Examining the Relative Roles of Domestic and Foreign Direct Investments in Nigeria

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ABSTRACT

This study examines the relative relevance of domestic investment (DI) and foreign direct investment (FDI) on economic performance in Nigeria (1980-2014). In an attempt to achieve this broad objective, annual time series data sourced from the Central Bank of Nigeria's Statistical Bulletin, which was estimated using vector error correction technique, among others. The results, inter alia, show that both DI and FDI had significant effect on Nigeria's economic performance; however, the influence of the former was observed to be far greater than the latter with marked difference both in terms of the level of significance and size. Thus, the study recommends, among others, the need for government to create the ambience that will enable domestic investors to thrive, on one hand, and be complemented by foreign investment, on the other.

Keywords: Domestic Investment, Foreign Direct Investment, Economic Performance, Vector Error Correction Model
JEL Classifications: F21; F23

1. INTRODUCTION

Investment serves as a major source of economic growth in any country, Nigeria inclusive; whether it is from domestic or foreign sources, its importance is crucial for sustainable economic performance (Asiedu, 2002). Evidence from literature indicates two major ways by which foreign direct investment (FDI) may influence domestic investment (DI). Firstly, FDI has a crowding-in effect when it increases income levels by enhancing demand for commodities produced by the local firms or to buying their commodities as inputs. Secondly, FDI has crowding-out effect when foreign investors become the competitors to local firms by producing commodities that are close substitutes (Osabuohien, 2007; Osabouhien and Efobi, 2013).

Given Nigeria's natural resource base and large market size, it is expected to be a major recipient of FDI in Africa. However, the level of FDI inflows to Nigeria is not as much compared with her resource base and potential needs (Asiedu, 2003). As a result, the Nigerian governments since 1990 have taken measures to attract foreign investors into the country in order to augment domestic

resources to finance planned growth. The measures include the repeal of laws that are inimical to foreign investment, promulgation of investment laws, various oversea trips for image laundry by the Presidency. A related effort was the restructuring and reforming banks in Nigeria with a view to repositioning and stabilising their operations and in the long-run enhance the level of financial intermediation in the country (Osuagwu and Nwokoma, 2017). Consequently, the amount of FDI inflow into Nigeria has reached US$ 2.23 billion in 2003 and it rose to US$ 5.3 billion in 2004 the figure rose again to US$ 9.92 billion (87% increase) in 2005. The figure, however, declined slightly to US$ 9.44 billion in 2006 and has continued to decline since 2006 up till 2015 (Central Bank of Nigeria-CBN, 2015).

The level of FDI attracted in Nigeria has not been reflected in her development strategy. It is against this background that this study is motivated to examine the relevance of DI and FDI on economic performance in Nigeria. This is essential due to the fact that in the 1990s, the cross-border mergers and acquisition, particularly foreign investment surged worldwide, which led to increase in merger and acquisition through privatisation in

Nigeria has helped the economy to grow. However, the study by the United Nations Conference on Trade and Development-UNCTAD, 2000) indicates that Nigeria's share in FDI flow has steadily declined in recent times. Some of the factors pointed out as contributing to the trend in Nigeria (relative to other countries of the world) include: High level of corruption, poor governance, inadequate infrastructure, among others. Furthermore, while some studies (Abaukaka, 2014; Yılmaz, 2014) established crowd-out effect of FDI on DI; others (Amassoma and Ogbuagu, 2014) found crowd-in effect of FDI on DI. The controversial evidence on the relationship between FDI and DI a developing country like in Nigeria formed the motivation for this study. The study is structured into five sections: Following this introduction is a brief review of literature. The theoretical framework and methodology is encapsulated in Section 3, while Section 4 presents the empirical results. The last section concludes with some recommendations.

