment-growth relationship.

Co-integration would be used to model the long run steady state relationship among variables. Co-integration among variables is established if their linear combinations exhibit stable properties. For co-integration, the two series have to be the same "order". This means that they should be stationary after same number of differencing. For instance, when A_t and B_f are found to be co-integrated, then there must exist an associated error correction mechanism (ECM) as follows:

$$\Delta A_t = {}_i + {}^s\sum\nolimits_{j=0} {}_{2ij} \Delta_{i\text{-}j} + {}^q\sum {}_{t\text{-}i3ij} \Delta_{t\text{-}i} + {}_4ECM_{t\text{-}i} \qquad (1)$$

Where Δ denotes the first difference operator, ECM is the estimated residual of the co-integrating regression, s and q are the number of lag lengths; A is the dependent variables while B is the vector of exogenous variables. If stability is assured, then the coefficient $_4$ will be negative and statistically significant. The value of $_4$ measures the speed of adjustment of the dependent variable to the value implied by the long-run equilibrium relationship.

The ECM is a way of combining the long-run co-integrating relationship between the level variables and the short-run relationship between the first differences of the variables. If co-integration is established, it means that there exists a stationary long-run relationship among variables. If otherwise, it means the linear combination is non-stationary and the variables have no means of reversal.

In arriving at a parsimonious model, all necessary variables including their lag values would at the onset be included in the model and eliminated gradually from the model. Only variables that give the best explanation to the behavior of the dependent variable and meet the assumptions of the ordinary Least Square (OLS) would be retained.

IV. MODEL SPECIFICATION

In this study, a multiple regression model is adopted and specified as follows.

GDP= (FDI, IFR, TOP, PR)   (1)

$GDP = b_0 + b_1FDI + b_2IFR + b_3TOP + b_4PR + U_F$ (2)

Where,

GDP   = Gross Domestic Product a proxy for growth index.

FDI   = Foreign Direct Investment

IFR   = Inflation rate

TOP   = Openness to trade

PR   = Political risk index (dummy variable)

$b_1, b_3 > 0$

$b_2, b_4 < 0$

V. DATA ANALYSIS AND DISCUSSION OF FINDINGS
Table 1: Regression results for short-run FOREIGN DIRECT INVESTMENT – Growth model

Dependent variable: In GDP
Method: Least Square
Date 02/02/2016: Time 12:20
Sample: 1981-2013
Included observation: 33

Variables	Coefficient	Std. error	t-stat.	prob
C	10.61240	0.241046	36.41627	0.0000
In	0.054126	0.036712	1.33402	0.1944
IFR	-0.000214	0.001136	0.202414	0.8416
TOP	-0.37841	0.16420	2.501672	0.0186
PR	-0.05476	0.3124	1.3406	0.004

R-Squared	0.972156	Mean dep. Var.	12.62481
Adj-R-Squared	0.966644	S.D. dep. Variable	0.52524
S.E. of Reg.	0.08226	AKaike info. crit.	-1.75354
Sum sq. resid.	0.242146	Schuartz crit.	-1.42416
Log. Likelihood	35.54204	Hannan-duinn crit.	-1.64546
F- statistic	192.5426	Durbin Watson Stat.	1.13489
Prob (F-stat)	0.00000		

Source: Author's Computation

Table 1 shows the results of the multivariate growth- foreign direct investment model. Foreign direct investment is positively related to economic growth in line with apprior expectation and statistically insignificant. Political risk index (PR) and openness to trade (TOP) were negatively related to growth index. While PR was statistically significant; TOP appeared statistically insignificant. Inflation rate met our apprior expectation by having negative relationship, though statistically insignificant. The result for (TOP) and foreign direct investment could be attributed to over-dependence on crude oil as major source of foreign exchange earnings and import dependence. The political risk index (PR) behavior indicates that the level of insecurity in the country actually had impacted negatively on the foreign direct investment inflows. The Durbin Watson statistic indicates serial auto correlation in the model hence the stationarity test. The R squared of 97.2 percent indicates a good fit.

Table 2: Unit Root Test with ADF

Variable	Order of Int.	ADF test Stat.	Critical values (1%)	Sig. level
ΔIn GDP	1(1)	-3.4142	-2.8702	5%
ΔIn FDI	1(1)	-8.5112	-3.6112	1%
Δ FR	1(1)	-4.5241	-3.6124	1%
ΔTOP	1(1)	-7.0124	-3.6140	1%
ΔPR	1(0)	-3.3144	-2.9405	5%

Source: Author's Computation

The ADF test on table 2 indicates that the null hypothesis of a unit root could not be rejected for all the variables. In order to eliminate the unit root inherent in some of the variables, they were differenced once. The results indicated that all the variables were stationary and integrated of order one ie 1(1). The presence of co-integration amongst the included variables was affirmed using the Engel & Granger residual test. This showed that there existed a long-run relationship among the variables as their linear combination was found to be integrated at levels 1(0) at 5 percent significant level.

