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Foreign Direct Investment: An Impetus for Economic Growth in Developing Nations (Evidence from Nigeria)

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Abstract

This work titled foreign direct investment; an impetus for economic growth in developing Nations: Evidence from Nigeria has explored FDI's as engine for technology transfer and skills acquisition that is capable of expanding the nation's industrial base and generating revenue for the government as well as employment capable of transforming Nigeria economy from developing to a developed one. Therefore, the objective of the study was to examine effect of technological benefits in promoting backward and forward linkages in domestic economy and to determine the effect of revenue generation on domestic investment concurrently with debt servicing in Nigeria. The study adopted review and practical analysis method of scholarly works that contribute to the debate on FDI, by assessing the impact of technology transfer and revenue generation as impetus for growth in developing nations with particular reference to Nigeria. Findings from the study revealed that, technology has significant effect in promoting forward and backward linkages in diversifying domestic economy and that, revenue generated through FDI assist in additional domestic investment concurrently with debt servicing and the researchers recommended that; Nigeria need to put in place good policies that can attract high-tech FDI's and that, Nigerian government needs to reduce unnecessary/extravagant spending to enable the nation save revenue accruals from FDI's to enable Nigeria reinvest in order to expand its industrial base.

Keywords: *Foreign, Investment, Developing, Nations*

Introduction

Industrial development in developing nations is premise on foreign investment flows that serves as a means of earning foreign reserves investments, expansion and diversification of their industrial base. FDI is considered a valuable source of finance and capital formation, Technology and knowledge transfer, as well as a viable medium for trade among countries. The Spillover effect also allows for the transfer of innovations and invention to the receiving countries, one of which Nigeria belongs. According to the requirement for accelerated growth in association with the Sustainable Development Goals is not completely clear, however, for economies to experience sustainable and inclusive development, cross-border trade is paramount (UNCTAD, 2019).

There is an increasing dependence of developing countries on private capital flows as a source of funding investment despite the consensus on the impact of foreign investment and remittances on economic growth which has remained elusive on policy discussion (Agbola, 2013; Hammed & Okunoye, 2020; Chia, Chukwu & Igwe, 2023). However, the fact still remains that the flow of capital into any developing country will play a bigger role in revamping businesses at various sectors of the economy. As such, the growing importance of FDI as a form of external finance to developing countries reflects not only the fact that companies increasingly find benefits in expanding their

manufacturing globally but also that developing countries see dormant returns in FDI over other forms of investments like foreign portfolio investment, in their economies (Jugurnath et al., 2016; Chia et al, 2023). Between 2005 and 2007, Nigeria recorded a total of $5.32 million as an average of foreign investment inflow into the country which represents 14.3% of total gross fixed capital formation in those periods (Onkunoye, 2020). After the financial crisis of 2008, the figure has been on decrease and in 2015, the FDI inflows was $3.06 million with an increase of 45.2% in 2016. In the year 2017, the inflow was $3.5 million and fell drastically by approximately 43% in 2018 which make up only 3.8% of total gross fixed capital formation. This decline was attributed by Kamara (2013), to the effort of developed countries right after the global economic crisis of 2008 to tighten the budget which has led to a smoothing off and in some cases a litter in development aid and lending from these countries. In comparison with the total FDI inflows into West Africa and Africa in total, the share of Nigeria's FDI inflows was respectively 25.2% and 6% for the average of 4 years running from 2015 to 2018 (WIR, 2019). Also, as clarified by Ongo, (2014), FDI helps in the provision of capital directly needed by the developing country and which is necessary to boost investment and growth in the industrial sectors while still improving the productivity of local firms through knowledge transfer and adoption of more effective technologies or investing in human and material capital. Thus, the imperative of FDI ranges from serving as source of physical and human capital, creation of jobs and provision of access to foreign markets and impacting local businesses in terms of technology and efficiency, (Hammed & Okunoye, 2020). These vast benefits of FDI have made Nigerian government to give more attention to the potentials entrenched in attracting high FDI to the country through several strategies. For instance, Ease of Doing Business in Nigeria (EODB), Petroleum Industry Bill (PIB) among other interventions, attracted capital flows into Nigeria while at the same time improving its well-organized allocation in the private sector. In addition, it is eminent that FDI conveys superior knowledge spill over's to developing country's economy and stimulate the capacity of a host economy to take advantage and gain from these capital inflows might elude the question of has there been increasing or decreasing return of FDI- led development overtime. Many of developing countries, however, have realized the significance of foreign direct investment and many have equally offered seductive tax incentives and subsidies to attract foreign investment. The idea behind this is that FDI contributes to economic growth by motivating capital accumulation and/or through positive outwardness in the form of knowledge transfer to local firms (Herzer, 2010, Chia et al 2023). According to OECD report (2002), countries with higher level of per capita income, better human assets, higher degree of openness and well-developed financial system seem to benefit meaningfully from FDI. There are various avenues through which FI can bring about growth in an economy. The exogenous theory viewed by Oyegoke, (2021) argued that the important growth effect of FI on host country ranges from capital accrual, introduction of new goods and foreign technology while the endogenous theory believes that FDI enhances knowledge in the host countries by the transfer of skills. As put by OECD, FDI is a potential source of economic growth and development (Hammed & Okunoye, 2020). This and other versions make FI an attractive source of growth for developing nations which Nigeria is not an exception.