2. BRIEF REVIEW OF LITERATURE

Generally, investment is an addition to capital, such as addition to capital, such as occurs when a new house is being built or a new factory is built. Investment means making an addition to the stock of goods in existence (Jhingan, 2007). World Bank (1996) conceptualized FDI as an investment made to acquire a lasting management of about 10% of voting stock in business operating in a country other than that of the investor defined according to residency. To Shenkar (2007), FDI is the investment in real or physical assets, such as factories and distribution facilities. The author asserted that it is not the foreign portfolio investment that has to do with investment in foreign financial instruments such as government bonds, mutual funds and foreign stocks. Others like André (2008) define FDI an investment made to acquire lasting interest in enterprise operating outside of the economy of the investor. To qualify as FDI, the investor must afford the parent enterprise control over its foreign affiliate and such control exist when the parent company owns 10% or more of the ordinary shares or voting power of an incorporated firm or equivalent for an unincorporated firm and if does not, it is known as portfolio investment (André, 2008).

The main reasons for attracting FDI inflows are to fill the savings, foreign exchange, revenue, and management gaps (Todaro and Smith, 2009). The first and most often cited rationale of FDI to national development (i.e., when development is defined in terms of the growth of gross domestic products-GDP). This is based on the role of FDI in filling the resource gap between targeted or desired investment and in mobilizing savings locally. When the domestic resources (savings) fall short relative to the potential investment, FDI is seen as an alternative to fill-up that gap; second, it contributes to filling the gap between targeted foreign exchange requirements and those derived from net export earnings plus net foreign aid. Furthermore, FDI augment the revenue of the host country. Also, foreign investments bring with them advanced management, entrepreneurship, technology and skills that can be transferred to their local counterparts by means of training programs and the process of learning by doing.

On the contrary, DI is a tool for measuring the level gross domestic product (GDP). It is an important component of GDP which is used for future production in an economy. It includes both replacement purchases plus net additions to capital assets and investments in inventories. The gross DI includes three types of investments like; non-residential investment, residential investments and change in inventories. DI is a catalyst necessary for the overall development of an economy. The primary objective of DI policies in any economy is to increase the level of economic activities. Hence, DI policies should be directed to the sector in which the impact of an increase in DI demand will be both desirable and large. It is a source of foreign exchange earnings since trade transactions among nations are settled in foreign exchange (Abou-Strait, 2005).

Literature is replete on the relationship between FDI and economic growth and also on the relationship between DI and economic growth. However, there are few studies on the relationship between FDI and DI. The results of some of these studies find out that FDI has a crowd-in effect on DI, while the others find a crowd-out effect of FDI on DI. In another dimension, some of the studies find a uni-directional relationship between FDI and DI, while others find a bi-directional relationship between FDI and DI. Among the studies that find out that FDI have a crowd-out effect on DI, Abaukaka (2014) examines the relationship between FDI and employment generation in Nigeria using multiple linear regression model for data (2002-2012). From the empirical results, it was noted that FDI exhibit negative relationship with the level of employment in Nigeria while GDP, interest rate are positively related with the level of employment but none of the explanatory variables significantly impact on the level of employment in Nigeria within the period of the study.

The above position was supported by Yılmaz (2014) who investigates the relationship between economic growth and FDI inflows in Turkey (1980-2012) by using co-integration test and vector error correction (VEC) model based on autoregressive distributed lag (ADRL) bound testing approach. The study found that there was a long run relationship among the economic growth, FDI inflows and DI. On the other hand, their findings showed that FDI inflows affect economic growth negatively in the short and long run, while gross DI affects economic growth positively both in the short and long run. The submission of Eregha (2011) who examines the association between FDI inflow and DI in countries of Economic Community of West African States (ECOWAS) also corroborated the crowding-out effect of FDI on DI. Their study revealed that FDI inflow substitutes DI in the ECOWAS sub-region. Export openness and import openness were found to positively and negatively affect respectively DI accumulation in the ECOWAS sub-region.

Other studies that found FDI having a crowd-in effect on DI include: Lean and Tan (2010) who examined the linkages between FDI, DI and economic growth in Malaysia (1970-2009). Using a number of tests such unit root, Johansen-Juselius multivariate cointegration test and Granger causality test, their findings show that 10th Malaysia plan attaches with an important mission of leading the country towards a high-income country.