Table 3: Result of Parsimonious Error Correction Growth-foreign direct investment Model

Dependent variable: Δ InGDP
Method: Least Squares
Date 02/02/2016: Time 12:20
Sample (adjusted): 1985-2013
Included observation: 29 after adjustment

Dependent variable: InGDP Method: Least Square Date 02/02/2016: Time 12:20 Sample: 1981-2013 Included observation: 33

Variables	Coefficient	Std. error	t-stat.	prob
C	0.090124	0.00876	10.1405	0.0000
ΔFDI (-2)	0.021412	0.010104	2.11670	0.0460
Δ FDI (-3)	0.034542	0.009541	3.51140	0.0020

Δ IFR	-0.001421	0.000214	3.51406	0.0422
ΔTOP	-0.105900	0.041564	-2.56402	0.0001
ΔPR (-1)	0.14246	0.031140	-4.9964	0.0000
ΔPR (-2)	-0.12404	0.02644	-5.62402	0.0021
Resid 01(-1)	-0.34534	0.056440	-6.21204	0.0000

R-Squared	0.80402	Mean dep. Var.	0.056124
Adj-R-Squared	0.72407	S.D. dep. Variable	0.041240
S.E. of Reg.	0.022421	AKaike info. crit.	-4.50140
Sum sq. resid.	0.01104	Schuartz crit.	-4.0124
Log. Likelihood	74.3041	Hannan-duinn crit.	-4.32110
F- statistic	10.16402	Durbin Watson Stat.	2.3102
Prob (F-stat)	0.000012		

Source: *Author's Computation*

Results from table 3 above indicate that in the long-run error correction model, the impact of foreign direct investment on growth index remained positive and significant. This shows that foreign direct investment promotes economic growth. The openness to trade index has significant negative impact on growth index. The index of macro-economic stability (IFR) remained negative and significant while the political risk index remained negative and significant. The Durbin Watson statistics indicates absence of serial auto-correlation in the model. The coefficient of the residual term was negative and statistically significant. R- squared statistics showed evidence of good fit.

Summary of Findings

Overall, our results indicate that foreign direct investment (FDI) is positively related to economic growth proxied by Gross Domestic Product (GDP). Findings also reveal that the co-efficient of foreign direct investment (FDI) is statistically significant in the long-run, though statistically insignificant in the short-run. The conclusion drawn from our results is that increase in foreign direct investment inflows will lead to increase in economic growth in Nigeria.

Recommendations

Based on our results, the following recommendations are put forward. First, the government should create an enabling environment through provision of infrastructure which would lower the cost of doing business in Nigeria. This will no doubt attract more inflows of foreign direct investment. Second, the government has to intensify the anti-corruption policy in order to boost foreign investors' confidence in the country. Third, political risk index should be reduced through anti-insurgence crusade particularly in the North-East, anti-militant war in the Niger Delta among others. This will ensure security and boost foreign investment inflows. Fourth; macro-economic stability through reduction in inflation rates, stability in exchange rate and trade liberalization should be pursued vigorously.

VI. CONCLUSION

The study has examined foreign direct investment in Nigeria employing ordinary least square method involving multiple regression analysis and diagnostic tests. The outcome has shown the impact of FDI in Nigeria which has a long-run positive effect in the economy. This is because of the capability of FDI to increase the employment of idle manpower and other resources if allow to operate without any hitch. This means that the country's resource managers have to play a significant role to ensure continuous inflow of FDI so as to help revive the poor Nigeria economy. The three tiers of governments in Nigeria have to restructure the environment and make it conducive so as to attract foreign investors and encourage existing foreign investors who have the needed capital for investment.

In consideration of the study, it is our sincere opinion that studies can further be on (i) the impact of FDI on unemployment reduction and resources utilisation in Nigeria. (ii) An examination of the adequacy of the Nigerian environment on domestic and foreign in investment.

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APPENDIX

Years	FOREIGN DIRECT INVESTMENT (N' Million	GDP (Real GDP) (N' Million)	Inflation Rate (%)	TOP	PR
1981	334.70	205,222.06	20.90	0.50	0
1982	290.00	199,685.25	7.70	0.39	0
1983	264.30	185,598.14	23.20	0.31	0
1984	360.40	183,562.95	39.60	0.27	0
1985	434.10	201,036.27	5.50	0.28	0
1986	735.80	205,971.44	5.40	0.22	0
1987	2,452.80	204,806.54	10.20	0.46	0
1988	1,718.20	219,875.63	38.30	0.38	0
1989	13,877.40	236,729.58	40.90	0.41	0
1990	4,686.00	267,549.99	7.50	0.58	0
1991	6,916.10	265,379.14	13.00	0.68	0
1992	14,463.10	271,365.52	44.50	0.68	0
1993	29,660.30	274,883.29	57.20	0.56	1
1994	22,229.20	275,450.56	57.00	0.41	1
1995	75,940.60	281,407.40	72.80	0.88	0
1996	111,290.90	293,745.38	29.30	0.69	0
1997	110,452.70	302,022.48	8.50	0.74	0
1998	80.749.00	310,890.05	10.00	0.59	0
1999	92,792.50	312,183.48	6.60	0.64	0
2000	115,952.20	329,178.74	6.90	0.64	0
2001	132,433.70	356,994.26	18.90	0.68	0
2002	225,224.80	433,203.51	12.90	0.47	0
2003	258,388.60	477,532.98	14.00	0.61	1
2004	248,224.60	527,576.04	15.00	0.58	1
2005	654,193.15	561,931.39	17.90	0.69	1
2006	624,520.72	595,821.61	8.20	0.56	1
2007	759,380.43	634,251.14	5.40	0.59	1
2008	971,542.79	672,202.55	11.60	0.63	1
2009	1,273,815.79	718,977.33	12.50	0.51	1
2010	905,730.77	776,332.21	13.70	0.51	1
2011	1,360,307.91	834,000.83	10.8	0.67	1
2012	1,113,510.58	888,893.00	12.2	0.59	1
2013	875,102.46	951,140.03	8.50	0.56	1

SOURCE: CBN Statistical Bulletin and Authors Computation