It is against this background that this study attempts to examine the effect of technological benefits in promoting forward and backward linkages in domestic economy through FDI and to examine how revenue generation through FDI assist in additional domestic investment concurrently with debt servicing within the context of the Nigerian economy. This study provides answer to these specific questions answered are: 1) What are the effect of technological benefit in promoting forward and backward linkages in domestic economy through Foreign Direct Investment (FDI) on economic growth in Nigeria? 2) To what extent has revenue generation through FDI assist in additional domestic investment concurrently with debt servicing on Foreign Direct Investment (FDI) and

economic growth in Nigeria? The study is guided by the following specific objectives; these are to; examine the effect of technological benefits in promoting backward and forward linkages in domestic economy and to determine the effect of revenue generation on domestic investment concurrently with debt servicing on (FDI) in Nigeria.

CONCEPTUAL REVIEW

Foreign Direct Investment

The dependence of developing countries on private capital flows as a source of funding investment despite the impact of foreign direct investment and remittances on economic growth which has remained indefinable on policy debate (Agbola, 2013; Hammed & Okunoye, 2020). Moreover, the fact still remains that the flow of capital into any developing country will play a better role in facilitating businesses both at various sectors of the economy. As such, the growing importance of FDI as a form of external finance to developing countries reflects not only the fact that firms progressively find benefits in expanding their production internationally but also that host developing countries see varried advantages in FDI over other forms of investments like foreign portfolio investment, in their economies (Jugurnath et al., 2016). Between 2005 and 2007, Nigeria recorded a total of $5.32 million as an average of foreign direct investment inflow into the country which represents 14.3% of total gross fixed capital formation in those periods. Right after the financial predicament of 2008, the figure has been on decrease and in 2015, the FDI inflows was $3.06 million with an increase of 45.2% in 2016. In the year 2017, the inflow was $3.5 million and fell considerably by approximately 43% in 2018 which make up only 3.8% of total gross fixed capital formation. This deterioration was attributed by Kamara (2013), to the effort of developed countries right after the global economic crisis of 2008 to stiffen the budget which has led to a flattening off and in some cases a refuse in development aid and lending from these countries. In comparison with the total FDI inflows into West Africa and Africa in total, the share of Nigeria's FDI inflows was respectively 25.2% and 6% for the average of 4 years running from 2015 to 2018 (WIR, 2019). Also, as clarified by Ongo, (2014), FDI helps in the provision of capital directly needed by the host country and which is necessary to increase investment and growth in the industrial sectors while still improving the productivity of local firms through the adoption of more effective technologies and/or investing in human and material capital. Thus, the importance of FDI ranges from serving as source of physical and human capital, creation of jobs and provision of access to foreign markets and impacting local businesses in terms of technology and efficiency, (Hammed & Okunoye, 2020). These vast benefits of FDI have made Nigerian government to give more attention to the potentials entrenched in attracting high FDI to the country through several strategies. For instance, Structural Adjustment Program (SAP) introduction in 1986, among other interventions, attracted capital flows into Nigeria while at the same time improving its well-organized allocation in the private sector (Central bank of Nigeria 2005). In addition, it is argued that FDI conveys superior knowledge spill overs to host country's economy and the capacity of a host economy to take advantage and gain from these capital inflows might help them in servicing debts and additional domestic investment Sokang, (2018). Many of developing countries, however, have realized the significance of foreign direct investment and many have equally offered seductive tax incentives and subsidies to attract foreign capital. The idea in this is that FDI contributes to economic growth by stimulating capital accumulation and/or through positive externalities in the form of technology transfer to local firms (Herzer, 2010). There are various avenues through which FDI can bring about growth in an economy. The exogenous theory viewed, as mention by Mahembe and Odhiambo, (2014) that the important growth effect of FDI on host country ranges from capital accrual, introduction of new goods and foreign technology while the endogenous theory believes that FDI enhances the stock of knowledge in the host country by the

transfer of skill. As put by OECD, FDI is a potential source of economic growth and development (Hammed & Okunoye, 2020).