The study of Ndem and Okoronkwo (2014) examined the determinants of FDI and their impact in Nigeria (1975-2010). Specifically, the study determined how exchange rates, market size, investment in infrastructure, openness and political risks have impacted on the flow of FDI in Nigeria. In analyzing the data using ordinary least square (OLS), and co-integration error correction method (ECM) it was found out that market size (GDP), openness, and exchange rate impact much on FDI inflow while political risk was unfavorable to it. Investment in infrastructure was discovered to be favorable but its level is inadequate to improve FDI required for sustainable growth and development.

The issue of crowding-in effect of FDI on DI was also corroborated by the findings of Olusanya (2013) investigated the impact of FDI and economic growth in a pre and post deregulated Nigerian economy, a Granger causality test was use as the estimated technique (1970-2010). However, the analysis de-aggregates the economy into three periods: 1970-1986, 1986-2010 and 1970-2010, to test the causality between FDI inflow and economic growth. However, the result of the causality test shows that there is causality relationship in the pre-deregulation era that is (1970-1986) from economic growth to FDI inflow which means GDP causes FDI, but there is no causality relationship in the post-deregulation era that is (1986-2010) between economic growth and FDI inflow which means GDP causes FDI. However, for the period 1970-2010, it shows that there is causality relationship between economic growth and FDI inflow that is economic growth drive FDI inflow, and vice versa.

Furthermore, the contention on crowding-in effect of FDI on DI was articulated by Younus et al. (2014) who examined the determinants of gross DIs in Pakistan (2000-2010) using two-stage least squares. In order to assess their behavior over the time and to evaluate how these variables have either hindered or encouraged the growth of investment in Pakistan's economy. DI in Pakistan is stimulated by real GDP growth as well as with the expansion of exports of goods and services. The development of financial sector and human capital is vital for economic escalation in country. However, the stimulation in formal credit and formation of industrial capital may lead towards promulgation in DIs.

The study of Amassoma and Ogbuagu (2014) verify the interactions and transmission mechanism between FDI, private direct investment and public direct investment in Nigeria. The variables were examined to ascertain their direction of causality and whether or not they have long run linear relationship. Also, the impulse responses of these variables to shocks in the extraneous variables were verified; using the multiple-equation VAR models with time series data (1970-2012). The cointegration result indicates that there is no long run relationship between these variables. In addition, the variance decomposition result shows that 46% of innovations in FDI were explained by its own past values, while 21% of the innovations were due to shocks, to Private DI with 31% due to public investment. This also supported the findings of Onuorah (2012) evaluated the relationship between FDI inflow from sub-Sahara Africa (Ghana and Liberia) to the growth of the Nigerian economy (1980-2009). The OLS results

reviewed the independent variables have a positive relationship with Nigeria economic growth as a result of the normality significance of Jarque-Bera test. Vector autoregression (VAR) model was used to statistically test for a long-run relationship between FDI and growth of the Nigeria economy. Also construct vector autoregressive model which tested the causality between FDI and economic growth the Granger causality tests results revealed that GDP causes FDI.

In study by Alege and Ogundipe (2013) the impact of FDI on economic growth in ECOWAS countries (2000-2013) was examined. Using the generalized method of moments (GMM) technique, the empirical analysis revealed that FDI has a positive and statistically effect on economic growth in ECOWAS countries. In addition, DI, human capital development and inflation, although insignificant, have positive impact on economic growth in the region while trade openness and USA dollar appreciation discourage economic growth in the region. Moreover, the monetary union of West African Economic and Monetary Union countries contributes negatively to their economic growth. Arising from the findings of this study, the study concludes that FDI has a positive sign and statistically significant impact on economic growth.

