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THE EFFECT OF FDI INFLOWS ON NIGERIA'S BALANCE OF PAYMENT FOR THE PERIOD 1980-2009

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ABSTRACT

This research study deals with the effect of Foreign Direct Investment inflows on Nigerian's Balance of payment over the period 1980-2009.It helped examined empirically if Foreign Direct Investment inflows have any effect on the nation's BOP. Econometric model was developed to investigate the relationships between the BOP and foreign direct investment. Based on the data analysis it was discovered that foreign direct investments have positive and significant impact on current account balance in the Balance of payment. While Gross fixed capital formation is inelastic to Balance on current account. Therefore it is recommended that for Nigeria to attract the desired level of FDI, and have improved Balance of payment position, it must introduce sound economic policies and make the country investor friendly. Also its economy must be open to foreign trade, there must be political stability, sound economic management and well developed infrastructure.

KEYWORDS
Foreign direct investment, gross fixed capital formation, government expenditure, Nigeria, BOP.

INTRODUCTION

FDI is an investment made to acquire a lasting management interest (normally 10% of voting stock) in a business enterprise operating in a country other than that of the investor defined according to residency not nationality (World Bank, 1996) as cited by Adebgite and Ayadi (2010). Given the Nigerian economy resource base, the country's 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 under developed nature of the country's economy that essentially hindered the pace of her economic development. Generally, policy strategies of the Nigerian government towards foreign investments are shaped by two principal objectives of the desire for economic independence and the demand for economic development.

An analysis of foreign flow into the country so far have revealed that only a limited number of multinationals or their subsidiaries have made Foreign Direct Investment in the country. Added to this problem of insufficient inflow of FDI is the inability to retain the Foreign Direct Investment which has already come into the country. Also what effect have foreign direct investment have on such variables as- Gross Domestic Product (GDP) and Balance of Payment(BOP).Moreover, Carkovic and Levine (2002) in their study concluded that exogenous component of FDI does not exert a robust positive influence on economic growth.

The hypothesis to be tested in this study is stated below:

H_0. FDI does not contribute to Nigeria's Balance of Payment (BOP).

H_1. FDI contribute to Nigeria's Balance of Payment (BOP).

This paper is divided into five parts. Part one above is the introduction. Part two reviews the relevant literature, part three discusses the methodology employed in this study, and part four is data presentation and analysis while part five discusses the findings and recommendation.

This study will evaluate the effect of FDI inflows on Nigeria's Balance of payment. The period 1980-2009 will be investigated in the study. Only FDI, Government Expenditure and Gross Capital formation will be used as the explanatory variables. While the balance on Balance of payment current account will be used as the dependent variable.

LITERATURE REVIEW

The balance of payments is obviously affected by FDI in a variety of ways. Letto-Gillies (1992) assert that there are the direct effects of capital outflows and inflows destined to finance the outward and inward FDI. However, outward FDI does not necessarily involve outflow of funds from the home country, since there are other ways of funding direct investment, such as borrowing on international markets and using profits from such subsidiaries. Other direct effects are connected with the outflow and inflow of profits and dividend related respectively to past inward and outward FDI. For countries with long traditions of FDI these income are extreme of the spectrum. The net inflows of income from capital invested abroad have in many years outstripped the inflows of new inward FDI. Magdoff (1992) illustrates this with reference to United States investment during the period 1950-65. The outward investment in Latin America was US $3.8b while the related income flowing from Latin America to the USA in the same period was $11.3billion. This net inflow of funds was achieved in spite of the growing amount of foreign asset being acquired.

However, the balance of payments effects can have profound effects on the real sector of the economy that is not always beneficial. Rowthorn and Wells (1987) as cited by Alderson (1997) refer to such effects in relation to net income from foreign investment as the wealth trap. The manipulation of transfer prices also has effects on the balance of payment accounts. Indeed, very often the manipulation of transfer prices is motivated by the desire to take advantage of actual or expected changes in exchange rates or by the wish to transfer profits where legal impediments exist to such transfers (Letto-Gillies, 1992).

Foreign direct investment improves the balance of payments and current account substantially if it is directed towards the production for exports or import replacement (Hess and Ross, 1991). The government budget balance can also improve through high tax revenue from corporate profits, salaries of employees, and daily tax on finished goods and services. According to Adegbite and Ayadi (2010) FDI helps fill the domestic revenue-generation gap in a developing economy, given that most developing countries' governments do not seem to be able to generate sufficient revenue to meet their expenditure needs. Other benefits are in the form of externalities and the adoption of foreign technology. Externalities here can be in the form of licencing, imitation, employee training and the introduction of new processes by the foreign firms (Alfaro, Chanda, Kalemli- Ozean and Sayek 2006).

Foreign direct investment consists of external resources including technology, managerial and marketing expertise and capital. All these generate a considerable impact on host nation's productive capabilities. 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 boast the existing production capacity. Although the Nigerian government has being trying to provide conducive investment climate for foreign investment, the inflow of foreign investments into the country have not been encouraging. The economic impact of FDI on the level of economic activity has been widely investigated in recent years across different countries. See (Jenkins and Thomas 2002; Adelegan 2000, Akinlo 2006, Johnson 2006 e.t.c.).Although FDI has a positive impact on economic growth but the magnitude of the effect depends on the availability of complementary resources, especially on the domestic stock of human capital.

The inflow of FDI plays an important role in determining the surplus/deficit in the capital and current account of the BOP statement. The initial impact of an inflow of FDI on any nation's BOP is positive but the medium term effect could become either positive or negative as the investors increase their imports of intermediate goods and services, and begin to repatriate their profit.

According to Hossain (2008) Empirical research in several countries suggests that the initial inflow of FDI tends to increase the host country's imports. One reason for this is that primarily FDI companies have high propensities to import capital and intermediate goods and services that are not readily available in the