A great number of empirical studies on the role of FDI in host countries suggest that FDI is an important source of capital, complements domestic private investment, is usually associated with new job opportunities and enhancement of technology transfer, diversification of economic base and boosts overall economic growth in host countries, (Abdar & Mavrotos, 2006; Chia et al 2023).

In most developing countries, Foreign Direct Investment (FDI) serves as a means of earning foreign reserves through investments, businesses and foreign reserves that aids debt servicing to world financial institutions. FDI is considered a precious source of finance and capital formation, Technology-Transfer and know-how, as well as a possible medium for trade among countries.

Presently, Nigeria is the first host economy of FDI in Sub-Saharan Africa, and the third in the continent. Recently, Nigeria has witnessed a number of trade policies which aim at diversifying the economy away from oil revenue. These policies are focused on improving the industrial sector. In 2018, the total FDI inflow to the country was around USD 1.9 billion, while in 2017, FDI inflow was around USD 3.5 billion, showing a decrease due to the consequence of the austerity measures imposed in 2018. At the third quarter of 2019, the FDI was only 3.37% (USD 200.08 million) of the total capital inflow for the period Oyegoke, & Aras, (2021, Akowe et al, 2015).

Factors affecting foreign direct investment

1. Wage rates

A major incentive for a multinational to invest abroad is to outsource labor-intensive production to countries with lower wages. If average wages in the US are $15 an hour, but $1 an hour in the Nigeria, costs can be reduced by outsourcing production. This is why many Western firms have invested in clothing factories in the Indian sub-continent. However, wage rates alone do not determine FDI, countries with high wage rates can still attract higher tech investment. A firm may be reluctant to invest in Sub-Saharan Africa because low wages are outweighed by other drawbacks, such as lack of infrastructure and transport links.

2. Labour skills

Some industries require higher skilled labour, for example pharmaceuticals and electronics. Therefore, multinationals will invest in those countries with a combination of low wages, but high labour productivity and skills. For example, Nigeria has attracted significant investment in call centres, because a high percentage of the population speak English, and wages are low. This makes it an attractive place for outsourcing and therefore attracts investment.

3. Tax rates

Large multinationals, such as Apple, Google and Microsoft have sought to invest in countries with lower corporation tax rates. For example, Ireland has been successful in attracting investment from Google and Microsoft. In fact, it has been controversial because Google has tried to funnel all profits through Ireland, despite having operations in all European countries.it is therefore pertinent for Nigeria to consider her tax rates if we want high inflow of high tech FDIs.

4. Transport and infrastructure
A key factor in the desirability of investment are the transport costs and levels of infrastructure. A country may have low labour costs, but if there are then high transport costs to get the goods onto the world market, this is a drawback. Countries with access to the sea are at an advantage to landlocked countries, who will have higher costs to ship goods. It is expedient that Nigeria put in place the needed infrastructure that is capable of facilitating trade at our sea ports.

5. Size of economy / potential for growth
Foreign direct investment is often targeted to selling goods directly to the country involved in attracting the investment. Therefore, the size of the population and scope for economic growth will be important for attracting investment. For example, Eastern European countries, with a large population, e.g. Poland offers scope for new markets. This may attract foreign car firms, e.g. Volkswagen, Fiat to invest and build factories in Poland to sell to the growing consumer class. Small countries may be at a disadvantage because it is not worth investing for a small population. China will be a target for foreign investment as the newly emerging Chinese middle class could have a very strong demand for the goods and services of multinationals. In Nigeria there is a heavy populous market for finished goods thus making her a fertile ground for FDI (Tajvan, 2019).