The findings of Abu and Achegbulu (2011) on the impact of FDI on economic growth in Nigeria further buttressed the interaction between FDI and DI. In order to investigate the impact of FDI on economic growth in Nigeria and the causal relationship between them, liner regression and granger causality test were used. The data used were from Central Bank of Nigeria (CBN)'s Statistical Bulletin (CBN, 2015). The study has shown that FDI has a positive impact on GDP in Nigeria and the author therefore accept the alternative hypothesis. This also in line with the findings of Cristina and Babes (2014) who empirically test the hypothesis of FDI led capital accumulation in Central and Eastern European Countries (CEEC). More precisely, the study investigates the relationship between FDI and local investment, using a sample of 10 CEEC over the period 1990-2010. The study finds FDI to crowd out DI, while the effect decreases with time. The results also indicate that Greenfield FDI may develop long run complementarity with DI, while mergers and acquisitions do not prove any significant effect on DI.

Macaulay (2014) also examines FDI and the performance of the Nigerian economy. It investigates how FDI impacts economic growth in Nigeria. The study adopts descriptive method in its analysis. The study established that the linkage between FDI and economic growth in Nigeria are not unanimous in their submissions. A closer examination of these previous studies reveals that conscious effort 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. This also supported the findings of Azlina and Suhanis (2014) examine the impact of inward FDI on DI between 1970 and 2011. The Johansen and Juselius co-integration technique employed in this study reveals that there is a long run relationship between DI, FDI and economic growth. The error correction model suggests that there is a slow correction of disequilibrium of the investment model in the short run.

Rehmat et al. (2012) analyzed the relationship among FDI, exports, imports, DI and economic growth in selected South Asian countries namely Bangladesh, India, Pakistan and Sri Lanka using annual time series data from 1973 to 2010. Through Granger causality, relations are found among variables in the model. The main finding of the study is that the causality test supports export-led growth more as compared to FDI-led growth in all selected South Asian countries. The causality analysis shows that imports are caused by GDPs (GDP) at different lag periods in all countries but no evidence of causality from imports to GDP is found. Causality test also does not support the causality from trade openness to GDP but the other way round. Moreover, two-way causality between FDI and trade openness also exists.

Among the studies that find a uni-directional relationship between FDI and DI, Faruku et al. (2011) used a cointegration VAR model to study the contemporaneous long-run dynamics of the impact of FDI on GDP with other four macroeconomic variables in the Nigerian economy (1970:1-2004:12). The unit root test suggests that all the variables are integrated of Order 1. The VAR (3) model were appropriately Identified using AIC information criteria and the VECM (2) model with cointegration relation of exactly one. The study further investigated the causal relationship using the Granger Causality analysis of VECM which indicates a uni-directional causal relationship between GDP and FPI at 5%. The results of Granger Causality Analysis also show that some of the variables are Granger causal of one another, at 5% level of significance.

A study by Shawa and Grafoute (2014) on how FDI relates with host country's GDP growth, DI and export in Kenya supported the uni-directional relationship between FDI and DI. In the study, the causality relationship between FDI, Export, DI and GDP growth of Kenya (1980-2013) was examined by using co integration and granger causality test. The co integration test result indicates that there is a long run relationships ship among the four variables being analyzed in this study. The Granger causality test results shows that the causal unidirectional relationships exist between export (EXP) and DI at 5% level with the direction running direct from export (EXP) to DI implying that export (EXP) is a good predictor of DI in Kenya and that export led strategy is appropriate while the results found the bi-directional relationship between export (EXP) and FDI at 5 and 10% level respectively implying that there is a feedback linkage of predicting each other between these two variables suggesting that both the export led FDI growth and FDI led Export growth are appropriate strategy to be adopted for Kenya. The important fallout from the literature reviewed indicate the need for a more recent work that compare the relative relevance of FDI and DI in Nigeria, which happens to be the largest economy in Africa currently.