6. Political stability / property rights
Foreign direct investment has an element of risk. Countries with an uncertain political situation, will be a major disincentive. Also, economic crisis can discourage investment. For example, the recent Russian economic crisis, combined with economic sanctions, will be a major factor to discourage foreign investment. This is one reason why former Communist countries in the East are keen to join the European Union. The EU is seen as a signal of political and economic stability, which encourages foreign investment. Nigerian government must do everything possible to ensure political stability and security of lives and properties to enable a level playground for FDIs

Related to political stability is the level of corruption and trust in institutions, especially judiciary and the extent of law and order.

7. Commodities
One reason for foreign investment is the existence of commodities. This has been a major reason for the growth in FDI within Africa – often by Chinese firms looking for a secure supply of commodities. The vast commodity market in Nigeria provides a source of attraction to FDIs these can enhance revenue generation by our government can that can further be reinvested for growth purpose and even debt servicing, so as to reduce our foreign debt that has been over bloughted in recent years.

8. Exchange rate
A weak exchange rate in the host country can attract more FDI because it will be cheaper for the multinational to purchase assets. However, exchange rate volatility could discourage investment. However, this issue of exchange rate has made Nigerians to suffer untold hardship due to currency devaluation against the dollar. It is pertinent to note that, a moderate exchange rate is preferable than a weak one because the end result of it as witnessed in Nigeria has thrown many Nigerians into a precarious situation that made the so called attraction of FDI meaningless to many households in Nigeria.

9. Clustering effects

Foreign firms often are attracted to invest in similar areas to existing FDI. The reason is that they can benefit from external economies of scale growth of service industries and transport links. Also, there will be greater confidence to invest in areas with a good track record. Therefore, some countries can create a virtuous cycle of attracting investment and then these initial investments attracting more. It is also sometimes known as an agglomeration effect.

10. Access to free trade areas.

A significant factor for firms investing in Europe is access to EU Single Market, which is a free trade area but also has very low non-tariff barriers because of harmonization of rules, regulations and free movement of people. For example, UK post-Brexit is likely to be less attractive to FDI, if it is outside the Single Market.

Synthesis

There are many different factors that determine foreign direct investment (FDI) and it is hard to isolate individual factors, given there are many different variables. It also depends on the type of industry. For example, with manufacturing FDI, low wage costs tend to be the most important, as they are a labor-intensive industry. For the service sector, FDI, macro-economic stability and political openness tend to be more important. Also, it depends on the source of FDI, American firms may value political openness more than Chinese firms. Or American firms may have a preference for countries where English is spoken more.

Technology Transfer

The technological gaps between rich and poor countries have been stressed in much recent writing on development. It has been argued, for instance, that if only the world's available technological knowledge could be transferred to less-developed countries, their socio-economic transformation can be carried out rapidly. At the same time, the central role of multinational corporations (MNC's) in development and transfer of such knowledge has been recognized. This role, in turn, has been seen as a major justification for less-developed countries' encouraging FDI's to undertake investment in their economies. It suggests: first, that there are some rather particular economic factors that explain the central FDI role in technology transfer; second, that these factors underlie important problems that FDI technology transfer generates in developing economies; and third, that these technologies take either forward or backward linkages by investing in production and distribution of goods and services that promotes smooth flow on the supply chain and sometimes engaging in extraction of needed raw materials and processing them for secondary level needed for production of other finished goods that propel the value chain to contribute to economic growth in developing nations; this technological benefit metamorphosed into varied inter-sectoral linkages that contribute to economic growth and development that shape patterns of political economy in many developing states that themselves inhibit and distort broadly-based, widely-shared economic progress. The focus of analysis is primarily the MNC transfer of manufacturing technology (Mody & Murshid,2002; Eneche & Audu, 2014, Okafor & Okeke, 2023).

Revenue generation/ Debt servicing

Foreign direct investment in developing nations helps in generating revenue through taxes they pay to the host nations, these collections serve as revenue that is used in reinvestments in other sectors of the economy that boost accelerated economic development. As these developments take place they

open up new investment that creates employment opportunities for job seekers who also through such employment pay taxes to government thus creating an inter-sectoral linkage that propel the overall development of a nation. In addition, these revenues are also used to service debts being owed by developing nations to world financial institutions con currently with domestic investments.

Empirical Review

The write up on the impact of FDI on growth in developing nations has not reached conclusion. Some of these studies found FDI to be an impetus on growth while some looked at it as agents of imperialism. Nevertheless, some studies have looked into the area of examining various channels through which FDI influences growth and some have also looked into the causal effect between FDI and growth, all these with varying outcomes. The work of Anwar (2008) examined the impact of foreign investment and human capital on manufacturing sector in Singapore using annual data between 1980 and 2005. The vector error correction model (VECM) result found that foreign direct investment and human capital play important role in Singapore manufacturing sector growth. The result further shows that adjustment to long run equilibrium takes place at a fairly fast rate. In the same vein, Akinlo (2004) investigated the impact of foreign direct investment (FDI) on economic growth in Nigeria. The methodology was error correction model (ECM) for annual data series from 1970 to 2001. The result found that FDI into extractive sector is not growth enhancing as much as FDI into manufacturing sector. In addition, the result shows that both labour force and human capital have significant positive effect on growth.

Similarly, the study conducted by Adeolu (2007) investigated the relationship between non-extractive FDI and economic growth in Nigeria and examined the determinant of FDI into the Nigerian economy. The methodology was OLS and 2SLS with annual data spanning from 1970 to 2002. The result suggests that the determinants of FDI in Nigeria are market size, infrastructure development and stable macroeconomic policy. According to the same finding, openness to trade and available human capital are not. It was also found that FDI in Nigeria contributed positively to economic growth and FDI in communication sector has more potential to grow the economy than FDI in oil sector. However, the result found FDI in manufacturing sector to be negative in its effect on the economy reflecting poor business environment in the country.

Methodology: This paper uses practical analysis of scholarly works that contribute to the debate on FDI, by assessing the impact of foreign direct investment as impetus for growth in developing nations with particular reference to Nigeria.

Discussion of Findings

The findings of this study are discussed in line with the objectives of the study and to avoid biasing our findings, the researchers have supported the findings with relevant theories to validate the findings of this study.

To examine the effect of technological benefits in promoting backward and forward linkages in domestic economy

In order to examine whether technology affect backward and forward linkages, empirical evidence suggest that technology has been seen as a major justification for less-developed countries' encouraging FDI's to undertake investment in their economies. It suggests: first, that there are some rather particular economic factors that explain the central MNC role in technology transfer; second, that these factors underlie important problems that MNC technology transfer generates in developing economies; and third, that these problems underlie patterns of political economy in many developing

states that themselves inhibit and distort broadly-based, widely-shared economic progress. This is in line with Mody & Murshid, (2002). This can further be supported by the Structural transformation theory by Arthur & Lewis, (1954) who opines that a process of transforming the economy in such a way that the contribution of technology to the national income eventually surpasses the contribution of other sectors contribution of a primarily developing economy.

To determine the effect of revenue generation on domestic investment concurrently with debt servicing on (FDI) in Nigeria.

In order to ascertain the effect of revenue generation on domestic investment concurrently with debt servicing, empirical evidence suggest that revenue significantly assist countries in domestic investment as well as debt servicing. This is in line with Akiri, Vehe & Odike, (2016) they opine that revenue from exports has a positive and statistically significant effect on growth, domestic investments, GDP ratio has significant positive effect on debt servicing due to high capital inflow it generates. This can further be supported by Harrod- Domar economic growth theory (1939- 1946) it explains an economy's growth rate in terms of the level of revenue and savings and how it significantly assists domestic investment, debt servicing and employment creation. This suggest that, there will be no saving where revenue does not surpass breakeven point of all investments in an economy. Where returns on investments are high, there will be corresponding savings for corresponding domestic re- investment as well as debt servicing where such an economy is servicing debt.

Conclusion

Foreign investment, an impetus for growth in developing nations evidence from Nigeria is a wakeup call for Nigeria to try and exit itself on the list of developing nations, this is possible because when there is high-tech technology inflow that corresponds to high revenue generation, this will transcends into high domestic investments and this will make Nigeria to diversify its industrial base and concurrently service its foreign debts, this will enable Nigeria to exit the status of developing nations to a developed nation which has being the aspiration of most developing countries.

Recommendations

Based on the findings of this study the following major recommendations are made:

i) That Nigeria need tom put in place good policies that can attract high-tech FDI's, with such technology, it will be easier for technical knowledge to be transferred easily into our youth who can use it to accelerate technological transformation needed to exit Nigeria from the list of developing nations.

ii) That Nigerian government needs to reduce unnecessary/ extravagant spending to enable us save revenues accruals from FDI's to enable us reinvest into other sectors of the economy that are capable of bringing accelerated economic development.

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