3. THEORETICAL UNDERPINNING AND METHODOLOGY

There are some theories that help to investigate the relevance of DI and FDI in an economy. One of them is the Product Life-Cycle Theory, which explains certain types of FDI made companies in the manufacturing industries of Western Europe after the Second World War. There are four stages of Product Life Cycle Theory, namely: Innovation, growth, maturity and decline. The main thrust of the theory is that the manufacturer initially gains a monopolistic export advantage from the products innovations developed in the United States' market (Shenkar, 2007). The author opined that when the product becomes standardized, investors in the United States will have incentive to invest abroad with a view to taking the advantage of cheaper production cost and this will be made in another country where export sales are large enough to support the economies of scale in local production. At the later stage, all the producers go into cost completion including local firms imitating foreign firms. It is at this stage, the United States' initial producer shift production from the first country of FDI presence to a lower-cost country, sustaining the old subsidiary with new products (Shenkar, 2007).

Another theoretical postulation is the monopolistic advantage theory, which takes the forms of benefit which a firm derives from maintaining or monopolistic power Shenkar (2007). These advantages are essentially superior knowledge and economies of scale that influence the presence of FDI. The knowledge in this regards are production technologies, managerial skills, industrial organization and knowledge of the product. Economies of scale have to do with investment where it is possible to reduce a cost per unit of services such as financing, marketing, and technological research which is the horizontal investment and the other aspect of economies of scale is the vertical investment in which each affiliate produces those products for that local production costs are lower.

This study draws insight from the above theoretical underpinning to formulate the empirical model with a view to examining the relevance of FDI and DI on economic performance in Nigeria. It also builds on the work of Acar et al. (2013) by including additional variable (notably total trade-TT) and extending the period of study to more recent years as well as focusing on a single country in contrast to cross-country approach. Thus, the model is presented as follows:

$$GDP = f(DI, FDI, TTR) \tag{1}$$

This can be express in linear equation as follows:

$$GDP = \alpha_0 + \alpha_1 DI + \alpha_2 FDI + \alpha_3 TTR + e_t \tag{2}$$

Where,
GDP: Gross domestic products used as proxy for economic performance.
DI: Domestic investment proxied by gross fixed capital formation.
FDI: The net inflow of foreign direct investment.
TTR: Total trade used to capture the international competitiveness.
e_t: The error term[1].

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1   Other variables such as labour force that explains economic performance are not included to keep the model parsimonious and focus on the main objective of the study. In addition, preliminary test that include them show that there was not much difference in the signs, significance and size of the coefficients.

Table 1: Summary of unit root tests results

Variable	Series at levels			Series at 1st difference			Order of integration
	PP-statistics	Critical value@ 5%	Remark	PP-statistics	Critical value@ 5%	Remark	
LGDP	−0.6490	−2.9511	Non-stationary	−4.3064	−2.9540	Stationary	I (1)
LGDI	1.2600	−2.9511	Non-stationary	−7.3642	−2.9540	Stationary	I (1)
LFDI	−0.7354	−2.9511	Non-stationary	−9.1345	−2.9540	Stationary	I (1)
LTTR	−0.6043	−2.9511	Non-stationary	−6.2367	−2.9540	Stationary	I (1)

Source: Authors' computation using E-Views 7.0, PP: Phillip Perron

The equation was estimated using data sourced from Volume 23 of CBN's Statistical Bulletin.

4. EMPIRICAL RESULTS[2]

First a unit root test was conducted using Phillip Perron (PP) approach, to determine the level of integration of the variables. Furthermore the study employed Johansen maximum likelihood to examine the existence of a long-run relationship among the variables. The causality of the model was ascertained with the error correction modelling to establish the rate of adjustment from the short run dynamics to the run-long equilibrium.

4.1. Stationarity Test

Unit root test is required to check the integrated level of the data by conducting unit root test by using either PP or Augmented Dicker Fuller to check the presence or otherwise of unit root among the data series. In this study the PP test is used. The presence of the unit root in series makes the estimates to be biased and the result unreliable. To determine this result the PP t-statistic is compared with the critical value at 5% significance level. A greater PP t-statistic compared with the critical values in absolute terms indicates the absence a unit root leading to the rejection of the unit root null hypothesis, otherwise it is accepted.

Based on the unit root test result reported in Table 1, after the value of the variables were transformed using logarithmic transformation and tested for stationary using PP test. The variables were found to be non-stationary in levels at 5% level of significance. After the variables were difference once, all were found to be stationary at 5% level of significance, thus integrated of order I(1) making it possible to conduct co integration test on all the variables found to be stationary.

From the Johansen cointegration result reported in Table 2, the null hypothesis that there is no presence of cointegration among the variables is rejected at 5% level of significance. The implication of this is that there is possibility of co-movement among the variables in the long-run even when there is distortion in the system in the short-run. In view of this finding, a further examination was carried out using VEC technique to look at the long-run estimates as well as compute the speed of adjustment from short-run disequilibrium to long-run stability. The results are reported in Table 3.

The VEC modelling allows for the determination of the short-run adjustment process towards the long-run equilibrium

Table 2: Cointegration test

Hypothesized number of CE (s)	Eigen value	Trace statistics	Critical value@ 5%	P*
None*	0.6439	87.7515	69.8189	0.0010
At most 1*	0.5486	53.6815	47.8561	0.0129
At most 2	0.3844	27.4336	29.7971	0.0915
At most 3	0.2099	11.4259	15.4947	0.1866
At most 4	0.1047	3.6510	3.8415	0.0560

*Indicate significant at 5% level, Source: Authors' computation using E-views 7.0

Table 3: VEC results

Variable	LDI(-1)	LFDI	LTTR
Coefficient	0.9860*	0.0438*	0.1449
Standard error	(0.1343)	(0.0203)	(0.0940)
T-statistic	[−7.3413]	[−2.1599]	[−1.5413]
*Cointegration Eq1	−0.5788		
Standard error	(0.2266)		
T-statistic	[−2.554]		

To make the Table more compact and focus on the key issue, only the equation with GDP as dependent variable is reported. Also the constant term is included in all the equations but not reported. Source: Authors' computation using E-views 7.0. VEC: Vector error correction

state in the system. The error correction term reported in the lower part of Table 3 is correctly signed and also statistically significant at 5%. It is also observed to fall within the magnitude of 0 and 1. The result shows that the speed of adjustment of 57.9%, which denoted that in the eventualities of distortion about 57.9% errors of the past are corrected in the system. In other words, the system has the inertial of adjusting back to a state when acted upon by external forces; hence it exhibits a convergence property though with a relatively moderate adjustment mechanism.

Furthermore, the VEC results reported in Table 3, inform that in the long-run, the coefficient of DI is about 0.9860 compared to that of FDI of 0.0438. Their T-statistics denote that they are both significant at 5% level. The above result implicate that both DI and FDI are significant in their influence on Nigeria's economic performance for the period between 1980 and 2014. However, it is evidenced that the influence of DI is more than 20 times higher than that of FDI. This finding tends to lend support to earlier finding made by Osabuohien (2007) where the comparative importance of FDI was made between Nigeria and South Africa.

The policy message emanating therefrom is that while it is not a bad idea for Nigerian government to keep engaging in global campaign to woo foreign investors, efforts should rather be geared towards encouraging more of DIs. These efforts should include improving the level of infrastructural development, creating a

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2   The analysis started with summary statistic and correlation test. However, the results, not reported, show that there was no issue of multicollinearity.

more secured society that protects lives and property as well as improving financial intermediation that are germane for capital formation in the country.

5. CONCLUSION

This study provides recent empirical insights to the debate on the relative importance of DI and FDI on the economy performance of a country. Using time series data from CBN for the 1980 to 2014, which was estimated using VEC approach, a number of important findings were made in the study. In the for instance, the study observed the possibility of co-movement among the variables. In precis, both DI and FDI were found to have direct and significant impact on Nigeria's economic performance.

Worthy of reiterating is that the impact of DI on economic performance is approximately 22.5 times higher than the influence FDI has on economy performance. This is quite instructive as the findings suggest the need for more concerted efforts from Nigerian government in boosting the level of DI by putting in place strategies to enhance infrastructural provision, effective institutions as well as reliable security system in the country. The above will have more effects in promoting economic performance than glutting across the globe for foreign investors.

6. ACKNOWLEDGMENTS

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